CHASEFIELD | CAPITAL

Special Report

I'm writing a special report because of our stance on equities. As you know, we went underweight equities about a year ago. Through 12 months ending June 6, 2016, the S & P 500 is up about 3.5% while other indexes are flat to off as much as 15%. The key to making money in the stock market is to buy stocks right before they go up and sell them right before they go down.

> "I don't know anyone who's got it right. In fact, I don't know anyone who knows anyone who's ever got it right"
>
> Jack Bogle
> Founder, Vanguard Group

Where do we stand today? We continue to maintain our underweight stance as valuations remain rich compared to earnings and economies around the globe continue to struggle.

The U.S. economy continues to move forward with economists consistently predicting 2% to 2.5% growth. The numbers continue to come in softer that anticipated, though, prompting the Federal Reserve to take a more cautious stance on raising rates. Recent Fed comments suggest, I think, that rates will move up again before year-end. I say "think" because Janet Yellen is pretty good at speaking for 15 minutes and not saying much. It will take the remaining three quarters of growth above 2.7% to hit economists' original targets. Unemployment numbers are solid with the rate dropping below 5%, but this number is quite controversial as the way it is calculated was changed. I'm not confident that low unemployment numbers are a good predictor of good stock market returns.

There are many metrics that demonstrate that stocks are overvalued, from profit margins to book values. The prospect of earning the risk premium over the next several years is not good. The equity risk premium compensates you for taking on the volatility of stocks. This is around 6.5% above the rate of inflation over the long run. Other measurements are used as well, but it is difficult to see average or above average returns with the following:

1. Valuations elevated
2. Full employment
3. Margins still near all-time highs
4. Monetary policy globally accommodative with marginal impact on growth

Being fully invested is not defensible for money managers when corporate earnings have been declining for 5 consecutive quarters.

BCA RESEARCH INC.

The Current Shiller P/E Is Well Above Its Historic Average

Expected returns are anything but robust. Our model says equity returns are around 2% annually from June 2015 to June 2020. There is a lot of variation around that number, but that is the maximum likelihood. As we have articulated many times before, we will never be out of any asset class. Our tactical models are always 1 to 3 year shifts. Being wrong and being wrong big are two different issues.

We would welcome any input as to what you'd like to see or if you have some particular subject you'd like us to explore. Please feel free to contact me at my email below and I will get back to you.

harold@chasefield.co June 13, 2016

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