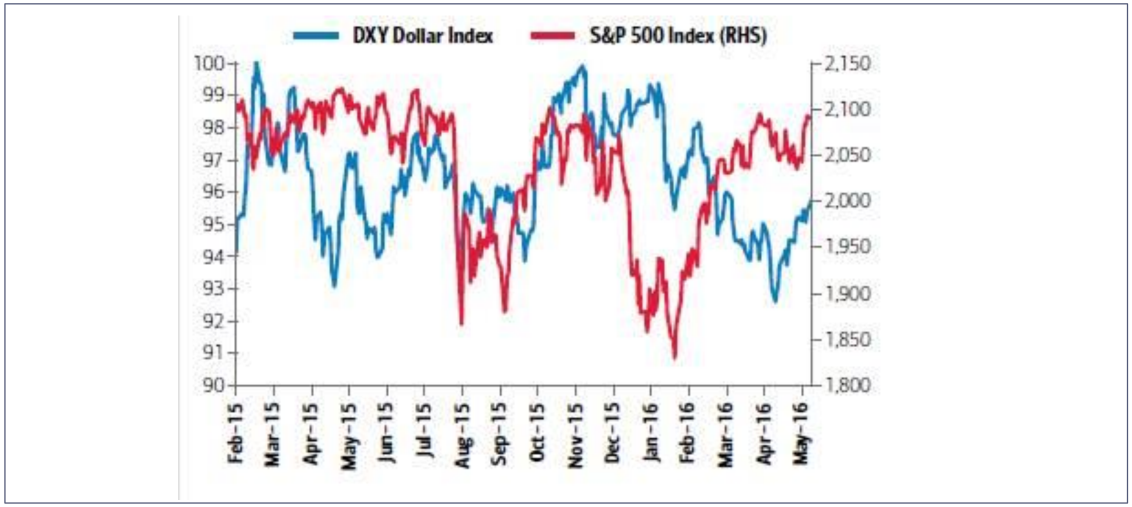
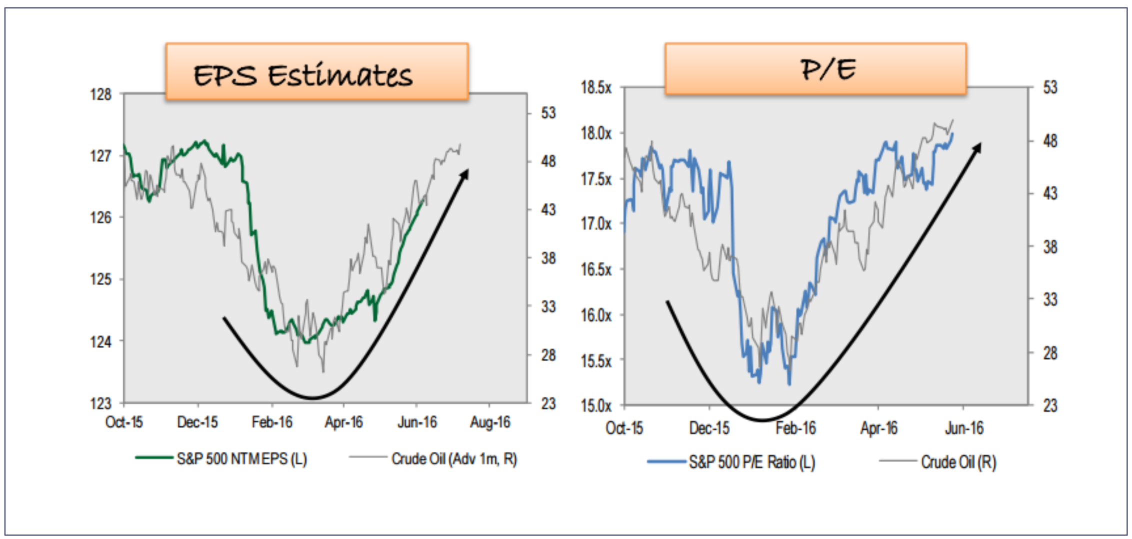
Market Recap

Range-Bound Market



Source: Bloomberg

Earnings, Not Just P/E's, Now Contributing to Market Gains



Source: FactSet

Equity indexes have traded within a fairly defined range over the past year, with the Dollar's similar behavior serving as something of a catalyst for the markets' sideways trading direction. Markets stuck in neutral tend to drift up and down between an upper and lower boundary, with the potential to break out forcefully in either direction if risk factors either abate or increase in a significant manner. While we began the year with the overhang of a number of major global risk factors, those issues have abated and P/E multiples have, in turn, risen since February as a reflection of de-risking in the market. While, with a Fed meeting, Brexit Referendum, and looming Political Conventions and dwindling primaries we could see a variety of actions or narratives that move markets over the next several weeks, the more important catalyst may be improving corporate profits. If EPS increases are realized, the market may have the impetus it needs to move higher.

With the market lows of February a full three months behind us, we have finally started to see corporate earnings contribute to market returns alongside increasing P/E multiples (investors' willingness to pay more for each $1 of profits). Throughout 2014 and 2015, earnings declined on the back of two powerful headwinds: lower commodity prices and a stronger U.S. dollar. Now, these headwinds are becoming tailwinds, propelling EPS estimates as low costs have finally resulted in an uptick to consumer spending. At the same time, moderation in the dollar and a recovery in oil prices have eased some concerns investors held about global markets, driving P/E's upward. Market returns are at their highest when both EPS and P/E's are rising, but the question remains as to how much higher oil can go before it is viewed as a negative and serves as a drag on P/E ratios.

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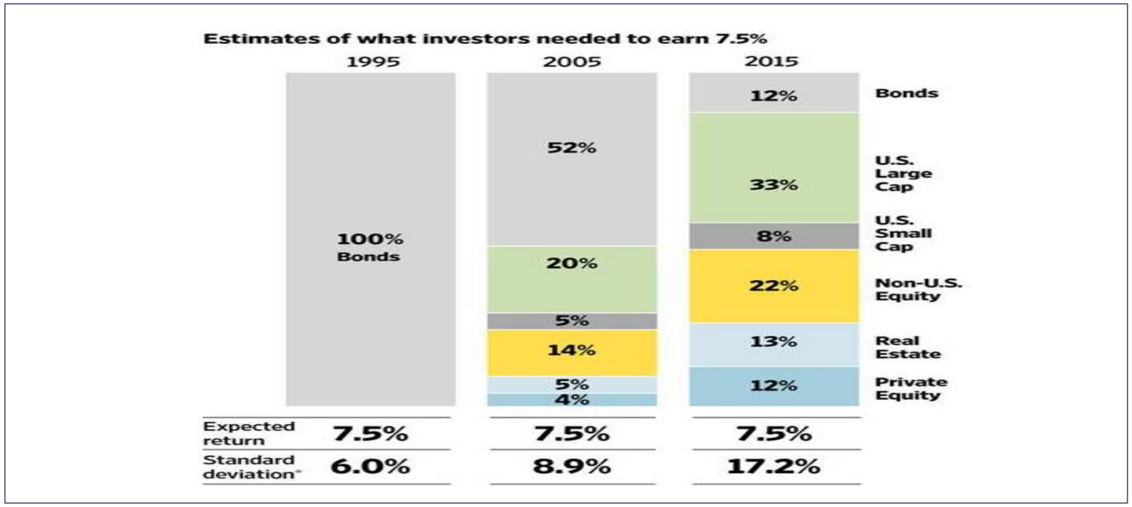
Pension Funds Piling on the Risk



Source: EPFR Global

More risk, lower returns. This has been the mantra of pension funds recently, as rock bottom interest rates and low-yielding credit instruments, accompanied by a range-bound equity market and flagging global growth, have made it difficult for pension fund managers to achieve their desired rate of returns. Twenty years ago, a 7.5% return was achievable with a portfolio entirely comprised of Investment Grade corporate debt. Today, in order to achieve that same level of return, endowment and fund managers have been dipping into riskier baskets of global stock, real estate, and private equity offerings. Equities and Alternative Investments are inherently more volatile (and, therefore, considered riskier) than bonds, which almost always pay back the initial investment plus some form of coupon payment. However, yields on those bonds have plummeted, forcing pension fund managers to look toward a more diverse mix of assets in order to reach a higher return.

Where Is "Ordinary America"?

States vs. Metros with Demographics Most Like America Today					
	Metro	Similarity to U.S. Overall		State	Similarity to U.S. Overall
1	New Haven-Milford, CT	93.2	1	Illinois	95.8
2	Tampa-St. Petersburg-Clearwater, FL	91.6	2	New York	92.2
3	Hartford-West Hartford-East Hartford, CT	90.2	3	New Jersey	91.5
4	Oklahoma City, OK	89.4	4	Connecticut	90.7
5	Springfield, MA	89.3	5	Virginia	87.6
6	Milwaukee-Waukesha-West Allis, WI	88.2	6	Florida	87.5
7	Chicago-Naperville-Elgin, IL-IN-WI	88.2	7	North Carolina	87.4
8	Wichita, KS	87.6	8	Delaware	86.7
9	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD	87.2	9	Rhode Island	86.3
10	Kansas City, MO-KS	86.8	10	Massachusetts	85.5

Source: Five Thirty Eight

Which U.S. city most closely embodies the demographics of the country at large? An economist analyzed America's metropolitan areas on the metrics of educational attainment, age, and race and ethnicity, and found New Haven, CT, with an index score of 93.2 out of 100, to be most representative of the country as a whole. Tampa, FL, claimed second place, with a score of 91.6, followed by another Connecticut contender – Hartford – at 90.2. The data suggest that medium-sized metros – those with one- to two-million residents – are most likely to mirror the demographics of the U.S. overall, while metros with fewer than 100,000 residences are the least representative. When evaluating entire states, Illinois and New York most closely reflect the composition of the U.S., with New Jersey, Connecticut, and Virginia rounding out the top five.

Contact: If you have any questions or comments, please do not hesitate to contact us at 703.992.6164. For more information about Harbour Capital Advisors, please visit our website at www.harbourcapitaladvisors.com.

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