OPTIVEST
WEALTH MANAGEMENT

Turning Success into Peace of Mind.

FOURTH QUARTER 2016

October 17, 2016

Financial Markets Review by Mark:

U.S. and World Economy –

The calm before the storm. Developed world financial markets (U.S., Japan and Europe) have become numb to the long-term effects of unprecedented monetary stimulus. The companies in the S&P500 are now reporting their 6th quarterly drop in revenue and 4th quarterly drop in corporate profits. The labor recovery peaked 8 months ago (job openings and unemployment) as weak hiring is catching up to weak GDP growth. After a 1% revised first half U.S. GDP growth, the second half of the year was supposed to bounce back – it has not. Yet both stock and bond markets remain near all-time highs amidst very low (by historic standards) volatility. The developed world stock markets have benefited from very low cost borrowing to facilitate share buy-backs, artificially creating higher earnings per share; bonds have benefited from Central Bank buy-backs as well.

However, these monetary maneuvers may have peaked this summer. Since then, interest rates have moved higher and the stocks which moved highest the first half of the year have dropped the most in the second half (REITs, utilities, tech). In addition, near-term election cycles here and in Europe have raised the voice of nationalism, border and trade protection. There is talk of "Italeave" ala "Brexit". We believe that the next major downturn will start in Europe where low and negative interest rates have pulled business forward as much as possible, bringing the weak economic expansion to an earlier than expected close. Initially, the U.S. will be the beneficiary of a flight to quality, but a stronger Dollar set against a falling Yen and Euro will hurt our exports and lead to our own recession.

Unfortunately, we do not see bonds as a safe haven for a weaker U.S. economy. The worldwide bond market is three times the size of the world stock markets and arguably near the end of a 35 year “super cycle”. Both stocks and bonds have been highly correlated lately and we see that trend continuing. We believe that the next major shift in the economy will result in a drop in the price of most financial assets (stocks and bonds) and an increase in the value of hard assets and the emerging market countries which produce them. This is a multi-year trend that we could see starting very soon. Similar to the unreasonably high valuations of the U.S. mortgage markets in 2006-7, BBB- quality sovereign national bonds (like Italy) trading below U.S.' AAA rated bond yields, could be the bubble that bursts first.

Portfolio Update by Leslie:

During the year our focus has been on mitigating risks as we have cut U.S. and European equity exposure close to 50% and still purchased Emerging Market equities and REIT stocks at attractive prices. As we anticipated during the 3rd quarter, the Federal Reserve voted to leave rates unchanged again but a slightly more hawkish tone could be interpreted from the notes of the meeting. So while the S&P 500 rose 3.85% during the quarter, we primarily observed and held on to our remaining reduced US equity ETF positions which were up 3.84% with no inclination to increase exposure. For our reduced European equity sector exposure, we saw gains in Q3 for our model funds of between 4.6% and 8.2%, so while we are happy with returns, we are monitoring the European Central Bank efforts and the overall strength of the European economy closely to determine if further tactical moves are necessary.

Year-to-date we have concentrated our attention on both building larger than normal cash positions as well as in holding and growing exposure in vehicles that hedge against falling bond and equity prices which remain the foundation of a diversified portfolio. Specifically we are seeing value from holding and growing exposure to: non-constrained and multi-sector bond funds, funds holding longevity contracts, and managed and hedged futures funds.

With certainty, there are many known events on the calendar over the next 6+ months that will inevitably create large market swings. We expect these hedged investments will create "crisis alpha" in our portfolios. More simply stated, they will create excess returns relative to bond and stock benchmarks to help insulate near-term losses that any investment portfolio will likely suffer, diversified or not. We look forward to hedged allocation appreciation and opportunities to invest in our favorite universe on market dips.

Summary:

While we are cautious of financial markets over the short-term, we are optimistic about long-term values for U.S. business and real estate. Volatility produces opportunities and we intend to both protect your capital and buy on dips. This requires us to keep larger allocations to less correlated alternatives and hold more cash than usual. In the interim, our balanced portfolios continue to provide income and stability.

Until next time,

Mark Van Mourick & Leslie Calhoun

Investment advisory services are offered by Optivest, Inc. under SEC Registration and securities are offered through Gramercy Securities, Inc., member FINRA & SIPC, 3949 Old Post Road, Charlestown, RI, 02813, 800-333-7450.

Legal disclaimer: The opinions written in this newsletter are for informational purposes only. There are no implied recommendations, offers to buy or sell, or guarantees of future results. All investments involve potential loss of capital and should only be made after careful consideration of objectives and risk tolerances.

To make sure you continue to receive our e-mails in your inbox (not in your bulk or junk folders), please add reports@optivestinc.com to your address book or safe sender list.

Optivest Inc. | 24901 Dana Point Harbor Drive, Suite 200 | Dana Point, CA 92629 | 949-363-8686 | www.optivestinc.com