TIMMONS
WEALTH MANAGEMENT

Market Commentary – Second Quarter 2015

July 21, 2015 – Investment returns were mostly flat across major US and International stock markets in the second quarter. As discussed in previous client letters, three major themes – CHINA, GREECE & FEDERAL RESERVE POLICY – appeared to dominate and drive investor actions during the quarter. China's stock market entered correction territory in June declining more than 20% despite repeated efforts by the government to stabilize the stock market and stimulate the economy via emergency measures. A rising Chinese stock market has benefited heavily indebted companies (many state-run) enabling them to issue shares and reduce outstanding debt, while serving as a de facto casino for local retail investors. Unfortunately, the driving force behind rising Chinese markets has been small investors speculating on daily price changes and borrowing heavily to finance stock purchases (not typically a healthy sign for a market). Heavy margin borrowing exacerbated the Chinese market selloff in June, while fears over a further slowdown in the Chinese economy caused declines across major commodity and stock markets.

Adding to investor worries, the Greek debt crisis reached a crescendo as negotiations between the Greek government and Eurozone creditors fell apart. Greece defaulted on its $1.7B loan to the International Monetary Fund in June, while Greek Prime Minister Tsipras's ill-fated decision to call for a referendum to accept creditor proposed austerity measures led to a resounding "No" vote by the Greek people. By the end of the quarter, Greece had effectively been cut off from receiving additional financial assistance leading the country to impose capital controls including closing banks, stock markets and limiting ATM withdrawals. As the Greek crisis escalated, European and US stock markets fell giving back gains from earlier in the quarter. Though the S&P 500 managed a positive return of +0.28%, the DJIA declined -0.29% while mid-size US company stocks fell -1.92%. European markets experienced a broad selloff from May-June with France, Germany and Spain all declining more than -4.5%. These losses were partially offset by rebounds across previously hard hit emerging markets including Russia and Brazil, as well as continued strength in the Japanese stock market.

Signs of a second quarter rebound in the US economy including improvements in the US labor market, rising home prices, improving retail sales and rising consumer confidence increased the likelihood that the Federal Reserve would begin raising short term interest rates as early as June. Despite much speculation, the Federal Reserve kept its interest rate policy unchanged in June with investors now anticipating the first interest rate hike will occur by September. With rising interest rates potentially months away, interest rate sensitive areas of the market including bonds and high yielding stocks declined in value. The yield on the 10 Year US Treasury moved rapidly higher from 1.93% in March to 2.34% in June, while the US Aggregate Bond Index declined -1.68%. European bond markets were particularly hard hit, as uncertainty across the Eurozone in the face of the Greek crisis led to rising yields and falling bond prices that wiped out European bond returns earned in the first quarter. In the US, utility stocks and Real Estate Investment Trusts (REIT) declined as investors feared that rising bond yields would make high-yielding dividend stocks less attractive. REITs were among the hardest hit sectors declining -10.7%. It is my personal belief that the selloff across higher yielding dividend stocks has been somewhat indiscriminate and fails to consider some key points including the likely *gradual pace of interest rate increases* and *individual company fundamentals*. Too often we see group-think permeate Wall Street and when consensus opinion becomes viewed as fact the opposite tends to occur.

After the strong gains we have experienced across stock and bond markets in recent years, the investment results of the second quarter are likely to be viewed as rather unexceptional despite the exciting headlines which dominated the news on a daily basis. If anything can be taken away from the quarter, it is a reminder that global markets can often become disconnected from underlying company fundamentals with short term returns driven by fear and panic. Though there were no major strategy shifts during the quarter, I did adjust client portfolios to further reduce exposure to Emerging Markets while taking additional profits on our healthcare-focused investments. I continue to favor investment strategies focused on value investing and dividend-growth companies. Allocations to cash within client portfolios as a result of portfolio rebalancing in June enabled us to make some new investments as the US market declined. In particular, attractive opportunities emerged among utilities, telecommunication services, airlines, business development companies (BDCs) as well as companies undergoing shorter term restructuring efforts. Allocations to new stock holdings across client accounts were driven by individual risk tolerances and portfolio size constraints. Though the core of client portfolios are expected to remain invested in a diversified mix of low cost actively managed mutual funds and exchange traded funds (ETFs), I believe opportunities will continue to emerge to selectively add individual stocks that can serve to reduce portfolio volatility, lower costs and increase client returns over the longer term.

So What Should We Expect Going Forward? The recovery in the US economy since 2009 has driven company sales higher, while low levels of inflation across goods and services has increased company profit margins (arguably at the expense of employee wages). Higher margins have led to rising company earnings, while historically low interest rates have driven investment valuations on stocks higher. All of these factors have led to strong stock market returns with market valuations continuing to rise and now sitting above historical levels. Valuation tools are a necessary part of every investor's toolkit, and useful in gauging how much investors in the marketplace are willing to pay for a company's future earnings. In theory, companies with proven growth potential and those with strong business fundamentals should command higher valuations. As of today, the S&P 500 trades at 17.5x 2015 estimated earnings (per FactSet) vs. the 25 year average of 15.7x forward earnings. Though elevated US market valuations are defensible given high profit margins and current interest rates, it is difficult to see how much further valuations can expand as interest rates begin to normalize and earnings growth rates moderate. The more likely scenario is that future market returns will be driven primarily by company earnings growth rates leading me to believe that future returns will be lower than historical levels. However, this does not mean that valuations can't become more inflated should investor demand continue to drive multiple expansions.

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Currently, stock market valuations outside the US appear to be more attractive relative to historical levels particularly given economies across Europe and Japan remain further behind the US in their phase of economic recovery. Weaker currencies and economic stimulus from foreign central banks should keep interest rates low outside the US while helping to boost exports and stimulate demand for domestic goods and services. Though recent economic data including GDP growth, inflation and manufacturing indicate improvements are continuing across parts of Europe and Japan, risks still remain to the Eurozone related to Greece and the slowdown in China. For bond investors, rising interest rates pose a unique risk given the low absolute level of interest rates today. As noted previously, interest rates and bond prices tend to move in opposite directions with interest rate increases having a more profound negative effect on longer term bonds and when rates are at very low levels. Though no single bond strategy can completely shield bond investors from rising interest rates, I have continued to favor a targeted mix of investment grade, variable rate and high yield bond strategies emphasizing bonds with shorter maturities that have historically performed better during periods of rising interest rates.

Putting all of this into perspective, ***projected long term returns across major asset classes (stocks, bonds and cash) are likely to be lower going forward***. Long term projected asset class returns are a function of assessing current valuations within the context of historical valuations and returns, risk free rates and asset-class premiums (the additional return expected for taking on more risk). Though stock market returns are expected to be lower than historical levels, I believe projected stock returns still remain attractive relative to projected returns for bonds and cash. Additional information related to these projections will be provided in your annual Investment Policy Statement update and are available upon request.

Please do not hesitate to call my office with any additional questions or to schedule a time to meet and review your current investment strategy.

On a personal note, I would like to extend a special thanks to all of my clients for continuing to help drive the growth and success of Timmons Wealth Management. In the July 2015 issue of Financial Advisor magazine, Timmons Wealth Management was ranked #22 on FA's 2015 Annual RIA Ranking as one of the 50 Fastest Growing Firms. Thank you for your continued trust in Timmons Wealth Management!

Sincerely,

Liam Timmons, President
Timmons Wealth Management

<u>Second Quarter 2015 Market Data:</u>

Broad Market Benchmarks	**2Q2015**
S&P500	0.28%
DJIA	-0.29%
Russell 2000	0.42%
FTSE Global All-Cap ex-US	1.24%
MSCI Europe	0.36%
S&P Developed Ex US Small Cap	4.61%
MSCI Emerging Markets	0.69%
Barclays US Aggregate Bond Index	-1.68%
Barclays US Treasury Bill 1-3 Months	0.00%
Bloomberg Commodity Index	4.66%
CBOE Interest Rate 10 Yr Treasury	2.34%
Consumer Price Index (CPI-U) 12 Month Core	1.70%
TWM Client Benchmarks	**2Q2015**
Aggressive Growth Strategy	0.49%
Capital Appreciation Strategy	0.06%
Balanced Return Strategy	-0.29%
Capital Preservation & Income	-0.78%

Disclosure: Historical performance results for investment indices and/or benchmarks have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. You cannot directly invest in an index.
Index return information is sourced from Morningstar Office.