American Heritage Financial

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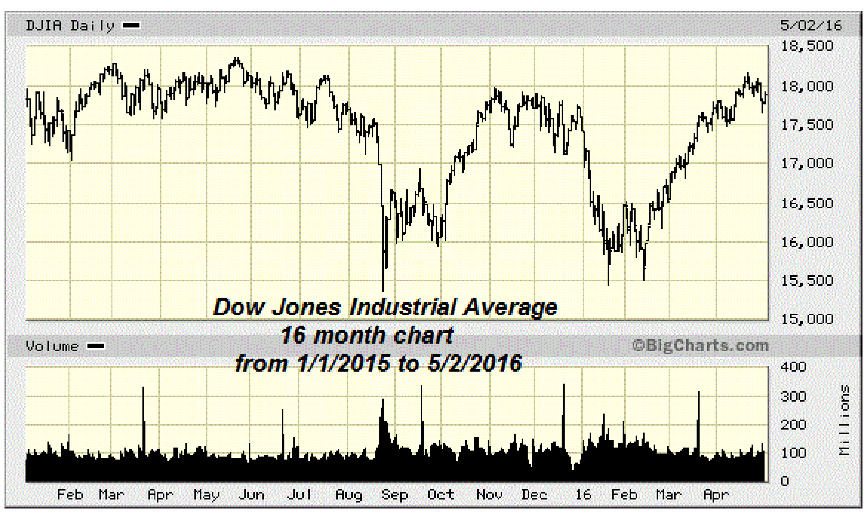
Building a Big Wall

Big—***Beautiful!***—walls are in vogue in some corners these days so we thought we should contribute to the discussion. We aren't referring to the walls that politicians talk of building or, alternatively, tearing down. Rather, our focus is on the *Wall of Worry* investors face in today's market.

The adage that ***"bull markets climb a wall of worry"*** is timeless, insightful market wisdom. Its premise that a healthy market is a fearful one, one in which investors are cautious, tentative and holding back cash because they worry about the market's future. The result is that many investors sit on the sidelines waiting to feel more comfortable before investing; but that cash will eventually enter the market as they become more confident. On the other end of the spectrum, once investors become so comfortable that they go **"all-in"** (as the ***Cav's*** might describe it) a market struggles since there is no one left to buy.



The current long bull market began in March 2009 at the depth of the financial crisis and it has been an extended version of a bull market climbing a wall of worry. Investors' fears were at all-time highs when the bull market began and there was only a short reprieve before stocks entered a three month 16% correction in 2010 under the cloud of Greek debt, the BP oil spill, and an up-tick in unemployment to near 10%. 2011 and 2012 followed with their own scary corrections due to global turmoil, the U.S. debt rating downgrade, the "Fiscal Cliff" drama and record high gas prices (yes, as recent as four years ago you paid $4 or more at the pump!). 2013 was one of the best years for stocks in history with a near 30% advance but the year was still filled with political controversy and crashing gold prices. The last two years have been a constant rotation of worries about the global economy, collapsing commodity prices, a sometimes hot and sometimes cold economy and an increasingly bizarre political landscape.

You get the picture as far as the long history of this bull market generating persistent gains paired with plenty of concerns. Understanding that, helps us deal with the worrisome picture investors see as they look to the rest of 2016. One big concern is simply fully priced stocks. It is becoming increasingly difficult to find stocks with a compelling valuation combined with the long-term sustainability and growth prospects that make a great investment. Many companies are extremely productive and efficient but if the overall economy is not expanding faster than the 0.5% growth reflected in the first quarter GDP, most companies will have trouble producing the earnings growth needed for good stock gains. Along with a struggling economy, investors face headwinds due to the Federal Reserve's uncertain plans to increase interest rates and…who knows what effect the upcoming Presidential battle will have on investor sentiment.

An additional question for investors relates to what areas to focus on—or where to hide, depending on your attitude. In 2015 the stock market return was basically zero (S&P declined 0.7%, or gained 1.4% including dividends). Yet, within the market, there were huge winners—such as large cap tech stocks like **Google, Facebook,** etc., and lots of losers such as utility stocks which lost about 8% on the year, commodities, energy stocks and any company remotely dependent on the oil industry. After continued weakness in the first six weeks of 2016, there was an amazing rebound in the price of oil which also pulled up depressed commodity and energy stocks. And, it is not just the normally volatile energy related areas doing well; even utility stocks have surged by about 12% so far this year. The question is, can the rebound by these previously lagging sectors last?

Oil—as usual—highlights the point. The decline that began in 2014 turned into a rout in 2015 and then the price of oil collapsed another 24% in the first weeks of the 2016 (from about $41 to $31). Oil has now rebounded to over $45 per barrel—but the big surprise is that this rebound took place while supply has been added by Iran and discussions by OPEC to limit production have totally collapsed. Oil over $40 is certainly more healthy for large sectors of the economy but it is impossible to have a lot of confidence that oil prices have truly stabilized.

So the market continues to face a true wall of worry and investors reflect their "worried" attitudes by mutual fund statistics showing steady out-flows from equity funds as well as surveys of investor sentiment. Following our message that ***"bull markets climb a wall of worry,"*** there is reason to expect these seemingly negative conditions to support future market gains. There are also specific positives to consider such as continued low interest rates, strong employment numbers, decent housing markets and the rebound in oil prices. We will continue to weight these many conflicting factors as we work to climb the **Wall of Worry** that is defining 2016.

Best regards,

Ted Ingraham

EGI Financial, Inc.
American Heritage Securities, Inc.

Questions or comments?
Email us at: ahs@egifinancial.com or call 330-535-0881. Visit us atwww.EGIFinancial.com