SAPLING
WEALTH MANAGEMENT

# Market Strategy 2015-2016

## Capital Markets Outlook

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# 2015-2016 Executive Summary

We are tempering our bullish stance from the prior few years and recommend a more conservative investment posture in light of recent market advances and headwinds for earnings visibility. We believe additional risks, caused by the strengthening of the US dollar, could dampen US economic growth and be a catalyst for volatility. Hedged international investments in developed markets, high quality & municipal fixed income choices and special situations look attractive.

## Equity Risks Not Worth Potential Reward, In Our Eyes

We believe that the risks associated with a tepid world economy and deteriorating margins are greater than the upside potential for stocks. In summary:

- World Economic Growth Is Tracking Below Forecast
- Federal Reserve Will Slowly Try to Normalize Rates
- Unchecked Currency Devaluations Will Dampen US Economic Growth
- Unanticipated Currency Risks Bear Watching
- S&P 500 Earnings Estimates Are Too Rosy, In Our View
    - Sales Fine, but Operating Margins Represent a Big Risk
    - Our S&P 500 Estimates Are Well Below Consensus
    - EPS Uncertainty May Lead to P/E Multiple Contraction

### *Factoring In All Scenarios, Market Set Up For (0-5%) Returns*

Our probability weighted estimate for the S&P 500 total return from a level of 2,089 is (1.9%) in 2015. And while we consider optimistic scenarios that register much higher returns, we believe the likelihood of problems are comparatively much higher. Investment returns in our more bearish scenarios are below (20%) and thus drag our estimated returns down for the year.

#### Not All Is Lost

We still think there are interesting investments to make. Exciting growth stories, hedged international equity and fixed income investments, municipal bonds, and special situations all have appeal. For certain investors, there will be major advantages of opportunistic timing.

# Equity Markets May Pause, or Worse

Robust equity market returns have left valuations just above 25-year averages, however we believe that consensus S&P 500 earnings expectations for the 2015-2016 period are set too high, particularly due to declining operating margins and modest sales growth. While upside of increased consumer spending may bolster select US domestic names, companies with high international sales will have difficulty with foreign currency changes. International political and monetary solutions may disappoint with unintended negative consequences.

## Equity Risks Not Worth Potential Reward, In Our Eyes

We believe that the risks associated with a tepid world economy and deteriorating margins are greater than the upside potential for stocks. We believe the fundamentals for the market are tracking below consensus expectations, which creates downside price potential in equity financial markets. In addition, we see additional new risks that we would prefer to play out before taking a more constructive investment posture.

## World Economic Growth Is Tracking Below Forecasts

The prospects of economic growth in the world is challenging. The World Bank's economic forecast, which was published in January 2015, is already looking too rosy. Key disappointments include the world's second largest economy (China) slowing from an estimated 7.1% GDP growth to a 6.5-7.0% range. Recent economic indicators from this important country have been weaker than expected and most anticipate Chinese monetary authorities to take actions that lower interest rates and stimulate the economy. We believe that Europe will remain stuck in a slow-to-no growth environment, but that deflation will be avoided by ECB quantitative easing efforts. Herculean efforts by the Japanese to stimulate their economy with aggressive quantitative easing has boosted its export sector in the near term (and depreciated the currency), but total economic growth remains anemic at 1-2%. As many monetary authorities adopt accommodative monetary strategies (China, Europe, India), near term export gains from depreciating currencies gains will be harder to achieve and we believe will amount to mere Pyrrhic victories. Certain economies may do well in this

shifting environment, particularly those that are heavy net importers of energy, such as the India and Korea. Also, those closely tied to the United States, such as Mexico and Canada, may offer more stability. The US economy will continue lend support to the world economy. A strong dollar will keep domestic inflation in check and high employment will eventually result in real wage increases that will support higher domestic consumer spending.

**Table 1: World Bank Projected Economic Growth Rates, January 2015**

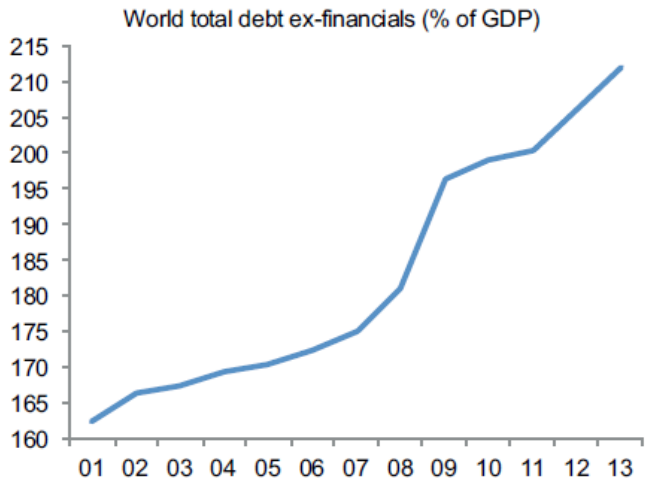
| | 2012 | 2013 | 2014e | 2015f | 2016f | 2017f |
|---|---|---|---|---|---|---|
| *REAL GDP*[1] | | | | | | |
| **World** | **2.4** | **2.5** | **2.6** | **3.0** | **3.3** | **3.2** |
| **High income** | **1.4** | **1.4** | **1.8** | **2.2** | **2.4** | **2.2** |
| United States | 2.3 | 2.2 | 2.4 | 3.2 | 3.0 | 2.4 |
| Euro Area | -0.7 | -0.4 | 0.8 | 1.1 | 1.6 | 1.6 |
| Japan | 1.5 | 1.5 | 0.2 | 1.2 | 1.6 | 1.2 |
| United Kingdom | 0.7 | 1.7 | 2.6 | 2.9 | 2.6 | 2.2 |
| Russia | 3.4 | 1.3 | 0.7 | -2.9 | 0.1 | 1.1 |
| **Developing countries** | **4.8** | **4.9** | **4.4** | **4.8** | **5.3** | **5.4** |
| East Asia and Pacific | 7.4 | 7.2 | 6.9 | 6.7 | 6.7 | 6.7 |
| China | 7.7 | 7.7 | 7.4 | 7.1 | 7.0 | 6.9 |
| Europe and Central Asia | 1.9 | 3.7 | 2.4 | 3.0 | 3.6 | 4.0 |
| Latin America and the Caribbean | 2.6 | 2.5 | 0.8 | 1.7 | 2.9 | 3.3 |
| Brazil | 1.0 | 2.5 | 0.1 | 1.0 | 2.5 | 2.7 |
| Mexico | 4.0 | 1.1 | 2.1 | 3.3 | 3.8 | 3.8 |
| Middle East and North Africa | 1.4 | 0.5 | 1.2 | 2.5 | 3.0 | 3.5 |
| South Asia | 5.0 | 4.9 | 5.5 | 6.1 | 6.6 | 6.8 |
| India[2,3] | 4.7 | 5.0 | 5.6 | 6.4 | 7.0 | 7.0 |
| Sub-Saharan Africa | 4.0 | 4.2 | 4.5 | 4.6 | 4.9 | 5.1 |

*Source:* World Bank, January 2015 Economic Forecast[i]

## *World Debt Levels High and Getting Higher*

Contrary to popular belief, the total world debt levels have not been decreasing, but in fact, have significantly increased as a percent of world GDP. We agree

**Figure 1: Debt Super Cycle Is Alive and Well**



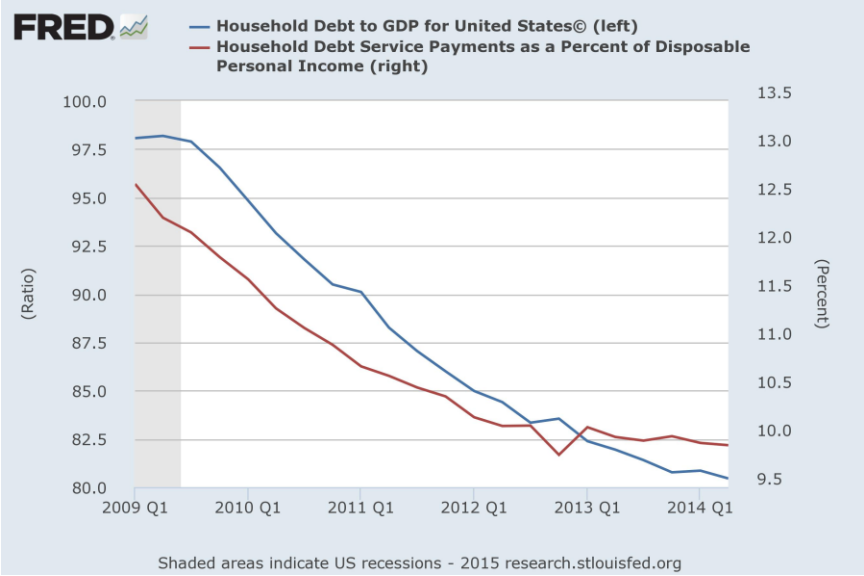

*Source:* Buttiglione, Lane, Reichlin & Reinhart, "Deleveraging? What Deleveraging?[ii]

with many analysts that the weaker-than-expected global growth is linked to the debt "Super Cycle" (where debt is to increasingly tapped to finance current consumption). In theory, the near-term increase in debt can be offset by long-term real growth, where productivity gains outweigh the increase in interest expense and principal repayment. However, too much debt causes borrowers to retrench, as was the case in the US during the 2009 financial crisis. An accommodative monetary policy was the primary solution in the US, which allowed households to grow out of their debt constraints.

### Easy Monetary Policies a Success for US Households

There has been real improvement in debt-to-GDP and debt service ratios for US households. The ratio of household debt to GDP has fallen from 97-98% to 80-82%. Debt service as a percent of disposable income fell from 12.5% to 10.0%. Both of these indicators have dropped 20% in five years.

**Figure 2: US Household Debt Service Ratios Improved Since 2009**

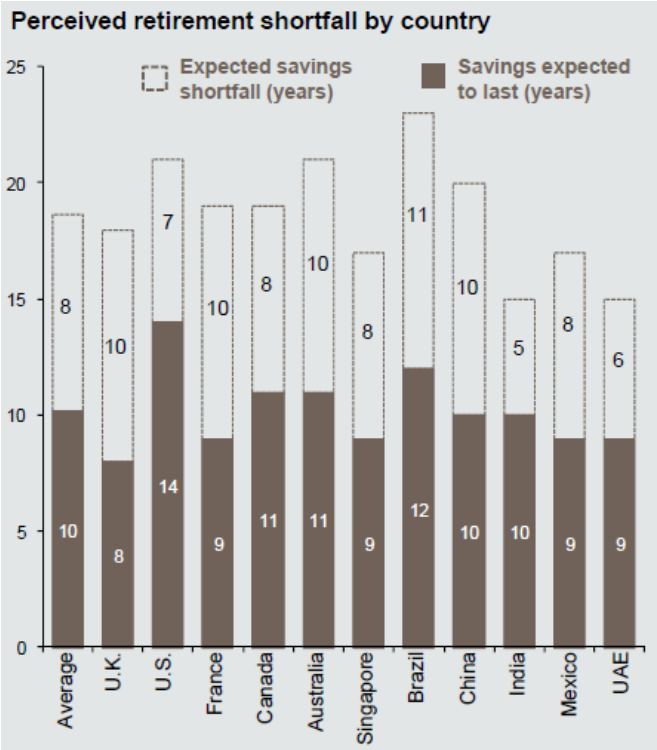



*Source:* Federal Reserve[iii] and Sapling Wealth Management

### Will These Same Policies Work In Other Economies?

The key question is whether other world economies will be successful executing a similar strategy, and we believe the answer will depend on the situation. Some countries (e.g. Greece) are unlikely to ever climb out of their debt burden without some form of debt forgiveness. By June 2015, Greece may offer the first glimpse of how these issues get resolved between the borrowers and creditors (and we expect the process and conclusion will be difficult). Every country wrestles with its unique situation, which may include overall debt levels, aging demographics, and insufficient retirement savings (Figure 3 below). We believe the United States is on much better footing than most economies. We expect resolving these issues will be extremely contentious in many countries.

Figure 3: US is Best of a Bad Bunch for Retirement Savings




*Source:* JP Morgan[iv]

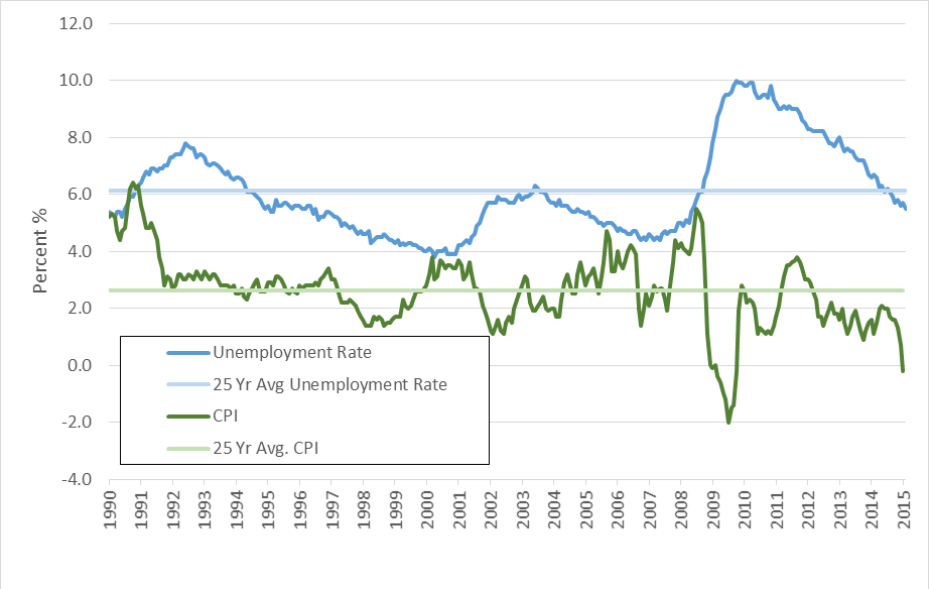
## US Federal Reserve to Slowly Normalize Rates

As the US economy strengthens, we believe the Federal Reserve will gradually move to raise interest rates; this stands in stark contrast to the monetary policies of Japan, Europe, and (soon) China, which are pushing liquidity into their domestic financial systems.

### *Even With Less Accommodation, Much Higher Rates Unlikely*

The Federal Reserve is guided by its "dual" mandates – balancing employment and inflation levels. With the US economy nearly at "full employment" (5.0-6.0% unemployment), the US Federal Reserve has less reason to maintain its extremely accommodative monetary policy stance. While ultra-low interest rates have helped households support debt payments and maintain savings rates, we expect the Federal Reserve will slowly begin taking steps towards interest rate normalization. However, recent inflation data has been benign (as represented by the Consumer Price Index - CPI) which will decrease the urgency of monetary tightening.

Figure 4: Inflation and Employment "Dual Mandates" Below 25 Year Average




*Source:* Bureau of Labor Statistics[v], Sapling Wealth Management

### Big Rate Rises Unlikely in 2015, In Our Eyes

If interest rates rise in the US, then all capital markets will shift to accommodate for the relatively more attractive US yields. For instance, for a German bond holder getting a negative return on a 5-year bond will look to the US rates at 1.5% with a potential for 10-20% currency appreciation as a fantastic investment. The chart below documents the double digit declines of nearly all major developed market currencies relative to the dollar in the last year. We believe that capital inflows to the US will temper interest rates domestically and that higher rates won't be a serious risk in 2015.

Table 2: 1Y USD Appreciation Significant for Developed Market Currencies

| | Spot Returns vs. USD (%) | | | | |
|---|---|---|---|---|---|
| Currency | 1-Mo. | YTD | 1Y | 3Y | 5Y |
| U.S. Dollar (USD) | - | - | - | - | - |
| Euro (EUR) * | -0.78 | -7.45 | -18.87 | -5.63 | -3.86 |
| British Pound (GBP) | 2.44 | -0.94 | -7.84 | -1.02 | 0.25 |
| Japanese Yen (JPY) | -1.79 | 0.13 | -14.90 | -12.13 | -5.75 |
| Australian Dollar (AUD) | 0.53 | -4.40 | -12.47 | -10.05 | -2.70 |
| Canadian Dollar (CAD) | 1.73 | -7.14 | -11.59 | -7.52 | -3.42 |
| New Zealand Dollar (NZD) | 4.28 | -2.98 | -9.78 | -3.21 | 1.62 |
| Norwegian Krone (NOK) | 0.83 | -2.79 | -21.68 | -9.98 | -5.07 |
| Swedish Krona (SEK) | -0.62 | -6.36 | -23.13 | -7.40 | -3.10 |
| Danish Krone (DKK) | -1.09 | -7.64 | -18.87 | -5.75 | -3.91 |
| Swiss Franc (CHF) | -3.57 | 4.19 | -7.75 | -1.77 | 2.38 |

*Source:* Eaton Vance Monthly Market Monitor[vi]

## Currency Issues at the Top of Our Risk List

However, we believe there could be adverse unintended consequences stemming from divergent international monetary policies. As the ECB launches its first quantitative easing efforts, the value of the Euro relative to the US dollar is on course to decline by 20-25% in just 12-18 months. Japan's aggressive monetary experiment has caused its currency to devalue nearly 50% since the policy began in 2012.

**Figure 5: US $ vs. Yen Foreign Exchange May Be Shape of Things to Come**

*Source:* ADFVN[vii]

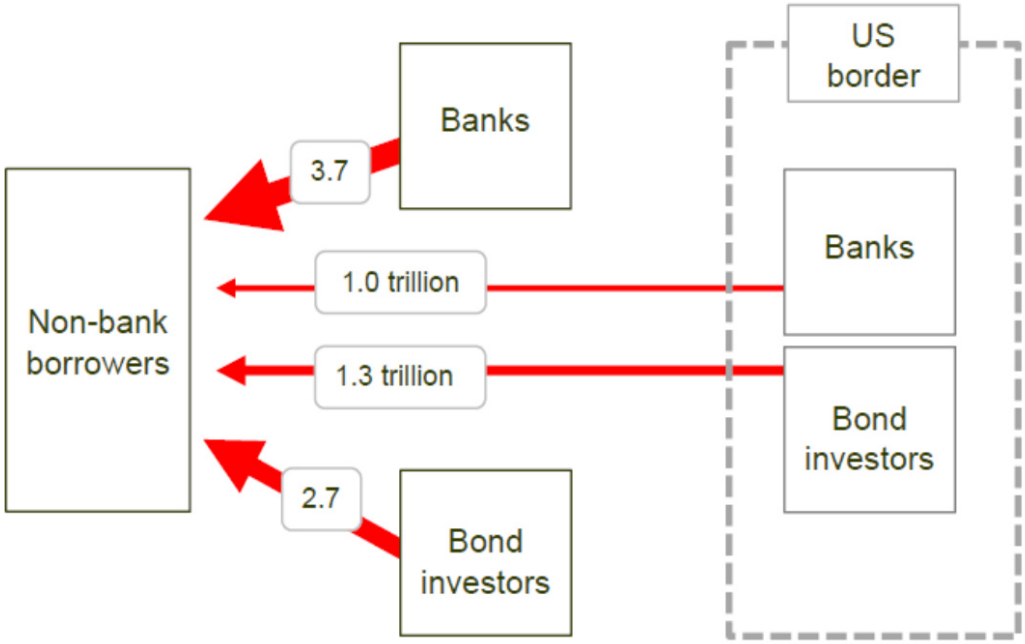
China, in the face of slowing growth, is in the process of lowering interest rates as well – which may lower the value of the Chinese yuan relative to the US dollar. Emerging market currencies have not depreciated as much as some of the developed economies, in part because of the pressure to maintain high interest rates to attract foreign capital.

### *Currency Swings Will Affect Borrowers Differently*

A strong US dollar may benefit international exporters selling goods to the United States, but it also hampers those non-US based corporations that have borrowed in dollars. We do not believe, as some do, that the next wave of international monetary policy accommodation will be as successful as in the US. One big difference is that in the last few years, huge amounts of dollar denominated debt was placed outside of the US. This debt source may become significantly more expensive (from the perspective of a non-US borrower in a country with a depreciating currency), as US interest rates rise and the US dollar appreciates. Also, if US investors lose their appetite for foreign bond investment, due to decreased relative returns and the cost of hedging, it may cause large amounts of capital to exit smaller, more fragile, markets.

Dr. Shin, the Head of Research at the Bank for International Settlements, estimated that there is roughly $8.8 Trillion in US denominated debt placed outside of the US via multiple entities – hedge funds, banks, bond investors.

**Figure 6: US Dollar Denominated Credit to Borrowers Outside of US - 2013**



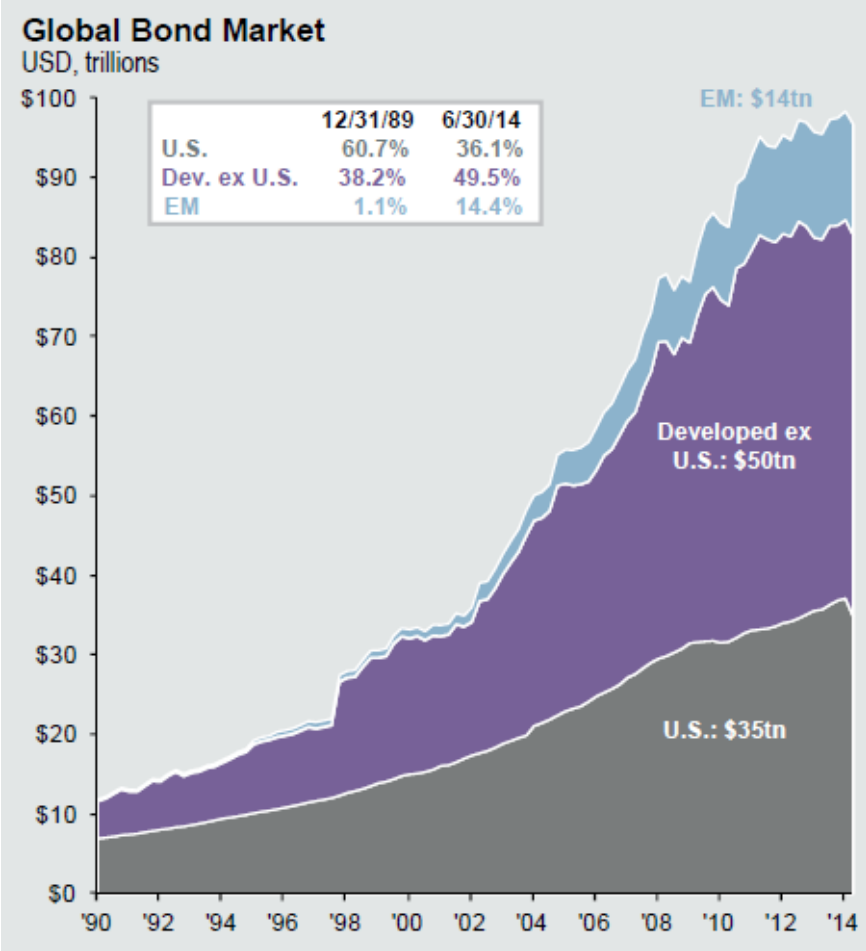

*Source:* Hyun Song Shin Presentation to Brookings Institution[viii]

We estimate this represents roughly 13-14% of the $64 trillion ex-US bond global bond market ($14 trillion emerging markets and $50 trillion developed world excluding US). In some countries (euro area, China) this only represents single digit exposure, while the UK/Brazil/India/Korea have 10-15% exposure. Some countries, such as Mexico/Canada and Philippines the exposure may reach 20-33% of total debt levels. However, these statistics are rough estimates, as there are significant analytical challenges to capturing these international fund flows. For instance, the complexities of correctly capturing the effects of a Chinese company selling dollar denominated debt via a subsidiary based in Japan are significant. It is safe to say that during that last five years the majority of the US dollar denominated debt expansion has occurred in emerging market economies.

### It Is All In the Execution and We Are Cautious …

If companies have properly hedged their currency risk, they can rollover their obligation to another currency denomination (such as Euros). However, currency hedges are expensive to implement and may not be set up to take into account the massive moves that have taken place in the last 6-12 months.

Figure 7: US Denominated Debt 13-14% Global Bond Market ex. US




*Source:* JP Morgan Guide to Markets[ix]

### … Therefore Emerging Markets Currencies Are the Ones to Watch

In the past, quick capital exits from emerging market economies have resulted in cathartic economic contractions – such as the 1997 Asian Financial Crisis. The recent "Taper Tantrum" was a more recent example of this capital flight dynamic. Given the level of US dollar denominated lending to these areas, these economies may not have the latitude to depreciate their currencies without risking capital flight. Generally, the emerging market currencies are soft, but not down dramatically in the last year.

We expect that capital flight scenarios will be driven by more fickle bond investors than bank capital sources. The exposure to US based bond investors is $1.3 Trillion – a large amount by any measure. While yield seeking investors are unlikely to completely abandon this area completely, but it is ripe for extreme volatility. We believe this bears close watching.

**Table 3: 1Y USD Appreciation Just Beginning For Some Emerging Nations**

| | Spot Returns vs. USD (%) | | | | |
|---|---|---|---|---|---|
| Currency | 1-Mo. | YTD | 1Y | 3Y | 5Y |
| **ASIA, EX. JAPAN** | | | | | |
| Chinese Renminbi (CNY) | -0.30 | -1.02 | -1.98 | 0.13 | 1.72 |
| Malaysian Ringgit (MYR) | 0.70 | -2.97 | -9.08 | -5.99 | -1.14 |
| Indian Rupee (INR) | 0.05 | 1.95 | -0.13 | -7.45 | -5.71 |
| Indonesian Rupiah (IDR) | -2.01 | -4.21 | -10.22 | -11.31 | -6.29 |
| Philippine Peso (PHP) | 0.04 | 1.42 | 1.22 | -1.05 | 0.91 |
| Singapore Dollar (SGD) | -0.64 | -2.74 | -6.98 | -2.79 | 0.63 |
| South Korean Won (KRW) | -0.39 | -0.64 | -2.77 | 0.63 | 1.10 |
| Taiwanese Dollar (TWD) | 0.22 | 0.63 | -3.61 | -2.24 | 0.39 |
| Thai Baht (THB) | 1.25 | 1.71 | 0.63 | -1.99 | 0.43 |
| **LATIN AMERICA** | | | | | |
| Brazilian Real (BRL) | -5.57 | -6.46 | -17.49 | -15.45 | -8.65 |
| Chilean Peso (CLP) | 2.77 | -1.81 | -9.54 | -8.09 | -3.21 |
| Colombian Peso (COP) | -2.37 | -4.92 | -18.13 | -10.92 | -5.07 |
| Mexican Peso (MXN) | 0.18 | -1.33 | -11.38 | -4.89 | -3.10 |
| Peruvian New Sol (PEN) | -1.12 | -3.69 | -9.52 | -4.69 | -1.65 |

*Source:* Eaton Vance Monthly Market Monitor[x]

## S&P 500 Earnings Estimates Too Rosy, In Our View

Consensus earnings estimates for the S&P 500, as reported by S&P Dow Jones Indices, are slated to increase +5.0% in 2015 and +14.5% in 2016. We believe this is a much higher rate than is practically achievable in the coming 12-18 months. Our earnings forecast for the 2015-2016 period is 5-10% lower than consensus forecast.

### *2015 S&P 500 Sales Growth Rates Remain Stable*

We believe the 2015 sales growth rate for the S&P 500 will be at or marginally below 2014. Solid US domestic economic growth will be offset by slowing international economies and a stronger US dollar. We estimate that 2014 registered 4.12% sales per share growth (3.42% organic, 0.7% share repurchase). We believe it is reasonable to assume the S&P 500 will average 3.5-4.0% sales per share growth in the 2015-2016 period, driven by 3.0-3.5% organic sales growth and 0.5% share repurchases and cash redeployment.

**Table 4: Components of S&P 500 Earnings Growth, by Year**

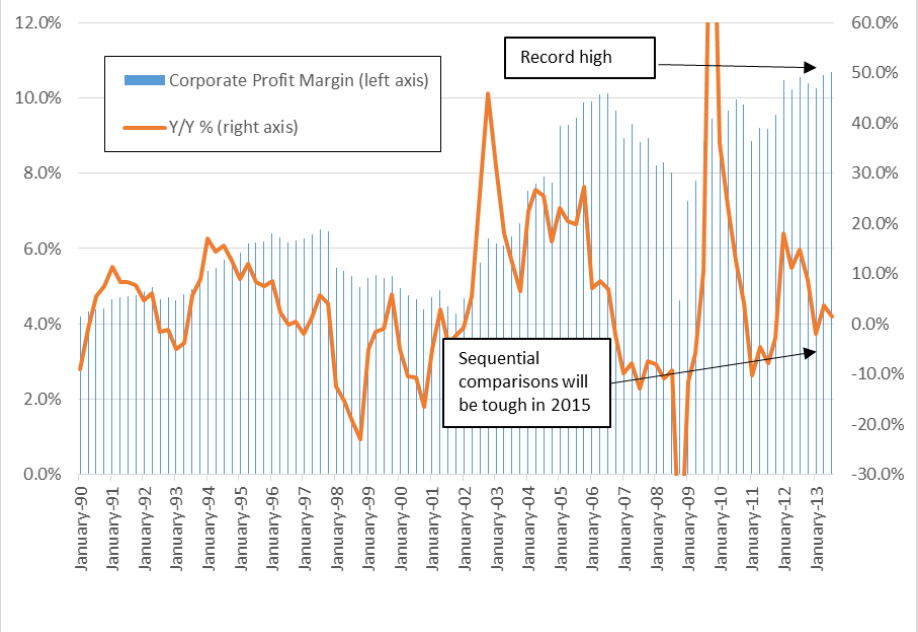
| | 2013A | 2014E | 2015E | 2016E |
|---|---|---|---|---|
| Sales Per Share | $ 1,117 | $ 1,163 | $ 1,204 | $ 1,252 |
| Baseline Sales Growth | 2.19% | 3.42% | 3.00% | 3.50% |
| Share Reduction | 0.10% | 0.70% | 0.50% | 0.50% |
| Total Y/Y % Growth | 2.29% | 4.12% | 3.50% | 4.00% |
| | | | | |
| Operating Margin | 9.61% | 9.72% | 9.55% | 9.82% |
| Y/Y % Growth | 8.3% | 1.2% | -1.7% | 2.8% |
| | | | | |
| Sapling S&P Earnings Est. | $ 107.29 | $ 113.05 | $ 115.00 | $ 122.90 |
| Y/Y % Growth | 10.8% | 5.4% | 1.7% | 6.9% |
| | | | | |
| S&P 500 Consensus | $ 107.29 | $ 113.05 | $ 118.75 | $ 135.92 |
| Y/Y % | 10.8% | 5.4% | 5.0% | 14.5% |
| | | | | |
| Our Estimate vs. Consensus | | 0.0% | -3.2% | -9.6% |

*Source:* S&P Indices[xi], Sapling Wealth Management

## *Operating Margins Are Soft and Represent a Big Risk*

Operating margins are near record highs for the S&P 500 in 2014. Negative sequential comparisons will likely continue a trend that started in Q3:14.

**Figure 8: Operating Margins at All Time Highs, Tough Sledding Ahead**




*Source:* Federal Reserve Board[xii]

We believe that economic headwinds are now producing visible margin deterioration across multiple industry categories. While many analysts have

attributed the Q4:14 margin decline on energy profits, this does not address the widespread margin erosion across nearly every major industry category. In Q4:14, 8 out of 10 sectors posted margin declines over the prior quarter and annual averages. Q3:14 had comparable results, with 7 out of 10 segment showing deteriorating margins. For companies with foreign sales, we believe it will be very difficult to maintain margins with currency headwinds. Eventually, lower energy prices will be reflected in the economy via higher consumer purchases and lower input costs, but that this process will take a while to play out.

**Table 5: Operating Margins Deteriorating in 70-80% of Industry Sectors**

| | Act. | Act. | Avg. | Est | Q4:14 Change | | Q3:14 |
|---|---|---|---|---|---|---|---|
| | Q2:2014 | Q3:2014 | 12-Mo. | Q4:2014 | 4Q/3Q | Q/Avg. | 3Q/2Q |
| Energy | 8.28% | 8.94% | 8.12% | 5.72% | -3.21% | -2.40% | 0.66% |
| Materials | 8.25% | 7.84% | 7.63% | 6.23% | -1.61% | -1.40% | -0.42% |
| Industrials | 9.60% | 9.44% | 9.15% | 8.80% | -0.64% | -0.35% | -0.16% |
| Consumer Discretionary | 7.18% | 7.02% | 6.91% | 7.28% | 0.26% | 0.37% | -0.16% |
| Consumer Staples | 6.82% | 6.83% | 6.69% | 6.01% | -0.82% | -0.68% | 0.01% |
| Health Care | 9.12% | 8.57% | 8.67% | 7.93% | -0.64% | -0.75% | -0.55% |
| Financials | 15.60% | 15.29% | 15.08% | 13.31% | -1.98% | -1.76% | -0.31% |
| Information Technology | 16.20% | 15.89% | 16.60% | 18.63% | 2.74% | 2.03% | -0.31% |
| Telecommunication Services | 10.85% | 10.15% | 12.60% | -4.57% | -14.73% | -17.18% | -0.70% |
| Utilities | 8.14% | 12.53% | 9.28% | 7.93% | -4.60% | -1.35% | 4.39% |
| *S&P 500* | *10.07%* | *10.10%* | *9.92%* | *8.99%* | *-1.11%* | *-0.93%* | 0.03% |

*Source:* S&P Indices[xiii], Sapling Wealth Management

### Declining Margin Environment Tough on Investment Performance

3-4% sales growth and flat-to-down margins will force companies to pursue other strategies to bolster growth. Opportunities to make positive changes to the capital structure are largely played out, as US interest rates normalize. Cash can still be redeployed into share buybacks or acquisitions, which on the whole, will provide some support (+0.5% by our estimate). However, efforts to win market share via increased capital expenditures or price reductions will have a negative effect on near term earnings.

## Our Earnings Expectations Are Well Below Consensus

Our earnings expectations are 3-10% below S&P Indices consensus forecast for 2015 & 2016. If we are wrong, it would be due to our estimates not fully factoring in a revitalized US consumer, emboldened by lower cost of imports & oil, strengthening job markets and the eventually, higher real wage growth.

**Table 6: SWM Earnings Expectations Well Below Consensus**

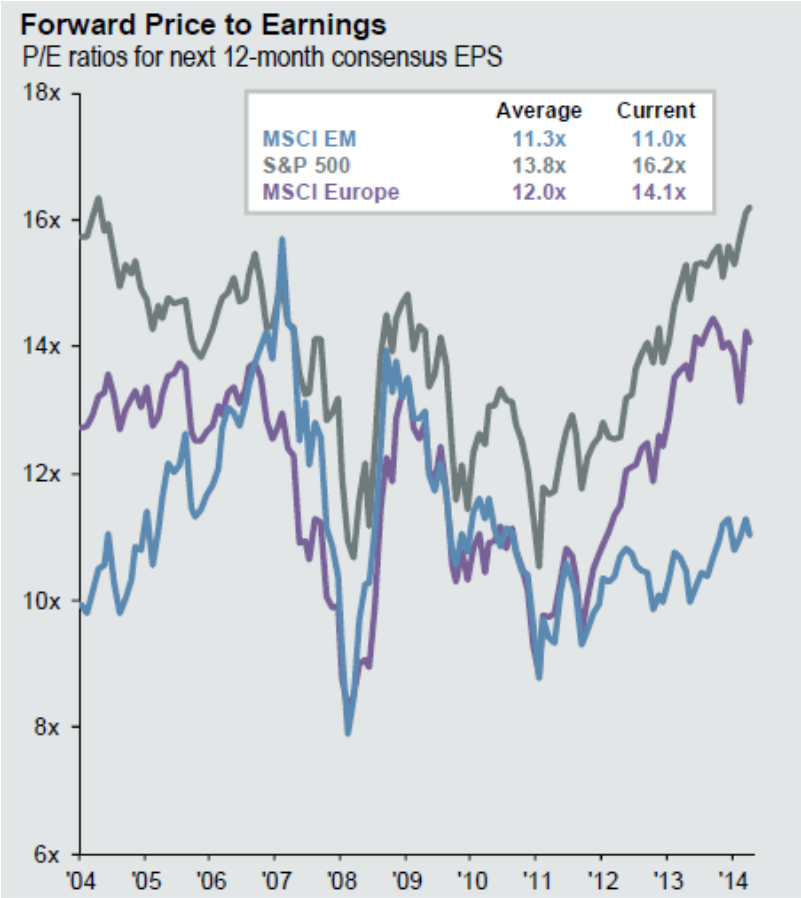
| | SWM S&P 500 EPS | | |
|---|---|---|---|
| | 2014A | 2015E | 2016E |
| SWM Earnings Estimate | $ 113.05 | $ 115.00 | $ 122.90 |
| S&P Indices Consensus | $ 113.05 | $ 118.75 | $ 135.92 |
| Difference | $ - | $ (3.75) | $ (13.02) |
| % Difference | 0.0% | -3.2% | -9.6% |

*Source:* S&P Indices[xiv], Sapling Wealth Management

### *P/E Multiple Contraction Risks To Follow EPS Uncertainty*

According to J.P Morgan, the forward P/E ratio on consensus S&P 500 earnings is 16.2X, which is at a 10 year high. We could easily see a 10% downside to P/E multiple valuations from earnings disappointments. MSCI Europe markets trade at 14.1X, which represents a 13.0% discount to US multiples and is consistent with the past 10 years. However, emerging market P/E multiples, which normally trade at an 18.1% discount are now trading at a 32.1% discount to US P/E multiples, a clear reflection of the degree of perceived risk in these economies. It is interesting to note that these disparities have occurred despite relatively stable financial markets. Any sign of major economic uncertainty would cause these valuation disparities to expand further. Further compression of riskier assets earnings multiples would provide an excellent entry point for an investor with a long-term investment time horizon.

Figure 9: Disparity in Valuations a Sign of Market Risk




*Source:* JP Morgan Guide to the Market[xv]

## *All Things Considered, Negative Returns a High Probability*

Our projected 2015 returns for equities, weighted by probability, registers a disappointing (1.9%) in 2015 – which is much too low to take a constructive stance towards stocks. This is, in large part, due to factoring in a relatively high probability that a strong US dollar will soften earnings growth in the US. In our two bear scenarios, we estimate stock returns could register declines over (20.0%). In our worst case scenario (a 10% probability) we see a currency crisis driving a (47.4%) valuation reduction in equities stemming from a double whammy of earnings and P/E multiple contraction. Our likelihood of a rosy scenario does not offset this risk, in our view, as we estimate a +24-25% equity upside at only a 5% probability.

**Table 7: 30% Odds of Very Negative Scenarios Dampen Our Enthusiasm**

| | 3/19/15 | SWM S&P EPS | | | P/E Ratio | | | Trailing 12 Month | Trailing 12 Month | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | S&P 500 | 2014A | 2015E | 2016E | 2014A | 2015E | 2016E | Yield | Dividends | | |
| Prices & Ratios | 2,089 | $ 113.05 | $115.00 | $ 122.90 | 18.5 | 18.2 | 17.0 | 1.9% | $39.44 | | |
| Y/Y % | | | 1.7% | 6.9% | | | | | | | |
| ***Projected Valuations*** | Probability | 2016 SWM EPS Estimate | 2016/ 2015 Y/Y % | % of S&P Estimate | SWM Est P/E Multiple | Chg. '16/ '15 Y/Y % | Target S&P Valuation | % Return S&P | + | % Yield | = | Total Return S&P |
| Currency Crisis & Global Recession | 10% | $ 95.00 | -17.4% | 77.3% | 11.0 | -39.5% | 1,045 | -50.0% | | 1.9% | | -48.1% |
| Weak Int'l Currency & Economy + Deflation | 20% | $ 113.00 | -1.7% | 91.9% | 14.0 | -22.9% | 1,582 | -24.3% | | 1.9% | | -22.4% |
| World Flat, US Consumer Strong, Oil $50/brl | 35% | $ 128.00 | 11.3% | 104.1% | 17.0 | -6.4% | 2,176 | 4.2% | | 1.9% | | 6.0% |
| US Growth Solid, China +7%, Oil $60/brl | 30% | $ 130.00 | 13.0% | 105.8% | 18.0 | -0.9% | 2,340 | 12.0% | | 1.9% | | 13.9% |
| Europe Recovery, China +7-8% | 5% | $ 140.00 | 21.7% | 113.9% | 18.0 | -0.9% | 2,520 | 20.6% | | 1.9% | | 22.5% |
| | 100% | | | | | | | | | | | -1.9% |

*Source:* Sapling Wealth Management

## *Other Asset Classes Not Particularly Compelling*

Other assets classes don't offer much in the way of investment returns in 2015 either. Emerging markets, despite attractive P/E multiple valuations, have earnings and systemic crisis risks, in our view. High yield bonds yields have shrunk to a level where they provide only modest support in the case of an economic downdraft or a rising interest rate environment. High quality fixed income, represented by government agencies and corporate issues, offer valuable downside protection in the case of a crisis. International developed market valuations are low enough to be attractive in stable-to-positive economic scenarios, but still have associated risks.

**Table 8: Lackluster Outlook for Many Asset Classes**

| | | SWM EPS Est. | | P/E Ratio | | Bond Market | | |
|---|---|---|---|---|---|---|---|---|
| | S&P 500 | 2015E | 2016E | 2015 | 2016 | 10 Year | HG Corp | HY Corp |
| Market Valuations (3/19/2015) | 2,089 | $115.00 | $122.90 | 18.2X | 17.0X | 1.97% | 2.95% | 5.70% |

| | | Equity | | | Debt | | |
|---|---|---|---|---|---|---|---|
| Scenario | Probability | Int'l | Emerging | S&P 500 | 10 Yr | HG Corp | HY Corp |
| Currency Crisis & Global Recession | 10% | -58.1% | -63.1% | -48.1% | 11.2% | 2.5% | -25.5% |
| Weak Int'l Currency & Economy + Deflation | 20% | -27.4% | -37.4% | -22.4% | 6.3% | 4.7% | 3.5% |
| World Flat, US Consumer Strong, Oil $50/br | 35% | 11.0% | 1.0% | 6.0% | -0.5% | 0.4% | 5.3% |
| US Growth Solid, China +7%, Oil $60/brl | 30% | 18.9% | 18.9% | 13.9% | -4.8% | -5.6% | -0.1% |
| Europe Recovery, China +7-8% | 5% | 32.5% | 37.5% | 22.5% | -8.8% | -11.1% | -5.1% |
| | 100% | | | | | | |
| Wtd. Average | | -0.1% | -5.9% | -1.9% | 0.3% | -0.9% | -0.3% |

*Source:* Sapling Wealth Management

## What Could Go Right in 2015

There still is room for positive news on several fronts, which keeps us from being too pessimistic. High employment rates will likely lead to real wage gains and a rise in consumer spending. Falling oil prices and lack of inflationary pressures in the US may also bolster consumer confidence. Republican policy makers may be less adversarial as the election season approaches, hoping to signal to voting Americans that the party is able to effectively govern. While interest rates will likely be higher in 2015, we don't believe rates will rise enough to dampen US GDP growth (although currency issues might). The Middle East peace process could bear fruit this year, with a nuclear disarmament agreement in Iran or progress on stemming ISIS violence. Indeed, a lack of a political crisis may itself breed confidence.

### *Where to Look For Value*

There are still plenty of themes which offer investment merit and we are not recommending that investors put their heads (and wallets) in the sand. We believe quality growth stocks, particularly those that address lowering costs and productivity, will be bid up in a low interest rate environment. Stock selection and active portfolio management makes sense to us as, and special situations can offer unique upside potential. International markets offer nice upside in stable environments, and we prefer hedged equity and fixed income exposure. Finally, municipal bonds remain a relatively attractive asset in a rising tax rate environment.

ENDNOTES

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[iii] "Household Debt to GDP and Household Debt Service – FRED Graph", Federal Reserve Economic Data, https://research.stlouisfed.org/fred2/graph/?graph_id=228123. (March 19th, 2015).

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[v] "CPI and Unemployment Rates – Series CUSR0000SAO & LNS140000000", Bureau of Labor Statistics, http://www.bls.gov/. (March 10, 2015).

[vi] "Developed Market Currency Performance & Interest Rates", Eaton Vance Monthly Market Monitor, page 34, (March, 2015).

[vii] "US Dollar vs. Yen Historical Exchange Rates – 7 Years", ADFVN, http://www.advfn.com/stock-market/FX/USDJPY/chart. (March 19, 2015).

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[xi] "Index Earnings: S&P 500", S&P Dow Jones Indices, http://us.spindices.com/indices/equity/sp-500/. sp-500-eps-est.xls. (March 10, 2015).

[xii] "GDP & Corporate Profits", Federal Reserve Economic Data, https://research.stlouisfed.org/fred2/. (March 10th, 2015).

[xiii] "Index Earnings: S&P 500", S&P Dow Jones Indices, http://us.spindices.com/indices/equity/sp-500/. sp-500-eps-est.xls. (March 10, 2015).

[xiv] Ibid.

[xv] "Guide to the Markets: Market Insights 1Q:2015", J.P. Morgan Asset Management, page 43, https://www.jpmorganfunds.com/blobcontentheader/202/900/1158474868049_jp-littlebook.pdf. (January, 2015).