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# INVESTMENT STRATEGY QUARTERLY



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*Investment Strategy Quarterly* is intended to communicate current economic and capital market information along with the informed perspectives of our investment professionals. You may contact your financial advisor to discuss the content of this publication in the context of your own unique circumstances. Published 04/01/2016. Material prepared by Raymond James as a resource for its financial advisors.

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## INVESTMENT STRATEGY COMMITTEE RECAP: A MIX OF DOMESTIC STRENGTH AND A DRAG FROM OVERSEAS

Financial market headwinds for the next six to twelve months include sluggish global economic growth, Federal Reserve policy, earnings growth and commodity prices. The committee also noted low oil prices, an improving labor market and consumer spending as top tailwinds, with a positive attitude toward real U.S. GDP growth.

### ECONOMIC & MARKET OUTLOOK

#### THE ECONOMY

The U.S. economic indicators are mostly positive, while investor sentiment is not. As Chief Economist Scott Brown shared, “Consumer fundamentals should remain strong, reducing recessionary fears.”

As a point of validation, Brown stated, “With only a couple of gauges flashing yellow, such as the stock market decline, most other measures suggest that we’re likely to avoid a recession. Still, there’s some risk that we could talk ourselves into one.”

With regard to business fixed investment, Brown noted signs that firms are hoarding cash and delaying projects. They have the means and ability to increase capital spending. “My expectation is that the consumer hangs in there and the job market remains strong, and eventually business fixed investment will follow suit. The consumer is 70% of the economy, so that’s most important.”

#### FEDERAL RESERVE POLICY

The Fed is looking at a tighter job market and budding wage pressures, so it remains in tightening mode, eager to normalize policy. However, worries about global economic and financial developments should keep rates on hold for now.

**SCOTT BROWN,**  
Chief Economist, Equity Research

“With only a couple of gauges flashing yellow, such as the stock market decline, most other measures suggest that we’re likely to avoid a recession.”

“If the economy were to stumble badly, the Fed has a limited ability to respond. Negative interest rates are a possibility, but not very likely. If the economy and the consumer remain strong and financial conditions stabilize and improve, the Fed could end up pulling the trigger in June, but I don’t think that’s something the market should fear,” Brown said.

#### EUROPE

European Strategist for Raymond James Euro Equities\* Chris Bailey said, “In an uncertain world, Europe has a couple of angles to ease concerns, albeit slightly. Looking at consensus earnings growth, I get very excited about Europe relative to several other parts of the world for 2016. You’ve got this combination of the growth trajectory, extra stimulus in the market, low sentiment and actual earnings which may be even better than hoped.”

#### OIL AND ENERGY

Pavel Molchanov, senior vice president and energy analyst for equity research, shared that it’s a very common myth that oil is the direct culprit behind what happened to equities in January and early February. Rather, he believes that commodity markets and equities have been affected by some of the same headline risks.

Molchanov believes oil at \$60 per barrel by the end of the year would be a happy medium for the market. Supply response, together with higher demand, should lead to a rebalancing in the market.

#### HOUSING

While housing is not a growth engine at the moment, it’s not a concern either. Real Estate Research Director Paul Puryear noted minimal changes in the market over the last quarter, citing a lack of inventory for first time homebuyers as a potential headwind. “Buyers are out there if we can get a product to them at a good price. Unfortunately, the median household buyer really can’t afford to purchase a house right now, so they’re renting, which we don’t think is going to change anytime soon.”

“If we don’t see a rate hike in the near future, when does the Fed step out of the way of the presidential election? Don’t they get quiet around that time and avoid any moves?”

– **Nick Goetze**, *Managing Director,  
Fixed Income Services*

“This comes up every four years, but the Fed is not going to shift the timing of policy decisions around a presidential election. I don’t think the political cycle’s really going to be the big factor for the Fed, especially given the expectation of gradual rate adjustments.”

– **Scott Brown**, *Chief Economist, Equity Research*

## INVESTMENT STRATEGY COMMITTEE MEMBERS

Each quarter, the committee members complete a detailed survey sharing their views on the investment environment, and their responses are the basis for a discussion of key themes and investment implications.

**Andrew Adams, CMT** Research Associate, Equity Research

**Chris Bailey** European Strategist, Raymond James Euro Equities\*

**Scott J. Brown, Ph.D.** Chief Economist, Equity Research

**Robert Burns, CFA, AIF®** Vice President, Asset Management Services

**James Camp, CFA** Managing Director of Fixed Income, Eagle Asset Management\*

**Doug Drabik** Senior Strategist, Retail Fixed Income

**J. Michael Gibbs** Managing Director of Equity Portfolio & Technical Strategy

**Nick Goetze** Managing Director, Fixed Income Services

**Peter Greenberger, CFA, CFP®** Director, Mutual Fund Research & Marketing

**David Hunter, CFA, CAIA** Officer, Institutional Research, Asset Management Services

**Nicholas Lacy, CFA** Chief Portfolio Strategist, Asset Management Services

**Ryan Lewenza, CFA, CMT** Senior Vice President, Private Client Strategist and Portfolio Manager, Raymond James Ltd.\*

**Pavel Molchanov** Senior Vice President, Energy Analyst, Equity Research

**Paul Puryear** Director, Real Estate Research

**Jeffrey Saut** Chief Investment Strategist, Equity Research

**Scott Stolz, CFP®** Senior Vice President, PCG Investment Products

**Benjamin Streed, CFA** Strategist, Retail Fixed Income

**Jennifer Suden, CAIA** Director of Alternative Investments Research

**Tom Thornton, CFA, CIPM** Vice President, Asset Management Services

**Anne B. Platt, AWMA®, AIF® – Committee Chair** Vice President, Investment Strategy & Product Positioning, Wealth, Retirement & Portfolio Solutions

**Kristin Byrnes – Committee Vice-Chair** Product Strategy Analyst, Wealth, Retirement & Portfolio Solutions

## ASSET ALLOCATION GUIDANCE

Asset Management Services Chief Portfolio Strategist Nick Lacy shared that from an overall portfolio standpoint, his team is increasing quality within fixed income and equities, reducing tail risk until the market environment improves. For fixed income, that means incorporating high-quality funds and managing duration. On the equity side, they are moving allocations up the market-cap spectrum.

### EQUITIES

Chief Investment Strategist Jeff Saut believes we're still in a secular bull market, "provided the recent lows around the 1800 level on the S&P 500 are not violated. Earnings for 23 quarters have continued to come in better than the bears have been telling us," he said.

Mike Gibbs, managing director of equity portfolio & technical strategy, thinks the market is stuck in a trading range until we get some answers on economic growth, bankruptcies in the energy space, capital flows around the world, and their impact.

Regarding recent revenue growth, Saut thinks that the economy is on the mend and that the business cycle has been elongated. "Usually at this stage of a recovery you're into late cycle, but because the downturn was so severe, we've elongated the mid-cycle and have a year or two before the late cycle begins. I think there are opportunities out there to put money to work," he stated.

### FIXED INCOME

Doug Drabik, senior strategist for retail fixed income, spoke to the overall benefits of low rates for homebuying, business borrowing and consumer spending. "There is a flight to safety in the U.S. Treasury markets, and that isn't going to change anytime soon. Although thinking about 2%-3% yields isn't exciting, spreads are widening, thus income goals can be met

"I see a re-evaluation of financial assets that makes sense juxtaposed against a 2% GDP growth-oriented world. You're going to get opportunities in credit. You're going to have to buy income-producing assets that are not pure debt, and that means dividend companies that actually sustain out of free cash flow, not through financial engineering. The risk-free asset has been the natural beneficiary, and I think corporate bonds are going to get really attractive over the next three to six months, but I'd be patient."

– **James Camp**, *Managing Director of Fixed Income, Eagle Asset Management\**

via spread products (i.e., corporate bonds, municipal bonds, and preferred securities)."

Benjamin Streed, strategist, Retail Fixed Income, added, "The key concern is credit risk, not duration. People shouldn't be afraid; duration is not a four-letter word as long as you understand what it is and its benefit to a diversified portfolio. Fixed income has a place regardless of where rates are, have been or might be going."

Nick Goetze, managing director, Fixed Income Services, reminded investors to be wary of bond proxies. "Ultimately, they don't behave like fixed income." James Camp, managing director of fixed income with Eagle Asset Management\*, chimed in: "If you're an asset allocator, you need duration and non-correlation through alternative investments or bonds. If you're an income generator, you need to be more varied in your approach – but that does not mean bond proxies." Regarding overall opportunities, investors should be picky and understand that the risk in fixed income is more about credit than duration. ■

## ECONOMIC SNAPSHOT

The mixed nature of the U.S. economy continued into early 2016. Consumer spending growth slowed, but it's hard to get excited about the data for January and February (the fundamentals are sound). Orders and shipments of capital goods, while uneven from month to month, have continued to trend lower. Housing continues to recover, but still faces some issues in both supply and demand. Eyeing a tighter job market, Federal Reserve officials are still planning to normalize monetary policy (that is, raise short-term interest rates) – but given the central bank's limited options to spur growth (if needed), the Fed will be cautious in deciding on the next rate increase. Longer term, market participants may struggle to come to grips with weak earnings and a slow trend in productivity growth.

**SCOTT BROWN**  
Chief Economist,  
Equity Research

STATUS	ECONOMIC INDICATOR	COMMENTARY
POSITIVE OUTLOOK	EMPLOYMENT	Job growth has remained strong, but the pace is likely to slow somewhat as the slack in the job market is reduced (and firms have a harder time hiring new workers). Job destruction remains low.
	CONSUMER SPENDING	Strong job growth and moderate wage gains should continue to support consumer spending growth in the months ahead. A firming in gasoline prices would mean some reduction in purchasing power.
	HOUSING AND CONSTRUCTION	Strong job growth has provided significant support. Tight credit and home price appreciation remain restraints for first-time homebuyers. Builders continue to note supply constraints. Rents and home prices are rising.
	INFLATION	There is little upward pressure in commodity prices and only the initial stirrings of labor cost increases, which feed into inflation in services. Shelter costs are rising at a faster pace, lifting core inflation.
	MONETARY POLICY	Fed officials remain in tightening mode, but are expected to be cautious and gradual in raising short-term interest rates. Global economic and financial developments may keep the Fed passive.
NEUTRAL OUTLOOK	GROWTH	Data available at the end of the quarter suggests that GDP growth was a lot slower than expected in 1Q16. That's not necessarily bad – the numbers do bounce around from quarter to quarter – but there's hope for a spring pickup.
	THE U.S. DOLLAR	While the direction seemed right, currency market participants have over-reacted to monetary policy differences. Currencies typically overshoot and we have seen some softening of the dollar as the Fed appears less aggressive.
	BUSINESS INVESTMENT	Capital spending has been on a downtrend, reflecting a further contraction in energy exploration. However, fears of a possible recession and political uncertainties may be compounding a sense of caution.
	LONG-TERM INTEREST RATES	Long-term Treasury yields have been pushed lower by a global flight to safety, but that ought to reverse somewhat as investors begin to look more optimistically on emerging economies (although that may take some time).
	REST OF THE WORLD	China's economic transition will be bumpy, but the country is unlikely to crash. Latin America is a mess. Europe is still slow, facing a number of issues. The U.S. remains an attractive location for global capital.
WILD CARDS		Uncertainty over the election and the priorities of the incoming administration may add to business caution well into 2017. Productivity growth has slowed in recent years and shows no sign of picking up – that has significant implications for the long-term outlook for the economy and the markets.





# Asset allocation:

## Part art, part science

**Nick Lacy, CFA**, *Chief Portfolio Strategist, Asset Management Services*

**Kristin Byrnes**, *Committee Vice-Chair, Product Strategy Analyst, Wealth, Retirement & Portfolio Solutions*

Since the financial crisis, the rumblings of asset allocation no longer working have been plentiful among market watchers. However, the idea that asset allocation should always protect investors from losing money is a false pretense leading to many of these criticisms.

“Asset allocation should be used primarily for risk management and secondarily for return generation.”

### WHAT IS ASSET ALLOCATION?

This investment decision involves the division of a portfolio among multiple asset classes – the broadest mix being equity, fixed income and cash – and depends greatly on individual goals, time horizon and risk tolerance.

Simply put, if an investor utilizes multiple asset classes that behave differently in any given market, the portfolio will be positioned to potentially avoid significant losses over time, as each piece of the pie should move in a different direction or to a different degree. This phenomenon is called diversification. By choosing the right mix of non-correlated assets, the overall portfolio risk is potentially reduced and its return stream may be smoother. Again, let me point out that portfolio risk is potentially reduced, not eliminated.

Asset allocation should be used primarily for risk management and secondarily for return generation. After all, if you don't have enough risk in your portfolio, you may not reach your financial goals.

### THE SCIENCE:

#### ASSET ALLOCATION AS A RISK MANAGEMENT TOOL

Asset allocation is commonly used to diversify a portfolio, or in other words, attempt to reduce the portfolio's risk and smooth out returns over time. One of the most important decisions to make from a risk standpoint is how much equity to own versus fixed income. The importance of this decision lies in the fact that the majority of your portfolio risk has historically been derived from equity exposure while fixed income

has been one of the only traditional asset classes that tends to move in the opposite direction (also known as negative correlation). Historically speaking, investment-grade bonds have generally performed well during periods of equity market stress. Over the last 40 years, when the S&P 500 lost more than 5% in a quarter, the Barclays U.S. Aggregate Bond Index earned

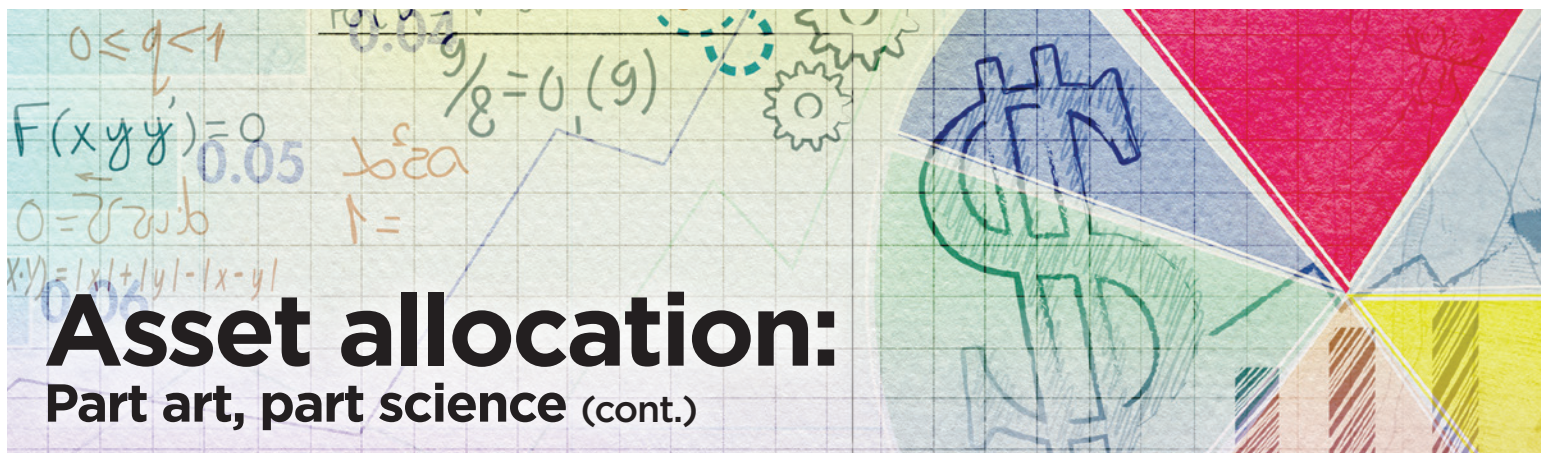
a positive average return of 3.4%. While there is no guarantee that this relationship will hold in the future, history demonstrates the likelihood that it should. There have only been three periods out of 20 over the last 40 years when the S&P 500 was down more than 5% in a quarter and fixed income was negative, first quarter 1977, third quarter 1981 and first quarter 2009. In all three cases, fixed income losses were substantially less than that of equity.

There is more to asset allocation than simply owning stocks and bonds; it also involves owning equities that are not perfectly correlated with each other, such as U.S. and non-U.S. stocks. While correlations between these two markets have increased in recent years, there are still meaningful diversification benefits to be potentially gained by owning both. Also, within U.S. equity markets, there has been a benefit to owning both large and small-cap stocks, and correlations between these investments have actually decreased over the last 40 years.

### THE ART:

#### ASSET ALLOCATION AS A RETURN GENERATOR

There are various investing principals that should, in theory, yield positive excess return over the long run. Keep in mind that what markets should do and what they actually do can be quite different. There are other factors that warrant consideration when analyzing investments, such as profitability, quality of the market, and current investor sentiment. Just as markets don't operate in a vacuum, investors don't always make choices solely based on “investment sense.”

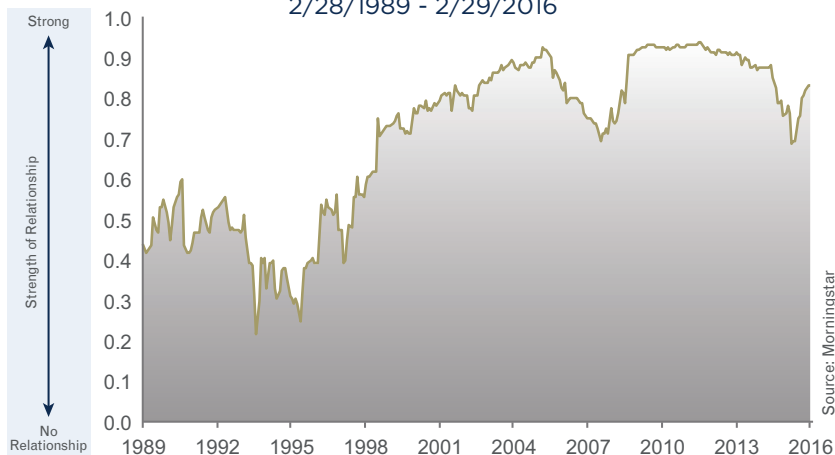


# Asset allocation:

## Part art, part science (cont.)

### RELATIONSHIP BETWEEN DOMESTIC AND INTERNATIONAL EQUITY RETURNS

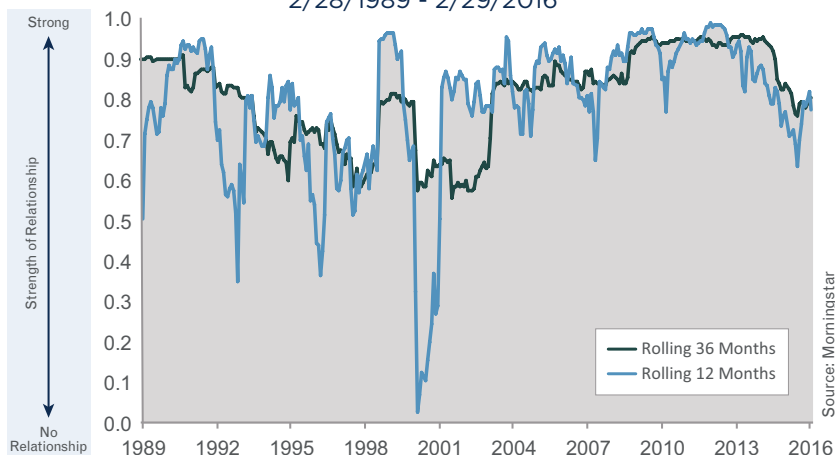
2/28/1989 - 2/29/2016



This chart plots correlation data between the S&P 500 Index and the MSCI EAFE Index on the rolling 36-month basis.

### RELATIONSHIP BETWEEN U.S. LARGE CAP AND U.S. SMALL CAP EQUITY RETURNS

2/28/1989 - 2/29/2016



This chart plots correlation data between the S&P 500 Index and the MSCI EAFE Index on the rolling 36-month basis. Correlations range between (-1 and +1), with -1 meaning they move in complete opposite directions, 0 meaning there is no relationship, and +1 meaning they move in the exact same manner.

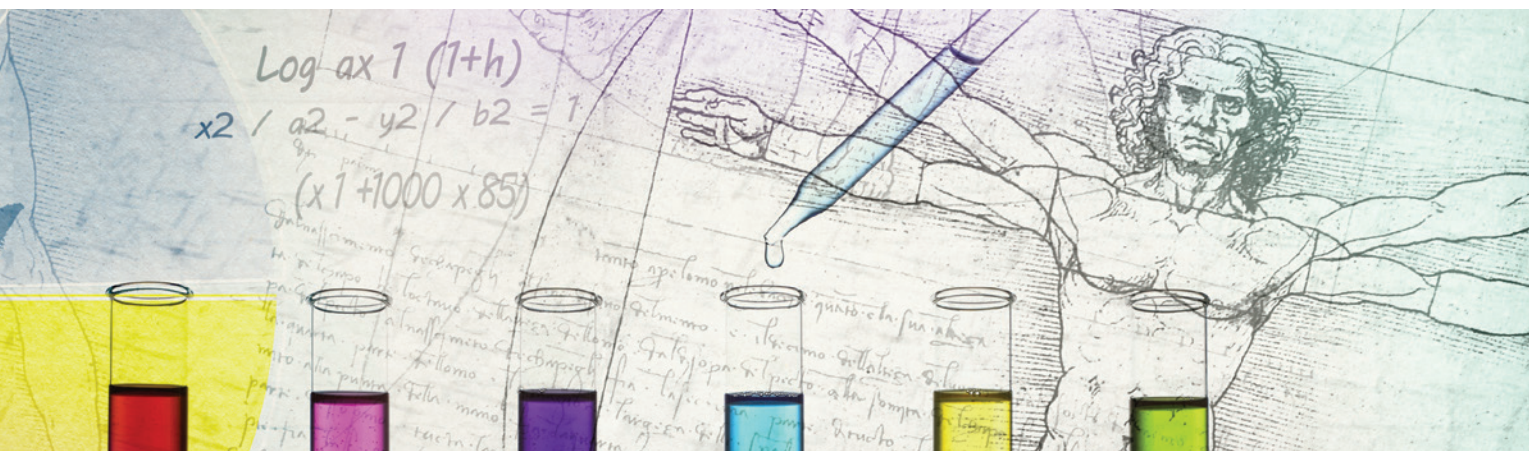
For example, history has taught us that investors can theoretically improve their risk and return profile by allocating to areas of the market that are less expensive and out of favor rather than those that are expensive from a fundamental standpoint. This strategy, known as value investing, has worked over time. However, in the real world, cheap assets always carry the risk of becoming even cheaper, like international equity in 2015, and "expensive" assets may continue to outperform, like domestic equity in the mid-1990s.

Asset allocation analysis typically yields a recommended portfolio containing some level of international equity exposure. Looking back at 2015, this allocation hurt investors relative to domestic equity, regardless of its attractiveness from a valuation standpoint. In this case, exchange rates were a key driver in performance as the U.S. dollar had an unprecedented rally versus other currencies and erased a decent year of returns in unhedged international developed markets. So, just because it makes "investment sense" and you believe it should produce higher returns, doesn't mean it always will. By contrast, in 1994 - 1998 U.S. equity markets, especially large cap, outperformed most investments while valuations continued to rise. Does this mean you shouldn't bother with asset allocation? I think not!

### A LONG-TERM APPROACH TO ASSET ALLOCATION

The key to successful investing is formulating a proven process with realistic goals and sticking to it. Abandoning ship in the height of the storm can have catastrophic effects on your long-run performance as you may never completely recover from





those losses. Think of the stock market in the same sense that Milton Friedman thought of the economy in that it behaves like a “plucked string.” The farther you pull on it, the more forcefully it snaps back.<sup>1</sup>

A strategic asset allocation portfolio should never generate the highest returns possible and, on the other hand, it should never produce the lowest either. Remember that the primary goal of asset allocation is risk management. Historically, the upside has taken care of itself over time. ■

#### KEY TAKEAWAYS:

- By choosing the right mix of non-correlated assets, overall portfolio risk is potentially reduced and the return stream should be smoother.
- Asset allocation should be used primarily for risk management and secondarily for return generation.
- The key to successful investing is formulating a proven process with realistic goals and sticking to it.
- A strategic asset allocation portfolio should never generate the highest returns possible and, on the other hand, it should never produce the lowest either.

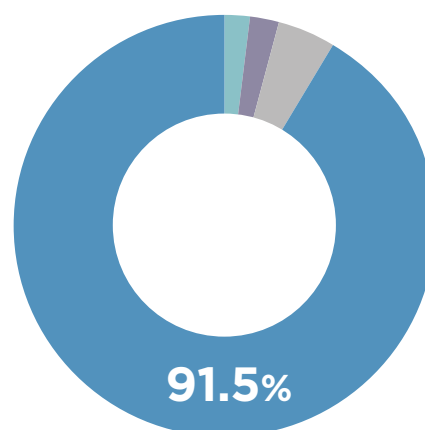
<sup>1</sup> Source: The ‘Plucking Model’ of Business Cycle Fluctuations, Milton Friedman, 1964

Source: Morningstar data using S&P 500 & Barclays U.S. Aggregate Bond Index total returns as of 3/1/1976 through 12/31/2015

Asset allocation and diversification do not guarantee a profit nor protect against loss. Past performance may not be indicative of future results. The performance mentioned does not include fees and charges, which would reduce an investor's return. Investing in international securities involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. Small-cap stock investing involves greater risks and is not suitable for all investors.

#### VOLATILITY OF PORTFOLIO RETURNS

Asset allocation decisions are among the most important factors affecting total portfolio volatility.



#### FACTORS AFFECTING PORTFOLIO VOLATILITY

■ Asset Allocation Decisions	91.5%
■ Market Timing	4.6%
■ Stock Selection	2.1%
■ Other	1.8%
<b>Total</b>	<b>100.0%</b>

Source: Brinson, Beebower and Associates, “Determinants of Portfolio Return,” 1986, updated 1991 and 1995. “Does Asset Allocation Policy Explain 40, 90, or 100% of Performance?” Ibbotson and Kaplan, Financial Analysts Journal, Jan./Feb. 2000. “The Equal Importance of Asset Allocation and Active Management,” Xiong, Ibbotson, Idzorek, and Chen, Financial Analysts Journal, February 2010. Asset allocation does not ensure a profit or protect against a loss. All investments are subject to risk. There is no assurance that any investment strategy will be successful.

# The Fed's dilemma: Normalization without the markets' permission?

**James Camp, CFA**, managing director of fixed income, Eagle Asset Management\*, weighs in on new factors affecting policy decisions.

Along with the dual mandate of price stability and full employment, the post crisis Federal Reserve (the Fed) has introduced the idea of a financial market “wealth effect” as a tertiary objective. A year after the sunset of asset purchases (quantitative easing or QE) and weeks after the first increase in the federal funds rate in over a decade, financial markets are pushing back. Policy actions have been highly reactive to market movements in the post-crisis era. Will policy makers tighten without the markets' permission?

## THE PICTURE HAS CHANGED

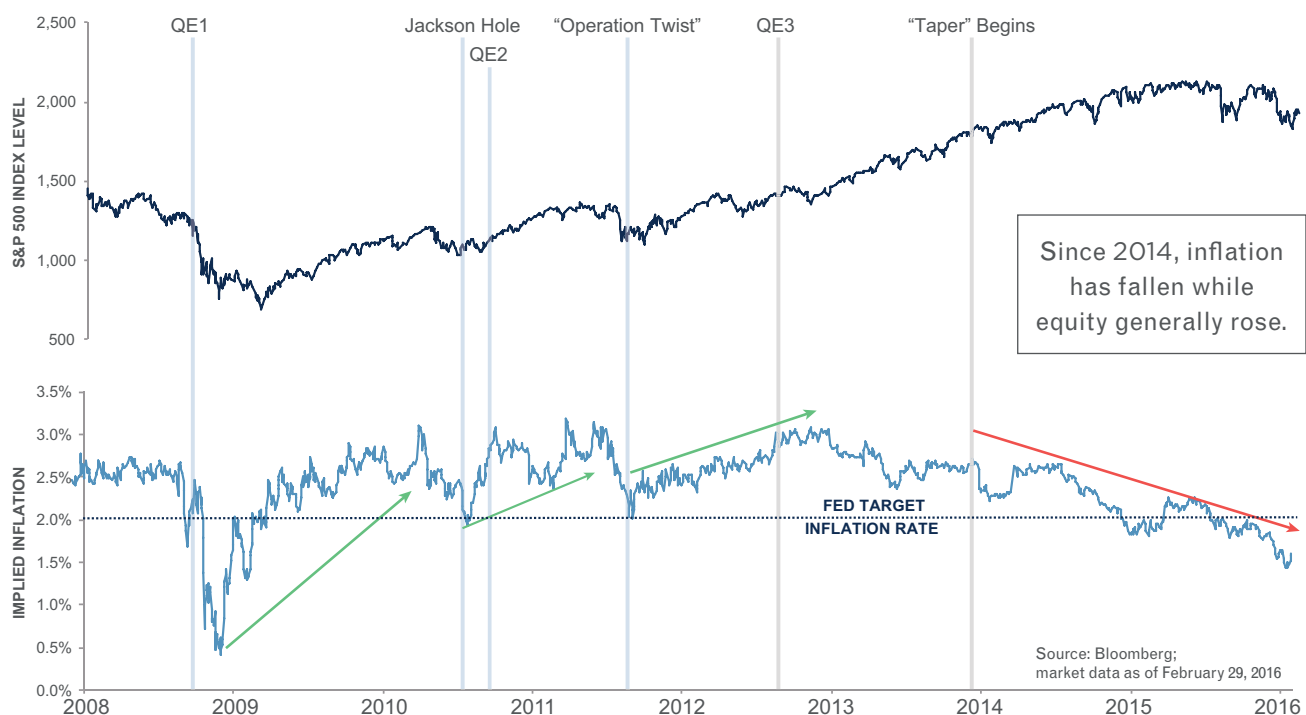
While the employment picture is decidedly better, meaningful wage growth is slow to materialize. Inflation expectations, on the other hand are rolling over. And, in the face of still strug-

“We think the Fed will tread very carefully as it relates to markets.”

gling commodity prices and the absence of QE, near-term catalysts are missing. The chart below shows the relationship between our risk asset prices (measured by the S&P 500) and inflation expectations. Note that periods of QE were followed by an uptick in both equity prices and inflation expectations, two desired outcomes for the Fed. Now, in the post-QE world, the picture has changed.

So, the dual mandate targets are at best incomplete. But, that does not fully encapsulate modern Fed policy. In our view, the December move was important operationally. The Fed proved to the market (and skeptics including us) that they could affect rate targets despite the massively over-reserved financial system. Though nominal, the move also began a

## PERIODS OF QE HAVE GENERALLY RESULTED IN RISING INFLATION AND RISING EQUITY PRICES







de-leveraging process that may partially explain downward pressure on stocks. For example, New York Stock Exchange margin balances have fallen by 20% over the past quarter.

In a speech at Bernard M. Baruch College about the 2015 economic outlook, New York Fed President Dudley stated, “with respect to how fast the normalization process will proceed, that depends on two factors – how the economy evolves, and how financial market conditions respond to movements in the federal funds rate target.” Moreover, former Fed Chair Bernanke actively supported Fed policy targeting financial markets: “Higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher income and profits that, in a virtuous circle, will further support economic expansion.”

The Fed’s reaction to market downturns was more QE. In fact, dating back to 2008, no QE periods coincided with negative equity markets, and conversely, rapidly rising equity prices followed periods of active QE. Recall that the market fully expected a rate hike last September, but the Fed passed at that time, according to Fed Chair Yellen because, “recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term.” So, on top of a challenging U.S. equity market, the Fed was now reacting to overseas conditions. In other words, the Fed did not have the markets’ permission to hike.

### **TIGHTER FINANCIAL CONDITIONS**

Risk asset prices across sectors have benefited from the central bank liquidity. The real economy, perhaps less so. We look at corporate behavior during this period and note considerable equity-friendly financial activity. Merger and acquisition activity is eclipsing 2007 levels and share buybacks, funded with debt, continue at record levels. And, investor credit, in the form of margin debt, hit record levels.

As normalization begins, the markets are “pushing back” on this financial activity. Specifically, investment-grade bond spreads have doubled to nearly 200 basis points (2%) while high-yield debt pricing, largely commodity driven, has gapped to nearly 800 basis points (8%). These are recession-type spread levels, and are suggestive of a considerable tightening of financial conditions. Downgrades of debt are accelerating, eclipsing upgrades for the first time since 2008.

Low oil prices now pose significant risks to the financial markets. Mainstream media and outspoken economists assert the effects are undoubtedly positive for growth. In a vacuum, this is true; in the capital markets, however, it is a clear negative. The steep, sustained drop in oil and the subsequent weakness in energy credits has effectively poisoned the well for new debt financing at the low end of the credit spectrum. The ability, or lack thereof, for low-quality credits to refinance maturing obligations will become a solvency issue if the situation does not improve.

Might this lead to a domino effect that ripples up the credit curve? We have seen evidence of this, but the high-grade new issue market is still functioning – for now. If we are experiencing the beginning of a new credit crunch, we think things could get worse before they get better. Further, the persistent weakness in oil pricing is creating a cash crunch in places like Saudi Arabia, which requires high(er) oil prices to fund annual expenditures. As a result, oil-rich countries need to tap the sovereign wealth fund well, which effectively creates a substantial headwind to asset prices. The stock market is taking notice; we have observed spiking correlation between energy and equity prices.

Moreover, with the volatility of equities and collapse of pricing in the commodity sector, equity market pricing is soft. In our estimation, the markets are already facing tightening financial conditions, irrespective of short-term interest rates.

# The Fed's dilemma: Normalization without the markets' permission? (cont.)

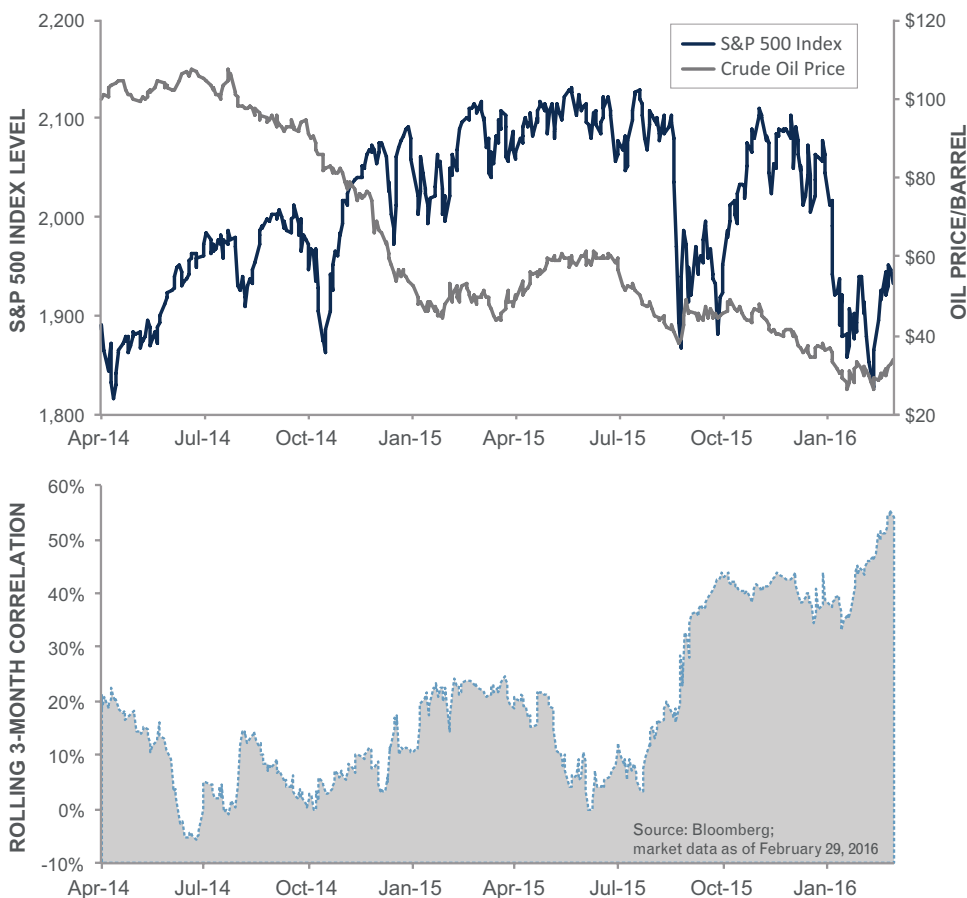
## GLOBAL RATES CONTINUE TO FALL

It is estimated that one quarter of the world's capital now resides in negative rate environments. The U.S. Treasury market has paradoxically rallied after the initial tightening. The yield curve is significantly flatter than it was just weeks ago. There is divergence between economic forecasts for the Fed and markets. The Fed Funds Futures price a September hike at 41%, and only 20% in June, while consensus is still two to three hikes this year. In our opinion this is a critical juncture. Under normal circumstances, the aforementioned tightening of financial conditions and general economic slowing would be suggestive of more accommodation, not less. But, these are

indeed not normal times. We think the Fed will tread very carefully as it relates to markets. A significant equity market correction would jeopardize Bernanke's wealth effect, and with inflation not yet near menacing, they have some latitude. One thing is clear to us. The thematically tired macro "risk on, risk off" market is coming to an end. Normalization, however gradual, is overdue. Capital markets should be more productive for asset allocation and security selection going forward. The Fed wants out of the market manipulation game.

As long as it has permission. ▀

## S&P 500 INDEX / CRUDE OIL PRICE CORRELATION



## KEY TAKEAWAYS:

- Policy actions have been highly reactive to market movements in the post-crisis era.
- With the volatility of equities and collapse of pricing in the commodity sector, equity market pricing is soft. In our estimation, the markets are already facing tightening financial conditions, irrespective of short-term interest rates.
- The thematically tired macro "risk on, risk off" market is coming to an end.
- Normalization, however gradual, is overdue. Capital markets should be more productive for asset allocation and security selection going forward.





## Q. WHAT DOES THE TALK ABOUT CHINA DEVALUING ITS CURRENCY REALLY MEAN?

**A.** China's economy is undergoing a major transformation. In recent decades, strong growth has been driven by exports and infrastructure spending. Much of that was fueled by an artificially weak currency and a build-up of currency reserves. Looking ahead, economic growth will have to be driven more by domestic demand. Increased consumer spending growth will depend on the development of a middle class. This transition is expected to be bumpy, with possible policy mistakes along the way.

### The dollar and the yuan

Since mid-2014, the U.S. dollar has risen sharply against most of the world's currencies. Slower global growth and a stronger dollar have had a significant negative impact on U.S. exporters.

The yuan, China's currency, has weakened against the greenback, but it has generally fallen a lot less than other currencies – which means that it has strengthened against those other currencies – and that makes the country's economic rebalancing more difficult. China is currently not expected to devalue the yuan simply to boost exports. Rather, natural forces have been acting to weaken the currency and Chinese investors have anticipated that a further devaluation is coming. That expectation, in turn, has put more downward pressure on the yuan. A devaluation in the yuan would likely lead other countries to devalue as well.

China continues to enjoy a large trade surplus with the rest of the world, but in recent months capital outflows have more than offset that, putting downward pressure on the yuan. Since mid-2014, the People's Bank of China (PBOC), the country's central bank, has depleted its currency reserves by nearly \$800 billion to prevent the yuan from weakening against the dollar. By the end of February, the PBOC still had \$3.2 trillion in currency reserves and the depletion of those reserves slowed to \$28.6 billion per month (vs. an average of about \$100 billion per month over the three previous months). Chinese officials have

indicated that a devaluation of the yuan is not in the works, which may have reduced capital outflow pressures.

In the U.S., dollar strength has been driven partly by divergent central bank policies (gradually tighter monetary policy from the U.S. Federal Reserve, easier policy abroad). However, that's only part of the story. Concerns about growth in China and other emerging economies, as well as lackluster growth expectations for many advanced economies, have made the U.S. an attractive location for global capital. This flight to safety has also pushed down yields on long-term Treasury securities.

Currencies have a tendency to overshoot. That is, directional moves in the foreign exchange market often go a little too far. At some point, emerging economies are going to look more attractive, but getting the timing right is likely to prove challenging.

– **Scott J. Brown, Ph.D.**, *Chief Economist, Equity Research*

## Q. WHAT ARE THE IMPLICATIONS OF NEGATIVE INTEREST RATES?

**A.** Through various monetary policy actions central banks attempt to control many of the lending rates throughout the economy. Most importantly, they exert significant influence over very short-term, often overnight, lending/borrowing rates for depository institutions (banks and credit unions). In the U.S. this is known as the “fed funds rate,” the interest rate at which a bank can loan any excess reserves to the Federal Reserve (the Fed), thereby earning interest, or if needed, borrow funds at this same rate. A negative interest rate policy (NIRP) is a new and unconventional phenomenon in the world of banking whereby banks would pay to deposit funds with their central bank. As a result of the worldwide financial crisis, global central banks pushed interest rates as low as possible, often to zero percent, to spur economic growth and inflation. An estimated \$11 trillion was spent on quantitative easing (QE) programs by central banks since the recession, and although the global economy is once again growing, some policymakers still need to combat a combination of weaker than anticipated growth and/or inflation.





Enter negative interest rates; in their quest to spur inflation and economic growth, many central banks have reached the limits of conventional monetary policy. QE has been all but exhausted, and short-term rates were already at zero percent, also known as the “zero lower bound” as they couldn’t possibly go any lower than zero. Or could they? Beginning in 2009 Sweden and Denmark implemented NIRP in their countries, with little fanfare. It was only when the economic behemoths of the European Union (2014) and Japan (late 2015) implemented NIRP that the world really took notice.

#### Could we see negative rates in the U.S.?

Unless the economic environment in the U.S. changes dramatically we are unlikely to see negative rates. Consider the following; the Fed is committed to raising rates here in the U.S. and moved away from the zero lower bound in December, its first rate hike in nearly a decade. Second, the U.S. is experiencing higher GDP growth and inflation compared to most of the developed world, especially those countries utilizing NIRP. Third, from a legal standpoint, the Fed’s charter gives them the ability to pay interest, but there’s no mention of their authority to charge interest on deposits. Finally, there is a two-sided argument as to why NIRP may never see the light of day in the U.S. On one hand, should these policies be successful in spurring growth overseas, the U.S. would likely benefit as a trade partner, leaving us less likely to need additional stimulus of our own. On the other hand, if NIRP fails and is proven to be an ineffective tool, why would the U.S. follow suit? For the time being, negative interest rates will remain an overseas experiment that the rest of the world will watch closely.

– Benjamin Streed, *Strategist, Retail Fixed Income*

#### Q. ARE OIL PRICES POISED FOR AN UPSWING BY YEAR-END 2016?

**A.** Investors often ask, “What gives us the confidence to argue that oil prices will nearly double into the \$60s by the end of 2016?” Both demand and supply trends play a role in the answer, but supply is the more important issue.

Let’s address demand first. Global oil demand increased in 2015 at its fastest rate in a decade, more than 2%. While we don’t forecast quite as much demand in 2016, even 1.4% would still be an above-trend year, as cheap fuel continues to support strong auto sales and higher vehicle usage. It’s a positive sign that demand is growing in almost all geographies, even places like the Mideast with oil-levered economies. Despite widespread economic fears about China, Chinese oil demand is in good shape, and India and other emerging markets are becoming more visible demand drivers.

Although demand is healthy, it will also take a supply response to rebalance the oil market and ultimately push prices higher. It’s taken about a year to materialize, but the signs of a supply response are unmistakable. U.S. oil production has been in gradual decline since June 2015, and this past February it turned negative on a year-over-year basis for the first time since the global financial crisis. While U.S. supply is particularly sensitive to the depressed oil prices, other countries are exhibiting their own examples of what we’ve come to call “austerity on steroids.” With global oil and gas investment down approximately 25% in each of 2015 and 2016, it is only a matter of time before supply begins to roll over in countries like Russia and Brazil. It’s important to underscore that none of this hinges on whether OPEC governments reach a deal to deliberately cut supply. Such a deal remains a possibility, but even without that, the collapse in investment is resulting in natural supply declines.

Higher oil prices obviously bode well for energy stocks (whose weighting in the S&P 500 is at a 12-year low), but some investors are also wondering whether this will help the broader market. It is true that oil and equities have been closely correlated, but that does not mean that one is directly causing the other. Rather, both are trading on some of the same headlines, including the Chinese slowdown and volatile currencies. Thus, oil in the \$60s by year-end would not materially boost stocks in, for example, tech or healthcare. Insofar as non-energy equities might get a small bump from an oil recovery, it would be a func-



"THE CURRENT LEVELS OF OIL PRICES AND INVESTMENT WOULD LEAD TO PERPETUAL SUPPLY DECLINES, WHICH OBVIOUSLY CANNOT HAPPEN."

– PAVEL MOLCHANOV

 **95%**

of the world's supply is **not** North American shale, meaning that, alone, it doesn't provide a comprehensive picture of the market.

**\$50**



The U.S. supply would probably be flat.

**\$60**



Price level needed to generate enough cash flow for achieving meaningful growth in U.S. supply.

**\$70**



Price that would support broad-based supply growth for the global oil industry.

tion of reduced selling pressure from sovereign wealth funds owned by oil-exporting countries.

– **Pavel Molchanov**, *Senior Vice President, Energy Analyst, Equity Research*

#### Q. IS BREXIT GOING TO HAPPEN?

**A.** "Brexit" is an ungainly word that refers to the potential exit of the UK from the European Union if after a referendum vote on June 23, the number of "leave" votes are greater than those to "remain."

This is not the first referendum held in the UK on the "Europe question." Back in the mid-1970s a popular referendum voted for the UK to join the then "European Economic Area" a forerunner to today's European Union. Nearly 40 years ago the main rationale to join the "common market" was to loosen trade barriers to the benefit of all in a not dissimilar rationale to the creation of NAFTA.

Europe has evolved in the interim with the creation of the euro being the most high profile step towards further and deeper integration as one currency leads to one interest rate and progressively over time one fiscal policy and a much tighter political union.

The UK is not part of the euro zone but the main fear of the local population about "Europe" is the creeping harmonization of rules and standards which threatens to subvert the power of the UK Parliament in favor of the institutions in Brussels. It is

certainly true that the meddling from Europe-wide regulators and legislators is on the rise but there is a method in the madness: such standards help facilitate pan-European trade.

Over 45% of the UK's exports go to the European Union and such rules and regulations have helped this grow materially over the last generation. The biggest risk of a Brexit is the uncertainty around the trade laws that would replace them. There are enough trade rumblings between the U.S. and Europe to show that stepping away from the European Union would boost uncertainty on this issue. And less trade leads to less economic growth. No wonder the pound fell sharply in the last couple of weeks since the referendum was announced.

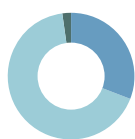
The pollsters are fairly clear however attributing a 66% probability to the "remain" campaign as the leaders of all three of the mainstream political parties campaign to stay, an outcome with which I would also agree.

The UK and European Union's relationship is likely to be maintained but it feels like the start of another stage in a long-standing debate ... a navel gazing which threatens to hurt both sides irrespective of the final vote. There's nothing like ongoing passionate political debate to help take policy makers' eyes off developing and changing the regional economy for the better. The real travesty in Europe remains too much talk and not enough (economic growth) action. ■

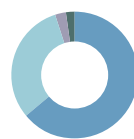
– **Chris Bailey**, *European Strategist, Raymond James Euro Equities\**

## STRATEGIC ASSET ALLOCATION MODELS

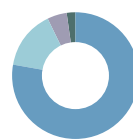
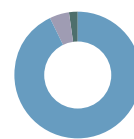
Several changes were made to the strategic asset allocation models. These trades are intended to improve the models' risk and return profiles by reducing asset classes expected to continue displaying elevated levels of volatility in the current market environment. Within equity, reductions were generally made to U.S. small cap and emerging markets with reinvestments to U.S. large cap and non-U.S. developed market equity. Within fixed income, global fixed income was eliminated and multi-sector fixed income was reduced. These allocations were redistributed to U.S. core fixed income. Within alternative investments, a managed futures position was established in the Balanced Model.



CONSERVATIVE

CONSERVATIVE  
BALANCED

BALANCED

BALANCED  
WITH GROWTH

GROWTH

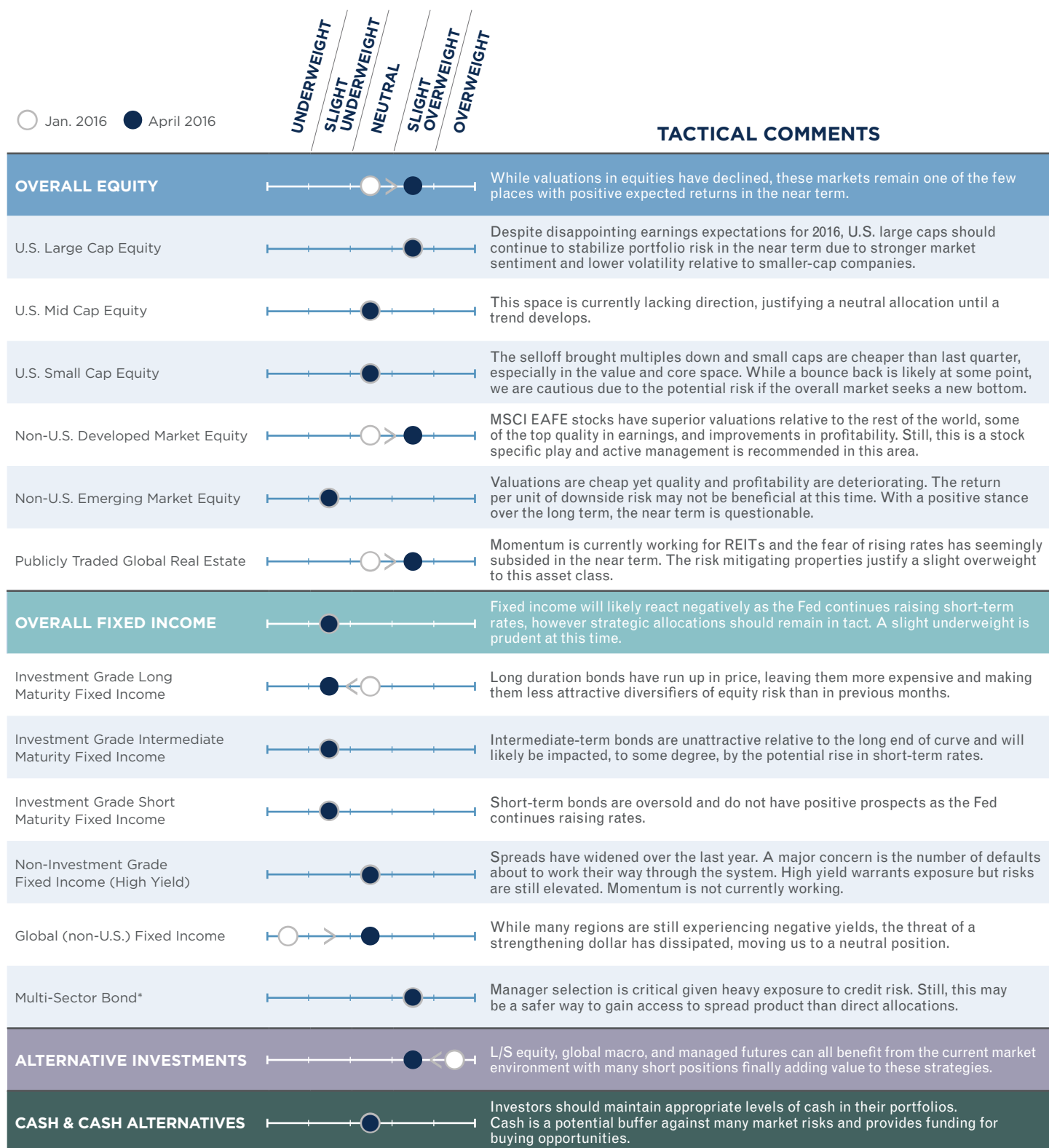
↑↓ Arrows indicate change in allocation from last quarter.

EQUITY	31%	51%	64% ↓	78%	93%
U.S. Large Cap Equity	19% ↑	31%	33% ↓	36% ↑	43% ↑
U.S. Mid Cap Equity	3% ↓	7%	9%	11% ↑	13% ↑
U.S. Small Cap Equity	2%	3%	4% ↓	5% ↓	5% ↓
Non-U.S. Developed Market Equity	7%	10%	14%	18% ↑	23% ↑
Non-U.S. Emerging Market Equity	0%	0%	4%	4% ↓	5% ↓
Publicly-Traded Global Real Estate	0%	0%	0%	4%	4%
FIXED INCOME	67%	47%	31%	15%	0%
Investment Grade Long Maturity Fixed Income	0%	0%	0%	0%	0%
Investment Grade Intermediate Maturity Fixed Income	43% ↑	31% ↑	22% ↑	15%	0%
Investment Grade Short Maturity Fixed Income	5%	0%	0%	0%	0%
Non-Investment Grade Fixed Income (High Yield)	4%	5%	4%	0%	0%
Global (non-U.S.) Fixed Income	0% ↓	0% ↓	0% ↓	0%	0%
Multi-Sector Bond*	15%	11%	5% ↓	0%	0%
ALTERNATIVE INVESTMENTS	0%	0%	3% ↑	5%	5%
CASH & CASH ALTERNATIVES	2%	2%	2%	2%	2%



## TACTICAL ASSET ALLOCATION WEIGHTINGS

For investors who choose to be more active in their portfolios and make adjustments based on a shorter-term outlook, the tactical asset allocation dashboard below reflects the Raymond James Investment Strategy Committee's recommendations for current positioning relative to our longer-term strategic models. Your financial advisor can help you interpret each recommendation relative to your individual asset allocation policy, risk tolerance and investment objectives.



## ALTERNATIVE INVESTMENTS SNAPSHOT

This report is intended to highlight the dynamics underlying seven major categories of the alternatives market, with the goal of providing a timely assessment based on current economic and capital market environments. Our goal is to look for trends that can be sustainable for several quarters; yet given the dynamic nature of financial markets, our opinion could change as market conditions dictate.

**JENNIFER SUDEN**  
Director of Alternative  
Investments Research

ALTERNATIVE INVESTMENTS	
EQUITY LONG/SHORT	During the last few years, the short positions within long/short equity portfolios have dampened performance given the equity market rally. However, in 2015 and into 2016, the short books have begun to once again add value to performance. The managers are witnessing a more robust opportunity set on the short side and expect to see stocks driven more by fundamentals rather than the overall macroeconomic environment. Long/short equity managers are typically long-biased, so they will generally participate, albeit to a limited degree, in rising markets, but also have the potential to protect on the downside.
MULTI-MANAGER/ MULTI-STRATEGY	For investors seeking a lower volatility, lower beta strategy, the multi-manager strategy could be a relevant option.
MANAGED FUTURES	Divergence in economic policy and elevated levels of volatility are tailwinds for the strategy. Additionally, the ability to go both long and short the various asset classes (fixed income, commodities, currency, and equities) allows the strategy to benefit even in times of financial distress.
EVENT DRIVEN	Event-driven managers may face some headwinds in the near term given the upcoming presidential election and recent increase in stock market volatility, which are likely to dampen M&A activity over the next few months. Activist investments may be indirectly impacted by recent developments in some high profile trades, while the timing on distressed investments continues to remain somewhat uncertain as opportunities outside of a few select sectors have been slow to emerge.
EQUITY MARKET NEUTRAL	As intra-stock correlations have decreased, managers have the potential to benefit from both the long and short exposure within the portfolio. For an investor who is bearish on equities, this could be a suitable option given its lack of dependence on market movements.
COMMODITIES	Though commodities as a whole may start to show signs of recovery throughout the year, the potential for downside risk remains significant. Beyond oil markets, industrial metals face the headwind of a decline in demand across emerging market economies.
GLOBAL MACRO	Similar to managed futures, divergence in economic policy and elevated levels of volatility are tailwinds for the strategy. Additionally, the ability to go both long and short across the various asset classes (fixed income, commodities, currency, and equities) allows the strategy to benefit even in times of financial distress.

## CAPITAL MARKETS SNAPSHOT

EQUITY	AS OF 3/31/2016*	1Q16 RETURN**	12-MONTH RETURN**
Dow Jones Industrial Average	17,685.09	2.20%	2.08%
S&P 500 Index	2,059.74	1.35%	1.78%
NASDAQ Composite Index	4,869.85	-2.43%	0.55%
MSCI EAFE Index	1,652.04	-3.01%	-8.27%
RATES	AS OF 3/31/2016	AS OF 12/31/2015	AS OF 3/31/2015
Fed Funds Target Range	0.25 - 0.50	0.25 - 0.50	0.00 - 0.25
3-Month LIBOR	0.63	0.60	0.27
2-Year Treasury	0.76	1.06	0.56
10-Year Treasury	1.83	2.27	1.94
30-Year Mortgage	3.83	4.01	3.69
Prime Rate	3.50	3.50	3.25
COMMODITIES	AS OF 3/31/2016	1Q16 RETURN	12-MONTH RETURN
Gold	\$1,237.00	16.70%	4.21%
Crude Oil	\$38.34	3.51%	-19.45%

\*Price Level

16 \*\*Total Return

## SECTOR SNAPSHOT

This report is intended to highlight the dynamics underlying the 10 S&P 500 sectors, with a goal of providing a timely assessment to be used in developing your personal portfolio strategy. Our time horizon for the sector weightings is not meant to be short-term oriented. Our goal is to look for trends that can be sustainable for several quarters; yet given the dynamic nature of financial markets, our opinion could change as market conditions dictate.

Most investors should seek diversity to balance risk versus reward. For this reason, even the least-favored sectors may be appropriate for portfolios seeking a more balanced equity allocation. Those investors seeking a more aggressive investment style may choose to overweight the preferred sectors and entirely avoid the least favored sectors. Investors should consult their financial advisors to formulate a strategy customized to their preferences, needs and goals.

These recommendations will be displayed as such:

**Overweight:** favored areas to look for ideas, as we expect relative outperformance

**Slight Overweight:** next favored areas to look for ideas

**Equal Weight:** expect in-line relative performance

**Slight Underweight:** expect relative underperformance in general, but opportunities exist within select subsectors

**Underweight:** unattractive expectations relative to the other sectors; exposure might be needed for diversification

For a complete discussion of the sectors, please ask your financial advisor for a copy of *Portfolio Strategy: Sector Analysis*.

**J. MICHAEL GIBBS**  
Managing Director of Equity  
Portfolio & Technical Strategy

### RECOMMENDED WEIGHT

	SECTOR	S&P WEIGHT	COMMENTS
OVERWEIGHT	INFORMATION TECHNOLOGY	20.6%	Tech is a favored area to search for opportunity. If the full year mid-single digit expected earnings gains materialize, the results should be favorable vs. the general market. The recent pullback in the USD could boost earnings relative to expectations due to the large percentage of foreign revenues.
	HEALTH CARE	14.1%	We remain overweight for now. Extreme underperformance and an overbought general market may make the sector an attractive refuge when general market profit taking (or rotation) develops. Prior to the election, stock picking in areas less exposed to headline risk may be warranted.
	CONSUMER DISCRETIONARY	12.8%	We will stay overweight due to numerous standout opportunities at the company level but will closely monitor to determine if 'overweight' is a justified position in the period ahead. Specialty retail, restaurants, and some areas of leisure look best.
EQUAL WEIGHT	FINANCIALS	15.9%	Worries regarding global macro factors, negative interest rates, and credit has weighed on the sector. Inexpensive valuations and potentially overly negative sentiment of the weakest subsectors (banks, capital markets) along with positive trends of other subsectors (REITs) keep us from an underweight position.
	CONSUMER STAPLES	10.4%	This is one of the most overvalued sectors, but strong technical trends and defensive characteristics keep us equal weight. Selectivity during individual stock consolidation periods is suggested for new money.
	INDUSTRIALS	10.2%	Technical momentum continues to build and information flow from companies point to a less negative atmosphere fundamentally. Monitored closely for opportunity. Areas of interest for new money are airlines, conglomerates, select transports- trucking and air freight.
UNDERWEIGHT	ENERGY	6.9%	Industry adjustments to oversupplied markets continue to weigh on fundamentals. The sharp rally is impressive but as of now a constructive consolidation or pullback is necessary.
	UTILITIES	3.4%	Utilities benefitted from lower interest rates in the U.S. Now that the Fed has admitted to a more dovish tone, the risk for rates may be slightly higher. This would be a negative for the sector.
	TELECOM	2.7%	Telecom is our favored underweight as reasonable valuation, acceptable fundamental trends, and an improving technical trend standout as positives. The extended nature of the index keeps us underweight.
	MATERIALS	2.9%	Fundamental trends are still a challenge for the sector as a whole. Despite short-term improvements, follow-through is needed to build the trend.



## ASSET CLASS DEFINITIONS

**U.S. Large Cap Equity**

Russell 1000 Index: Based on a combination of their market cap and current index membership, this index consists of approximately 1,000 of the largest securities from the Russell 3000. Representing approximately 92% of the Russell 3000, the index is created to provide a full and unbiased indicator of the large cap segment.

**U.S. Mid Cap Equity**

Russell Midcap Index: A subset of the Russell 1000 index, the Russell Midcap index measures the performance of the mid-cap segment of the U.S. equity universe. Based on a combination of their market cap and current index membership, includes approximately 800 of the smallest securities which represents approximately 27% of the total market capitalization of the Russell 1000 companies. The index is created to provide a full and unbiased indicator of the mid-cap segment.

**U.S. Small Cap Equity**

Russell 2000 Index: The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The Russell 2000 Index is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

**Non U.S. Developed Market Equity**

MSCI EAFE: This index is a free float-adjusted market capitalization index that measures the performance of developed market equities, excluding the U.S. and Canada. It consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

**Non U.S. Emerging Market Equity**

MSCI Emerging Markets Index: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of December 31, 2010, the MSCI Emerging Markets Index consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.

**Real Estate**

FTSE NAREIT Equity: The index is designed to represent a comprehensive performance of publicly traded REITs which covers the commercial real estate space across the US economy, offering exposure to all investment and property sectors. It is not free float adjusted, and constituents are not required to meet minimum size and liquidity criteria.

**Commodities**

Bloomberg Commodity Index (BCOM): Formerly known as the Dow Jones-UBS Commodity Index, the index is made up of 22 exchange-traded futures on physical commodities. The index currently represents 20 commodities, weighted to account for economic significance and market liquidity with weighting restrictions on individual commodities and commodity groups to promote diversification. Performance combines the returns of the fully collateralized BCOM Index with the returns on cash collateral (invested in 3 month U.S. Treasury Bills).

**Investment Grade Long Maturity Fixed Income**

Barclays Long US Government/Credit: The long component of the Barclays Capital Government/Credit Index with securities in the maturity range from 10 years or more.

**Investment Grade Intermediate Maturity Fixed Income**

Barclays US Aggregate Bond Index: This index is a broad fixed income index that includes all issues in the Government/Credit Index and mortgage-backed debt securities. Maturities range from 1 to 30 years with an average maturity of nearly 5 years.

**Investment Grade Short Maturity Fixed Income**

Barclays Govt/Credit 1-3 Year: The component of the Barclays Capital Government/Credit Index with securities in the maturity range from 1 up to (but not including) 3 years.

**Non-Investment Grade Fixed Income (High Yield)**

Barclays US Corporate High Yield Index: Covers the universe of fixed rate, non-investment grade debt which includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors. The index also includes

Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. Must publicly issued, dollar-denominated and non-convertible, fixed rate (may carry a coupon that steps up or changes according to a predetermined schedule, and be rated high-yield (Ba1 or BB+ or lower) by at least two of the following: Moody's, S&P, Fitch. Also, must have an outstanding par value of at least \$150 million and regardless of call features have at least one year to final maturity.

**Global (Non-U.S.) Fixed Income**

Barclays Global Aggregate Bond Index: The index is designed to be a broad based measure of the global investment-grade, fixed rate, fixed income corporate markets outside of the U.S. The major components of this index are the Pan-European Aggregate, and the Asian-Pacific Aggregate Indices. The index also includes Eurodollar and Euro-Yen corporate bonds, Canadian government, agency and corporate securities.

**Multi-Sector Bond**

The index for the multi-sector bond asset class is composed of one-third the Barclays Aggregate US Bond Index, a broad fixed income index that includes all issues in the Government/Credit Index and mortgage-backed debt securities; maturities range from 1 to 30 years with an average maturity of nearly 5 years, one-third the Barclays US Corporate High Yield Index which covers the universe of fixed rate, non-investment grade debt and includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors and one-third the J.P. Morgan EMBI Global Diversified Index, an unmanaged index of debt instruments of 50 emerging countries.

The Multi-Sector Bond category also includes nontraditional bond funds. Nontraditional bond funds pursue strategies divergent in one or more ways from conventional practice in the broader bond-fund universe. These funds have more flexibility to invest tactically across a wide swath of individual sectors, including high-yield and foreign debt, and typically with very large allocations. These funds typically have broad freedom to manage interest-rate sensitivity, but attempt to tactically manage those exposures in order to minimize volatility. Funds within this category often will use credit default swaps and other fixed income derivatives to a significant level within their portfolios.

**Alternatives Investment**

HFRI Fund of Funds Index: The index only contains fund of funds, which invest with multiple managers through funds or managed accounts. It is an equal-weighted index, which includes over 650 domestic and offshore funds that have at least \$50 million under management or have been actively trading for at least 12 months. All funds report assets in US Dollar, and Net of All Fees returns which are on a monthly basis.

**Cash & Cash Alternatives**

Citigroup 3 Month US Treasury Bill: A market value-weighted index of public obligations of the U.S. Treasury with maturities of 3 months.

**KEY TERMS****Long/Short Equity**

Long/short equity managers typically take both long and short positions in equity markets. The ability to vary market exposure may provide a long/short manager with the opportunity to express either a bullish or bearish view, and to potentially mitigate risk during difficult times.

**Global Macro**

Hedge funds employing a global macro approach take positions in financial derivatives and other securities on the basis of movements in global financial markets. The strategies are typically based on forecasts and analyses of interest rate trends, movements in the general flow of funds, political changes, government policies, inter-government relations, and other broad systemic factors.

**Relative Value Arbitrage**

A hedge fund that purchases securities expected to appreciate, while simultaneously selling short related securities that are expected to depreciate.

**Multi-Strategy**

Engage in a broad range of investment strategies, including but not limited to long/short equity, global macro, merger arbitrage, statistical arbitrage, structured credit, and event-driven strategies. The funds have the ability to dynamically shift capital among the various sub-strategies, seeking the greatest perceived risk/reward opportunities at any given time.

### Event-Driven

Event-driven managers typically focus on company-specific events. Examples of such events include mergers, acquisitions, bankruptcies, reorganizations, spin-offs and other events that could be considered to offer "catalyst driven" investment opportunities. These managers will primarily trade equities and bonds.

### Special Situations

Managers invest in companies based on a special situation, rather than the underlying fundamentals of the company or some other investment rationale. An investment made due to a special situation is typically an attempt to profit from a change in valuation as a result of the special situation, and is generally not a long-term investment.

### Managed Futures

Managed futures strategies trade in a variety of global markets, attempting to identify and profit from rising or falling trends that develop in these markets. Markets that are traded often include financials (interest rates, stock indices and currencies), as well as commodities (energy, metals and agricultural).

## INDEX DEFINITIONS

### Barclays U.S. Aggregate Bond Index

A broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. Securities must be rated investment-grade or higher using the middle rating of Moody's, S&P and Fitch. When a rating from only two agencies is available, the lower is used. Information on this index is available at [INDEX-US@BARCLAYS.COM](mailto:INDEX-US@BARCLAYS.COM).

## DISCLOSURE

All expressions of opinion reflect the judgment of Raymond James & Associates, Inc. and are subject to change. Past performance may not be indicative of future results. There is no assurance any of the trends mentioned will continue or forecasts will occur. The performance mentioned does not include fees and charges which would reduce an investor's return. Dividends are not guaranteed and will fluctuate. Investing involves risk including the possible loss of capital. Asset allocation and diversification do not guarantee a profit nor protect against loss. Investing in certain sectors may involve additional risks and may not be appropriate for all investors.

International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility. Investing in emerging and frontier markets can be riskier than investing in well-established foreign markets.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.

U.S. government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the U.S. government.

While interest on municipal bonds is generally exempt from federal income tax, it may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

If bonds are sold prior to maturity, the proceeds may be more or less than original cost. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revisions, suspension, reduction or withdrawal at any time by the assigning rating agency.

Commodities and currencies are generally considered speculative because of the significant potential for investment loss. They are volatile investments and should only form a small part of a diversified portfolio. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Investing in REITs can be subject to declines in the value of real estate. Economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of your portfolio.

Beta compares volatility of a security with an index.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

The companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

Investing in the energy sector involves risks and is not suitable for all investors.

The performance mentioned does not include fees and charges which would reduce an investor's returns. The indexes are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities. The Shanghai Composite Index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

## MODEL DEFINITIONS

**Conservative Portfolio:** may be appropriate for investors with long-term income distribution needs who are sensitive to short-term losses yet want to achieve some capital appreciation. The equity portion of this portfolio generates capital appreciation, which is appropriate for investors who are sensitive to the effects of market fluctuation but need to sustain purchasing power. This portfolio, which has a higher weighting in bonds than in stocks, seeks to keep investors ahead of the effects of inflation with an eye toward maintaining principal stability.

**Conservative Balanced Portfolio:** may be appropriate for investors with intermediate-term time horizons who are sensitive to short-term losses yet want to participate in the long-term growth of the financial markets. The portfolio, which has an equal weighting in stocks and bonds, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. The portfolio has return and short-term loss characteristics that may deliver returns lower than that of the broader market with lower levels of risk and volatility.

**Balanced Portfolio:** may be appropriate for investors with intermediate-term time horizons who are sensitive to short-term losses yet want to participate in the long-term growth of the financial markets. This portfolio, which has a higher weighting in stocks, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. The portfolio has return and short-term loss characteristics that may deliver returns lower than that of the broader equity market with lower levels of risk and volatility.

**Balanced with Growth Portfolio:** may be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which has a higher weighting in stocks seeks to keep investors well ahead of the effects of inflation with principal stability as a secondary consideration. The portfolio has return and short-term loss characteristics that may deliver returns slightly lower than that of the broader equity market with slightly lower levels of risk and volatility.

**Growth Portfolio:** may be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which has 100% in stocks, seeks to keep investors well ahead of the effects of inflation with little regard for maintaining principal stability. The portfolio has return and short-term loss characteristics that may deliver returns comparable to those of the broader equity market with similar levels of risk and volatility.

# **RAYMOND JAMES®**

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