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# INVESTMENT STRATEGY QUARTERLY

## 2016 OUTLOOK



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**RAYMOND JAMES®**

## INVESTMENT COMMITTEE RECAP: HEADING INTO 2016 WITH CAUTION

2015 marked the end of the low volatility days that investors had become accustomed to. The year ended with a cautiously optimistic outlook going forward. Still, uncertainties remain plentiful going into 2016 with escalating geopolitical concerns, bifurcated global monetary policies, and the upcoming U.S. presidential election at the forefront of people's minds.

### 2015: A YEAR IN REVIEW

#### THE ECONOMY

According to Chief Economist Scott Brown, domestic demand was strong in 2015, but overall growth (in gross domestic product) was restrained by a drag from the rest of the world. Going forward, a strong U.S. dollar should continue to weigh on exports, but domestic demand is expected to stay strong.

The pace of job growth remained brisk in 2015, although wage growth was relatively lackluster. Lower prices of oil and other commodities helped push overall inflation down. Strong job growth and the increase in purchasing power due in part to lower gas prices supported consumer spending growth. The strong dollar hurt corporate earnings, leading many companies to curtail capital expenditures.

On a global basis, emerging economies have suffered from soft demand and depreciating currencies.

#### EQUITIES

In last year's outlook, Private Client Strategist and Portfolio Manager, Raymond James Ltd., Ryan Lewenza predicted continued strength in the U.S. dollar and weak economic momentum in emerging markets, naming large-cap domestic equities as a top investment theme for 2015. He was spot on.

On August 17th, the S&P 500 Index embarked on a downward retreat, losing more than 10% in seven consecutive trade days followed by a choppy recovery through year end. The S&P 500 managed to land in positive return territory while most smaller-cap domestic equity markets fell short. Larger company stocks tend to fare better in volatile markets relative to their smaller brethren, and 2015 was sure to bring plenty of instability to the financial markets.

Turning our focus to markets abroad, developed equities held up considerably better than their emerging market counterparts. While the MSCI EAFE Index dipped into the red this past year, the MSCI Emerging Markets Index saw double-digit losses. Many emerging markets fell victim to several major headwinds including depressed commodity prices, slowing growth, and a strong U.S. dollar. Long-term fundamentals remain positive for these markets, but it will take time for these countries to recover.

#### COMMODITIES

While some countries benefited from depressed commodity prices throughout the year, many commodity exporters, particularly emerging market countries, saw significant damage from the downturn in prices. Making matters worse, the effect of oversupply was not just a problem for oil last year. With crude oil prices sitting at \$37/barrel at the end of December, many agricultural commodities also witnessed growing stockpiles as the U.S. dollar continued to strengthen and demand waned.

#### MARKET REACTIONS TO FED POLICY

Fed monetary policy seemed to rattle the equity markets more so than the bond markets last year as speculators honed in on changes in the Fed's language, trying to gauge the timing of the first interest rate increase in nine years.

In reality, the bond markets had already priced in much of the Fed's forthcoming actions as astute investors and industry professionals expect the long end of the yield curve to remain relatively stable as short-term rates gradually rise.

#### FIXED INCOME

The fixed income markets turned in a rather dreary year with insignificant moves in terms of rates and pricing across the yield curve. Perhaps the Fed's interest rate hike foreshadows what's in store going forward as the yield curve began to flatten out later in the year, while short-term rates rose. High-yield bonds sold off in the second half of the year, widening spreads to more normal ranges. Foreign bond yields remained low with near-zero yields, even negative in some cases, prompting global investors to consider the safety of the U.S. Treasury. Consequently, U.S. investment-grade bonds fared much better than most other markets, especially those exposed to geopolitical, currency, and credit risks.

### 2016: TRENDS, RISKS AND OPPORTUNITIES

As they look toward the new year, the committee discussed what's meaningful and what's noise. The loudest message? Investors should be diligent and flexible in 2016 as they balance finding acceptable growth opportunities without taking on too much risk.

## 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

**Kevin Giddis** Senior Managing Director, Fixed Income

**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

**Richard Skeppstrom** Managing Director of Investments, Portfolio Manager, Eagle Asset Management\*

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

**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

Influential macro factors on the economy include Federal Reserve policy, the U.S. dollar, earnings growth, global economic growth and geopolitical uncertainty. Even with concerns going into 2016, the general consensus is that the U.S. is better positioned than last year. So, what is worrisome and what do we have to look forward to?



### ELEVATED RISKS

The committee sees Fed policy, its impact on the strong dollar and depressed commodities as key headwinds. There are concerns that the strength of the dollar will perpetuate a negative feedback loop on U.S. company earnings, consumer confidence, and growth. This environment will continue to challenge exports, manufacturing and corporate profits. Sluggish, and divergent, growth from the global economy may hinder U.S. growth and keep corporations conservative over the coming year.

The slowing global economy – particularly in China and emerging markets – comes along with heightened geopolitical concerns. Lewenza believes that with the series of recent tragedies around the world, terrorism and geopolitics are likely to remain in focus for the coming months. “Further events could impact sentiment and destabilize the global economy. However, many nations are currently uniting with an increased commitment to combating the various terrorist organizations responsible.”

The committee also questions what the U.S. economy looks like without stimulus from the Fed as well as what rates will do in the context of the rest of the world. James Camp, managing

director of fixed income with Eagle Asset Management\*, is concerned that risk-taking behavior and capital budgeting have been distorted by long-term Fed policy. “I think we’re going to find out very emphatically how dependent upon the Fed we are,” he stresses. “We are academically and practically in a world we’ve never been in and, now that we begin the exit process, what will be the fallout from that? We speak of mergers and acquisitions and buybacks at record levels, but what does the real economy look like when we aren’t financially engineering it?” Lewenza agrees, “Interest rates are going to be pretty low for a long time, but I think the peak in stimulus is the biggest risk to the market.”

Brown sees a growing recognition that aging populations in the U.S. and other countries will, barring a pickup in productivity growth, lead to slower potential growth in the global economy over time.



### CAUTIOUS OPTIMISM

Tailwinds discussed by the committee include a healthy labor market, low interest rates and housing. A constructive outlook for the U.S. with continued strength in consumer spending is supported by strong job gains and nascent wage growth, further gains from the U.S. housing sector, and less drag from exports and manufacturing as oil stabilizes and the U.S. dollar sees more limited gains.

The housing recovery is in full swing, which typically has spill-over effects into the rest of the economy. Housing expansion will be driven at a sustainable rate by increasing population growth, decreasing vacancy rates and the low cost of commodities.

\*An affiliate of Raymond James & Associates and Raymond James Financial Services.

## HEADING INTO 2016 WITH CAUTION (continued)

Europe continues to surprise to the upside with euro zone unemployment at a four-year low, manufacturing and industrial production picking up, and services remaining healthy. While robust growth is not expected from Europe, we still expect growth to pick up on central bank stimulus, a weaker euro and pent-up demand. "It's the same old, same old from Europe. There is a lot of tension, but also a lot of potential," European Strategist Chris Bailey\* summarizes.

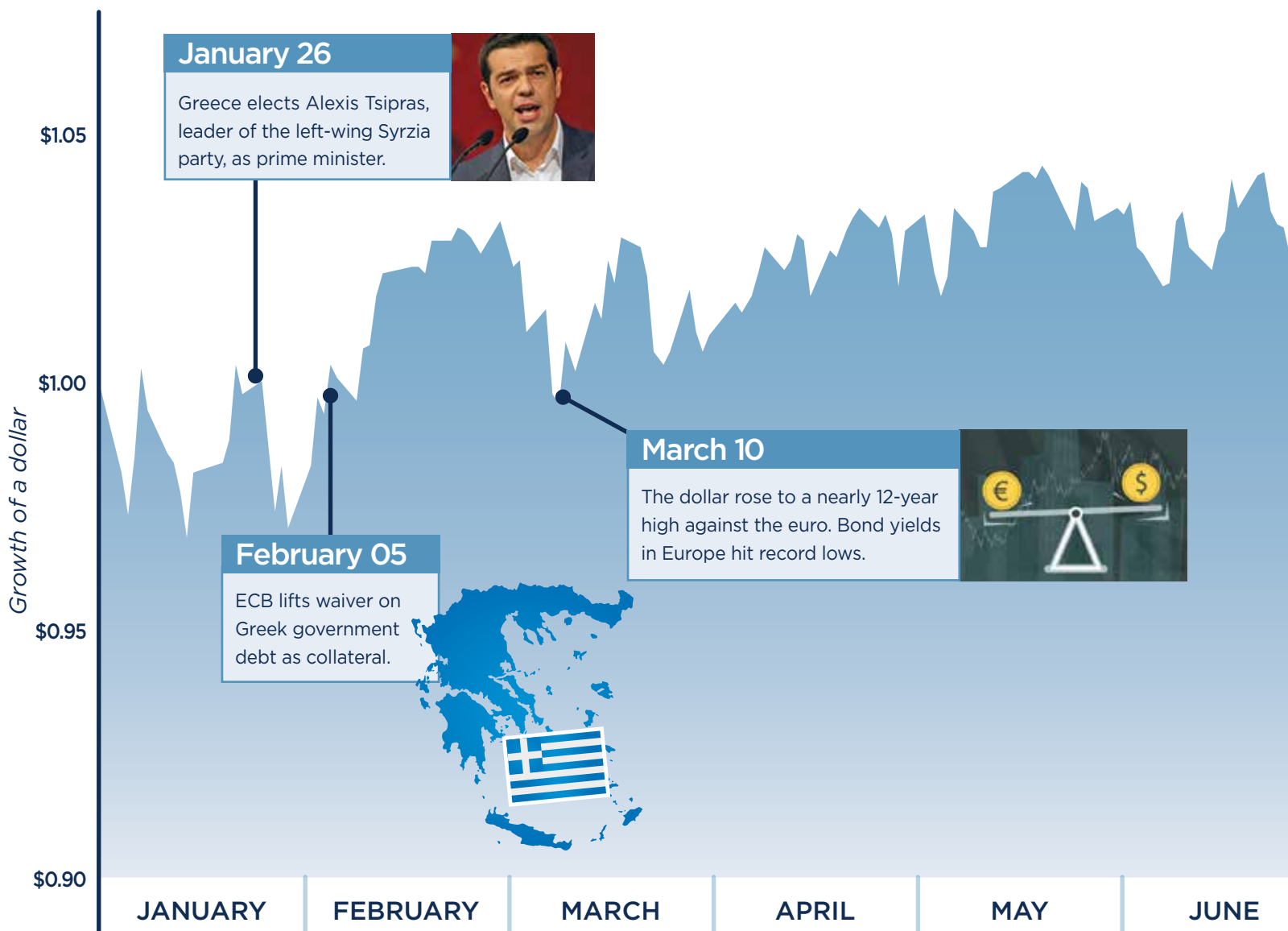
Camp weighs in, "It will be interesting because as we zig, the European Central Bank is zagging. There's going to be a pretty big disparity as they likely go negative on short rates overseas

between major currencies and major economies' monetary policy. I think the reaction of markets is going to be very meaningful to them in terms of how they progress in 2016."

After a considerable period of financial market anxiety regarding the timing of the Fed's initial rate hike, including adverse reactions in emerging economies, the Fed's policy outlook should be largely factored in. Looking ahead, financial market participants will remain focused on a variety of economic indicators in early 2016, including the pace of job growth and developments overseas. ■

## 2015

### RESILIENCY OF THE S&P 500 DURING A CHALLENGING MARKET ENVIRONMENT



\*An affiliate of Raymond James & Associates and Raymond James Financial Services.



**July 05**

Greece votes "no" on Europe's bailout offer.



**July 20**

Cuba and the U.S. re-establish diplomatic relations after 54 years. China's stock market falls 8.5% in one day.



**August 20**

Greece receives first portion of third bailout.



**October 31**

A Russian passenger plane crashes in Egypt, killing 700.



**December 02**

San Bernardino, CA: 14 killed and over 20 wounded in shooting massacre carried out by an Islamic State-inspired couple.



**August 11**

China devalues yuan against U.S. dollar. The failed experiment was reversed two days later.

**July 30**

China's Shanghai Index is down ~30% since mid June.



**June 30**

Puerto Rico Governor Garcia Padilla announces "our debt is not payable ... there is no other option."



**August 25**  
U.S. STOCK MARKET BOTTOM

**November 13**

ISIS executes six attacks throughout Paris, killing 129.



JULY

AUGUST

SEPTEMBER

OCTOBER

NOVEMBER

DECEMBER



# 2016 Economic Outlook

## Upside opportunities, with some downside risks

**Scott J. Brown, Ph.D.**, chief economist, equity research, outlines his expectations for the economy in 2016.

"The Fed doesn't have to hit the brakes, but it does need to begin taking its foot off the accelerator."

The 2016 outlook is dominated by the same themes that prevailed during the second half of 2015. Domestic demand is expected to remain strong, particularly in the first half of the year, but overall growth is likely to be somewhat restrained by the impact of sluggish global growth and a strong dollar.

Investors have expressed some concerns about tighter monetary policy, but worries are likely overdone. Expected to be gradual, the pace of the Federal

Reserve Bank's (Fed) rate increases reflects an economy moving toward its long-term potential. Even with higher short-term interest rates, Fed policy should remain accommodative over the course of 2016. Investors are likely to focus on the presidential election in the second half of the year, perhaps with some trepidation.



### DOMESTIC GROWTH

In its regular reports on gross domestic product (GDP), the Bureau of Economic Analysis has begun presenting a new output measure – private domestic final purchases (PDFP). A smoother gauge of underlying domestic demand, this measure is made up of consumer spending, business fixed investment and residential investment, and accounts for 85% of GDP. It excludes net exports, change in inventories and government – three components that are volatile quarter to quarter. Adjusted for inflation, PDFP rose 3.2% over the four quarters ending September 30, 2015, according to the government's second estimate of third quarter growth. In contrast, real GDP was reported to have risen 2.2% over the same period, largely reflecting an increased drag from foreign trade.

now. The Fed has to set monetary policy with an eye to where the economy will be in 12 to 18 months. In that regard, most Fed officials believe it's appropriate to begin moving to a more normal policy position. The Fed doesn't have to hit the brakes, but it does need to begin taking its foot off the accelerator.



### MONETARY POLICY

Financial market participants have been anxious about the timing of the first rate increase, but Fed officials have stressed that the pace of policy tightening will be much more important than the timing of the initial move. The Fed has continued to emphasize that monetary policy will still be accommodative after it begins to raise rates, future policy moves will be data dependent, and economic conditions are expected to evolve in such a way as to warrant a gradual path of rate increases.



### INFLATION

Low in 2015, inflation was held down by a sharp decline in gasoline prices. Excluding food and energy, the Consumer Price Index (CPI) rose about 2%, with half of that increase concentrated in higher

### THE JOB MARKET



Six and a half years into the economic recovery, the slack in the job market – generated in the financial crisis – has been largely, but not completely, reduced. While there are still signs of slack, including elevated levels of long-term unemployment, high involuntary part-time employment, and lackluster growth in average wages, there should be a lot less slack a year from



shelter costs (specifically in rent or rental equivalents). The Personal Consumption Expenditure Price Index (PCE), the Fed's chief inflation measure, has a smaller weighting on shelter with a core rate trending below 1.4% versus the Fed's official goal of 2%. Fed officials generally expect consumer price inflation to head higher as the impact of lower commodity prices fades. However, depending on how much is already factored into the markets, tighter Fed policy is likely to put some further downward pressure on commodity prices in the near term. While inflation in consumer goods is expected to remain low, services account for a majority of consumer spending, and inflation in services is driven largely by wage growth.



### CONSUMER SPENDING

Boosted by strong job growth and the increase in purchasing power associated with the drop in gasoline prices, consumer spending was strong in 2015. However, lower gasoline prices had a varied impact across households. For those at the upper end of the income scale, it doesn't matter how much it costs to fill up since their spending isn't going to change much. Those at the lower end of the income scale tend to drive less, so they are going to see less of a benefit from low gasoline prices. However, those in the middle have benefited significantly, although budgets have likely been strained by other factors that include rising rent and healthcare costs.



### CORPORATE EARNINGS AND MANUFACTURING

Corporate earnings from the rest of the world were restrained by slower global growth and the impact of a stronger dollar in 2015 – for any given level of foreign earnings, a stronger greenback will reduce the dollar value of those earnings. In response, many of those firms have reduced capital expenditures. Still, domestic demand

should be strong enough to sustain a moderate pace of business fixed investment in 2016.

Manufacturing activity has also reflected the mix of domestic strength and global weakness. Auto sales and production have been brisk, aided by strong job growth and relatively easy credit for auto loans.



### HOUSING

Residential housing has continued to recover, supported by strong job growth, but activity has remained below what may be considered normal.

Builders cited a number of restraints in recent years, but these should fade over time. Despite significant job gains over the last several quarters, the market for start-up homeowners has not recovered much but should improve as wage growth picks up. Bank credit to mortgage borrowers may get gradually easier even as the Fed begins to raise short-term interest rates.



### GLOBAL GROWTH

For many years, emerging economies have made a compelling story for investors. China, India, and the rest of developing Asia, along with Latin America and countries in Eastern Europe, have been growing rapidly since the financial crisis and were expected to account for much of global economic growth over the next couple of decades. With the exception of India, these economies have softened in recent quarters, putting downward pressure on commodities and leading to slower growth in commodity exporters. The longer-term outlook for emerging economies is still promising, but the post-recovery pace of growth is likely to be lower than was expected a few years ago. China's economy is transitioning from one led by export growth and infrastructure spending to one led by private domestic demand. China's capital markets will have to become more



## 2016 ECONOMIC OUTLOOK (continued)

market-determined in the years ahead. These transitions are likely to be challenging and financial conditions may be volatile in the months ahead. Unfortunately, the economic data coming out of China are unreliable, making it difficult to generate an accurate assessment and adding to the overall uncertainty in the global economic outlook.

The U.S. economy is mostly self-contained. China, for example, accounts for less than 8% of U.S. exports (or less than 1% of U.S. GDP). However, China and other emerging economies have been a rapidly growing market for U.S. exporters. The Fed bases monetary policy decisions on the domestic economic outlook, but officials do need to take into account how what's happening in the rest of the world influences our economy. In the near term, that may imply reduced demand for U.S. exports (hence, somewhat slower GDP growth) and a softer trend in inflation, but these impacts are viewed as transitional. ■

### KEY TAKEAWAYS:

- The 2016 outlook is dominated by the same themes that prevailed during the second half of 2015.
- Domestic demand is expected to remain strong, particularly in the first half of the year, but overall growth is likely to be restrained somewhat by the impact of sluggish global growth and a strong dollar.
- The pace of Fed rate increases is expected to be gradual and reflects an economy moving toward its long-term potential. Even with higher short-term interest rates, Fed policy should remain accommodative over the course of 2016.
- The longer-term outlook for emerging economies is still promising, but the post-recovery pace of growth is likely to be lower than expected a few years ago.

### THE RISE OF SHORT-TERM INTEREST RATES

Federal Reserve policymakers raised short-term interest rates for the first time in nine and a half years, citing “considerable improvement in the labor market” and confidence that inflation will return to the Fed’s long-term goal of 2%.

The Fed noted that monetary policy will still be accommodative after this move, supporting further improvement in the job market. Future policy action will be data-dependent, but the pace of interest rate increases should be gradual. Senior Fed officials generally expect an increase of a full percent over the course of 2016, or a quarter percent each quarter.

The Fed’s initial rate increase should not have a large impact on the economy in the near term. Deposit rates will remain low, lagging Fed moves on the way up. Longer-term interest rates, including home mortgage rates, may move a bit higher, but not sharply.

After a considerable period of financial market anxiety regarding the timing of the Fed’s initial rate hike, including adverse reactions in emerging economies, the Fed’s policy outlook should be largely factored in. Looking ahead, financial market participants will remain focused on a variety of economic indicators in early 2016, including the pace of job growth and developments overseas.



## ECONOMIC SNAPSHOT

The economic outlook for 2016 is similar to what we saw in the second half of 2015. The strong dollar and soft global growth should continue to weigh against U.S. exporters, while low oil prices will further dampen energy exploration. The rest of the economy appears to be in good shape, with a strong job market and better purchasing power supporting consumer spending growth. Residential homebuilding should pick up. Business fixed investment is likely to be mixed, but generally moderate. Fed policy is expected to gradually be less accommodative.

**SCOTT BROWN**  
Chief Economist,  
Equity Research

STATUS	ECONOMIC INDICATOR	COMMENTARY
POSITIVE OUTLOOK	GROWTH	Domestic demand should remain strong, as measured by private domestic final purchases, yet overall growth is likely subject to some drag from a wider trade deficit.
	EMPLOYMENT	Job losses remain limited. New hiring should continue, but the pace of growth is likely to slow somewhat relative to the last couple of years (due to supply constraints).
	CONSUMER SPENDING	Job growth has remained strong, but the pace of job gains is expected to slow as the labor market tightens. Wage growth has been relatively lackluster in recent quarters, but should pick up. Low gasoline prices have boosted purchasing power, but the impact should fade (and has been offset by higher rents and other strains in the household sector).
	HOUSING AND CONSTRUCTION	Supply constraints (high costs and a lack of skilled labor, among others) have been a restraint for homebuilders and tight credit has thwarted potential first-time buyers, but strong job growth is supportive. Mortgage rates may drift a bit higher, but not enough to hold back the overall recovery in the housing sector.
	INFLATION	Tighter Fed policy may put some further upward pressure on the dollar, helping to keep the cost of imported raw materials and finished goods down. Inflation in services has been running higher, but is mostly concentrated in rents.
	THE U.S. DOLLAR	In the short run, exchange rate movements largely reflect central bank policies. With the Fed expected to tighten further and others likely to remain "easy," the dollar may firm a bit more. However, much of this should already be priced in to the currency market.
NEUTRAL OUTLOOK	MONETARY POLICY	Expecting further improvement in the job market and an eventual rise in inflation (back to the Fed's 2% goal), the central bank is likely to raise short-term interest rates gradually, a quarter percent every three months (or possibly a bit slower if the Fed falls short of its goals or financial instability increases).
	BUSINESS INVESTMENT	Pressures on exporters and in energy production are headwinds, but the domestic economy is expected to be strong enough to sustain a moderate pace of capital spending.
	MANUFACTURING	The manufacturing outlook is mixed across industries. Healthy year-over-year growth in auto production is expected, but factory output is generally lackluster otherwise. The strong dollar has dampened exports.
	LONG-TERM INTEREST RATES	Long-term interest rates should trend gradually higher as the economy improves, but a sharp rise is not likely (as inflation is expected to remain relatively low by historical standards). Some of the global flight to safety may wear off as the year progresses.
NEGATIVE OUTLOOK	REST OF THE WORLD	Global outlooks are a mixed bag, with advanced economies expected to fare better. Some emerging economies, Latin America in particular, will continue to struggle this year. Low commodity prices have been a major setback for exporters of raw materials, but low prices are beneficial to commodity importers and should sow the seeds for better global growth down the line.
WILD CARDS		Watch financial conditions closely in early 2016 for signs of an over-reaction to less-accommodative Fed policy. The presidential race could become an important issue for the stock market in the second half of the year.



# Answers await for the global policy divide

**Chris Bailey**, European strategist, Raymond James Euro Equities,\* shares thoughts on the outlook for monetary policy worldwide.

## THE U.S. BEGINS TIGHTENING

*At the last count, 2015 saw 67 central bank, interest-rate reductions – a remarkable statistic approximately six years from the formal end of the global financial crisis.*

In a world of relatively free capital flows among the big western powers, there are consequences to tapering monetary policy. Even before it turns into an overt interest rate increase, tapering is a form of tightening – with the rise in the U.S. dollar over the last year a testament to this notion. While the U.S. economy may be able to absorb such an increase, other economies that are heavy on dollar-denominated debt, or are attempting to maintain currency pegs to the U.S. dollar, have struggled to handle the change.

A large proportion of central banks which cut interest rates last year were troubled emerging markets attempting to offset the losses associated with a U.S. monetary policy progressively moving away from extreme accommodation, a policy which supported these economies in recent years.

## EUROPE CONTINUES EASING

And then, of course, there is the euro zone. Despite an overall sense of reluctance, European policy makers finally implemented quantitative easing in the first quarter of 2015, causing a subsequent shift to negative interest rates and a lengthening of the anticipated duration of central bank balance sheet expansion. It's little wonder that the euro experienced multi-year lows against the dollar at various points throughout 2015.

The reality is that different economies are traveling at different speeds. Economists will likely reflect on monetary policy throughout the global financial crisis and conclude that those central banks that moved early by cutting interest

“The reality is that different economies are traveling at different speeds.”

rates and employing unorthodox quantitative easing policies – notably the Federal Reserve and the Bank of England – generated the fastest rates of economic growth over recent years.

With such growth comes the “prize” of tentative steps toward more conventional “normalized” policy. This process begins with the end of quantitative easing followed by the notion of an increase in interest rates from ultra-low levels.

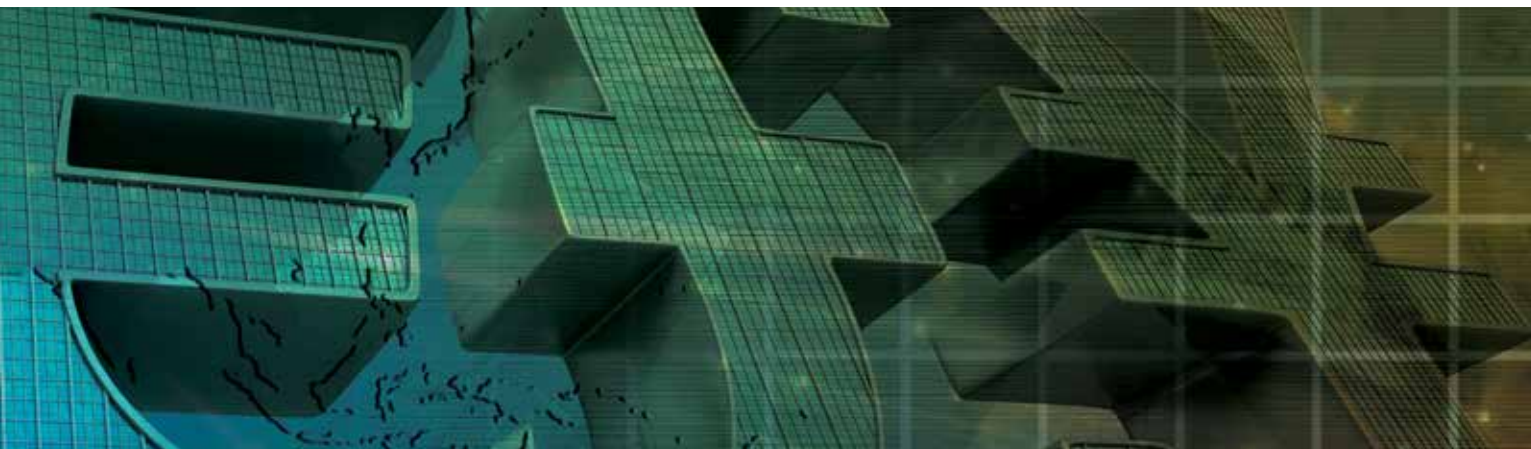
## UP, DOWN AND ALL AROUND

In short, it appears that the overt differences between current monetary policy cycles of the U.S. and Europe, as well as large swathes of emerging markets, should continue to escalate over the next few months. This divergence places further pressure on exchange rates and global economic growth, and increases the potential for financial market volatility going forward.

So, does a difficult year await? Before jumping to such a conclusion, a final observation from the last three U.S. monetary policy tightening cycles may help provide perspective on what lies ahead. In all three cases, the U.S. dollar rallied prior to the initial interest rate hike, then weakened in the following three-to-six months. Pressured emerging market economies and commodity-exporting nations would welcome such a move and, in Europe, it could help move economic discussions away from exports and cheap currencies toward economic reform and boosting regional consumption levels.

It looks as if, in a world of greater monetary policy variance, equity market participants and economic strategists alike will be watching some of the key exchange rate movements more closely than usual. ■

\*An affiliate of Raymond James & Associates and Raymond James Financial.

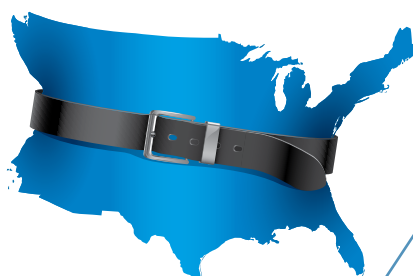


### KEY TAKEAWAYS:

- Economies that are heavy on dollar-denominated debt, or are attempting to maintain currency pegs to the U.S. dollar, have struggled to handle the strengthening currency.
- Divergence in global monetary policy places further pressure on exchange rates and global economic growth, and increases the potential for financial market volatility going forward.
- A slowing U.S. dollar would help shift Europe's attention away from cheap exports and towards structural reform.

### DIVERGENCE IN MONETARY POLICY CYCLES

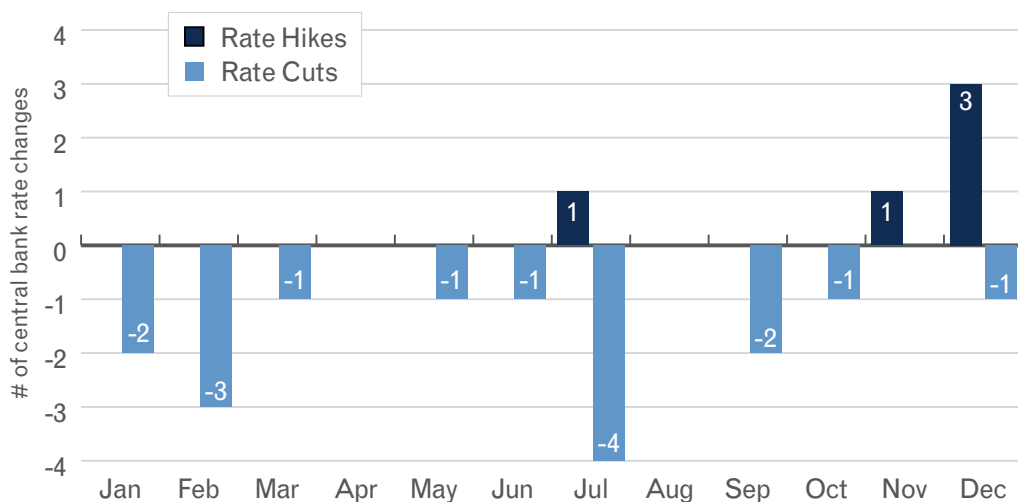
THE U.S.  
BEGINS  
TIGHTENING



EUROPE  
CONTINUES  
EASING



### 2015 CENTRAL BANK INTEREST RATE DECISIONS



Source: cbrates.com

This chart includes 21 of the largest central banks with significant influence on global growth.





# A base case for equities

**J. Michael Gibbs**, managing director of equity portfolio and technical strategy, weighs in on what lies ahead in 2016.

The new year ushers in more of the same as equity investors deal with the Federal Reserve Bank's (Fed) actions (magnitude, timing and commentary) regarding monetary policy. As the year unfolds, factors influencing the Fed moves — or lack of those moves — are likely to create volatile periods in the equity markets.

## EXPECTATIONS FOR THE YEAR

Influenced by Scott Brown's expectation of a gradual rate increase of 1 to 1.25 percent for the fed funds rate by year-end, our base case scenario is that the Fed's actions will not upset the global landscape. Equities should produce an upper single-digit to low double-digit total return in the new year. After stagnating in 2015, S&P 500 earnings will resume growth. While we're less confident earnings will achieve current consensus expectations of around 8% growth,\* we do feel 4-6% growth is possible. By year-end, a reasonable price-to-earnings multiple of 18 times on our expected year-end earnings would move the S&P 500 into the 2,200 to 2,230 range.

However, our confidence in an easy glide path to our base case return is low, and we're sorry to disappoint those looking for a table-pounding call on the market. Rather, since the landscape of the financial markets can shift abruptly, it's imperative to keep an open mind. Especially since shifts could be more significant this year as compared to previous years. The transition away from the main fuel of equity market gains in this bull market (accommodative Fed policy) in a world so financially connected is subject to errors and surprises. As we view the equity market fairly valued today, valuation no longer provides the comfort it did in this bull market's previous years.

"Investors seeking to be somewhat timely with investment decisions should be attentive, open-minded, and slightly more cautious than in recent years."

Our caution is also influenced by the message being sent by the market. Since mid-2013, fewer and fewer stocks have led the market higher. As more stocks fell well behind the headline S&P 500 return, the narrowness reached new heights in 2015.\*\* Historically, such narrowing of participation has often been a warning sign for the overall market. As 2016 begins, swirling financial winds suggest investors seeking to be

should be attentive, open-minded, and slightly more cautious than in recent years.

## MARKET REACTIONS TO FED POLICY

It's now time for the Fed to move short-term interest rates back into a more normal range. Doing so could have far-reaching implications on the global financial system. With other central banks signaling looser monetary conditions in the period ahead, a tighter policy in the U.S. could cause the U.S. dollar to move higher as money flows into dollar-denominated assets. The higher dollar can adversely impact many market-influencing areas such as currencies, capital flows, commodity prices and U.S. corporate profits.

If all goes as expected, meaning economic and world conditions allow for a slow increase in rates that does not trigger negative market reactions, the path higher for equities will be smoother than we expect. Yet, if any financial unrest or weakening of global economic conditions develops, the Fed may be forced to abruptly abandon the plan to raise rates. This will not send a reassuring signal to the equity markets. Conversely, should conditions improve to a point of causing inflation to increase more than expected, it might be forced to move more aggressively than currently planned. The fixed income market would certainly become volatile in this case, and the unexpected move higher in rates would spill over to





equity markets. Therefore, the initial move by the Fed will be less meaningful than subsequent moves, or more specifically, the reasons for subsequent moves.

### ALLOCATION IN THE NEW YEAR

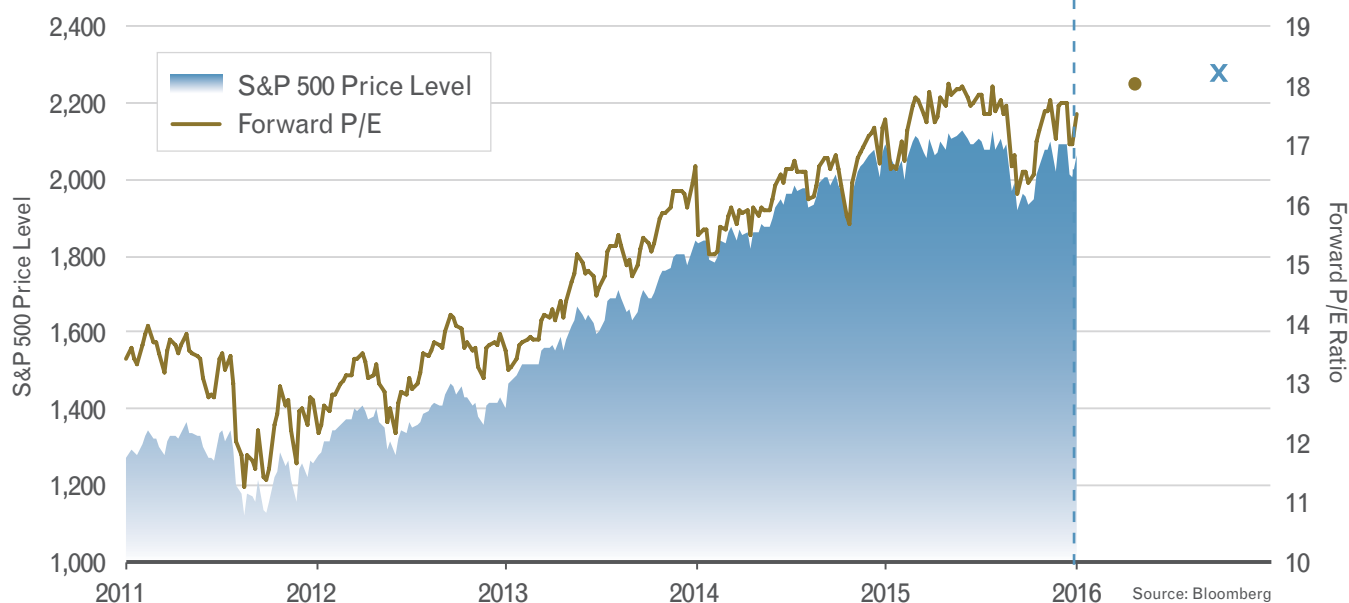
We eagerly await 2016 to have our questions answered. For now, we put forth our base case of upper single-digit total returns to the S&P 500 for the full year, but will remain flexible and could be quick to alter our stance should financial or economic stress be triggered as the year unfolds. We suggest investors do the same.

Investors with long-term goals and well-diversified portfolios need not make major adjustments in overall equity allocations. Those less diversified and seeking a more tactical bent (i.e., investors who prefer shorter-term positions that attempt to take advantage of anticipated financial developments) should be less aggressive with equity positioning until clarity develops. ■

### KEY TAKEAWAYS:

- Our 2016 base case is that the Fed's actions will not upset the global landscape and equities will produce an upper single-digit to low double-digit total return.
- While we're less confident earnings will achieve current consensus expectations of around 8% growth, we do feel 4% to 6% growth is possible.
- Investors with long-term goals and well-diversified portfolios need not make major adjustments in overall equity allocations.

**A BASE CASE FOR EQUITIES**  
S&P 500 and Forward Price/Earnings Ratio  
Data through 12/25/2015



### 2016 ESTIMATES:

- Est. P/E: 18x
- ✕ S&P 500 Index: 2,200-2,300
- Est. Earnings Growth: 4-6%

\*Source: FactSet

\*\* Source: 2015 Internal Equity Market Performance Analysis, November 30, 2015

# Bullish until proven otherwise

**Jeffrey Saut**, chief investment strategist, equity research, takes a look back to see what 2016 may bring for investors.

Year-end letters are always difficult to write because there is a tendency to discuss the year gone by, or worse, try to predict exactly what will happen in the coming year. As a reminder, pundits didn't predict the Paris terrorist attacks, Russian airliner crash in Egypt, Volkswagen emissions scandal or water on Mars. Still, while there is so much we can't predict, we can share our thoughts based on what we do know.

## LOOKING BACK: THE YEAR IN REVIEW

So, we began 2015 with advice to investors that if you have stocks in your portfolio that have not rallied in the straight up move since June 2012, without so much as a 10% pullback, there is likely something wrong and the stock should be sold. Our strategy was to raise some cash because the models/indicators that have worked so well were telegraphing 2015 was going to be sketchy with much more volatility and you would need some cash to take advantage of opportunities as they present themselves. That said, I still thought the S&P 500 would be up by 10.4% for the year. That view was probably my worst "call" of the year.

My best "call" was likely when my models said in early July that the equity markets were going into a period of contrac-

tion. Quite frankly, I did not think the contraction would be as deep as it was at 12.4% (based on the S&P 500), but I did say on CNBC at the August "lows" the equity markets were going to bottom that day. Becky Quick responded, "Jeff, NOBODY comes on this show and says the equity markets are going to bottom today," but that is exactly what I said while adding that bottoms tend to be a process and not an event.

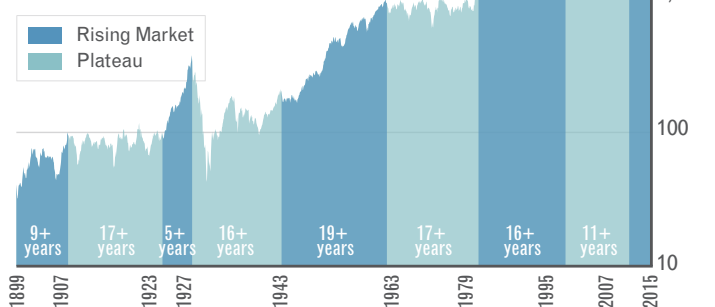
This meant that what you tend to get is a "capitulation low" (August 24th), followed by failed rally attempts, and then the market comes back down and tests the "capitulation low," which is precisely what happened in late September. The resulting chart pattern formed a classic "W-shaped" bottom (see chart), or as a technical analyst would term it, "double bottom." Accordingly, we averred the bottom was "in" late in September and the secular bull market was still alive.

Secular bull markets tend to last 14 to 15 years and compound at ~16% per year. So, if past is prelude, we should

## DOW JONES INDUSTRIAL AVERAGE – STRUCTURAL MARKETS

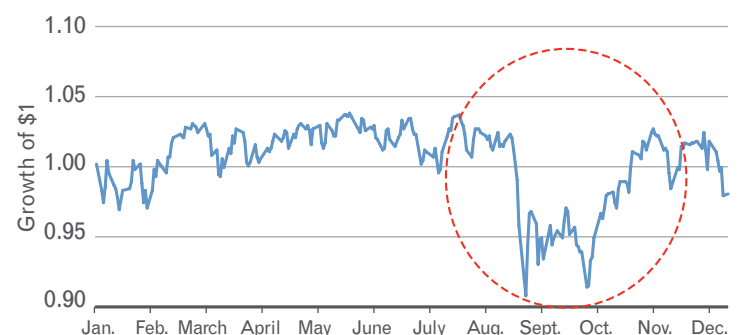
May 1896 - December 2015

Since 1896 the Dow Jones Industrial Average has experienced eight significant structural markets. Historically, these structural markets have lasted an average of about 14 years.



## CLASSIC W-SHAPED BOTTOM

2015 S&P 500 Daily Returns through 12/14





**PAUL TUDOR JONES,  
Legendary Investor**

"I'm always thinking about losing money as opposed to making money. Don't focus on making money; focus on protecting what you have."

have another seven to eight years left in this one. The only caveat I would offer is that if the August 25th closing "lows" for the Dow Jones Industrial Average and Dow Jones Transportation Average are both violated (the Transports have already done so) I will have to reconsider my bullish stance.

For the record, those closing lows are 15666.44 and 7466.97, respectively. We use these levels as a "failsafe point" because "The essence of portfolio management is the management of 'risks,' not the management of 'returns,'" indeed, investing is all about managing risk! As legendary investor Paul Tudor Jones once said, "I'm always thinking about losing money as opposed to making money. Don't focus on making money; focus on protecting what you have." Obviously, we carry that strategy into 2016.

**LOOKING AHEAD: THE OUTLOOK FOR 2016**

Speaking to 2016, I predict, as I always do when asked how much the S&P 500 will rise in the new year, a 10.4% return. Why 10.4%? ... because since 1921 that has tended to be the average annual return for the S&P 500. Of interest is that roughly 5% of that yearly return comes from earnings growth, 0.9% comes from price/earnings multiple expansions (PE), but a large 4.5% comes from dividends. Verily, dividends play a huge role in the total return of portfolios.

Yet while returns are important, your financial life is more about your long-term goals than it is about yearly returns. To this point, investing is about the "insights," and the screening out of "noise," gleanings you receive from your Raymond James team, as well as the management of "risks." There are three kinds of risk: 1) Personal Risk; 2) Market Risk; 3) Idiosyncratic Risk (specific risk to an asset class like we saw in the upstream MLPs). Hereto, your Raymond James team can help reduce these risks.

Strategically, I think the fundamentals will improve in 2016 for most U.S. equities. International equities need more of a "rifle approach" as there will be various winners and losers. On fixed income, I am circumspect, thinking with interest rates at zero there is only one way for rates to go. I do, however, like alternative investments, but hereto you need a "rifle shot" approach. The U.S. dollar looks higher to me, commodities look lower, Washington, D.C., looks more functional, the Federal Reserve has raised interest rates, but going forward it will be at a very slow pace, corporate tax reform is coming, energy prices are bottoming, inflation should remain contained, and the only sectors I am shy of are utilities and staples.

In conclusion, our 2016 outlook is supportive of equities driven by improving global growth, slowly rising interest rates, a stronger U.S. dollar and low inflation. I expect equities to outperform bonds, commodities and alternative investments. Managing the "risks," and rebalancing portfolios accordingly, should be the key for successful investing in the new year. ■

**KEY TAKEAWAYS:**

- Strategically, fundamentals will improve in 2016 for most U.S. equities. International equities need more of a selective approach as there will be various winners and losers.
- Equities are expected to outperform bonds, commodities and alternative investments.
- While returns are important, your financial life is more about your long-term goals than annual performance numbers. To this point, investing should focus on insights, screening out noise and managing three types of risks: personal, market and idiosyncratic (a specific risk to an asset class).

# Equity market themes to watch

As we enter 2016, Chief Investment Strategist Jeff Saut and Research Associate Andrew Adams highlight key investment themes likely to occupy headlines and client conversations in the coming year. Learn more about relevant topics transforming the financial landscape and revolutionizing industries such as technology, energy and healthcare.

## GLOBALIZATION/ INTERNATIONAL MARKETS



Markets such as Europe, Japan and China have proved they are willing to take the steps necessary to stimulate growth. We believe that will continue into 2016 and beyond. European equity valuations, in particular, look cheap and the European Central Bank (ECB) doesn't appear ready to take its foot off the gas when it comes to its quantitative easing program. The recent attacks in Paris also give ECB President Mario Draghi plenty of cover to keep injecting liquidity into the system to keep markets stable.

## DIGITIZATION OF SOCIETY



The "internet of things" has already begun to infiltrate our daily lives (connected cars, smart TVs, self-adjusting thermostats, etc.), but the complete "digitization of society" is still expected to explode over the coming years as even the most mundane aspects of our lives are brought online. Similarly, the continued evolution toward saving data in the "cloud" will necessitate secure, robust systems, and a mobile presence will become even more crucial for companies as users increasingly move business and personal lives to their phones and tablets.

## ENERGY EFFICIENCY



The movement toward sustainable energy sources is not going away, but the infrastructure and technology required to significantly move from fossil fuels is not there yet. Consequently, there is already a push to make our current energy system more efficient through the use of improved technologies such as smart grids and LED smart lighting.

## MODERN MEDICINE



Breakthroughs in modern medicine, pharmaceuticals and biotechnology will continue to extend our life expectancies and hopefully keep us living healthier and for a longer period of time. With baby boomers entering ages where many health problems develop, money will continue to be pumped into combatting age- and obesity-related diseases.



**HOMELAND  
CYBERSECURITY**

Modern wars are fought both on the ground and online, and the potential for a catastrophic cyberattack against the United States and our allies grows more likely as terror groups become better equipped to battle technologically. Companies are racing to protect us from this expanding and ever-changing threat and, with geopolitical tensions escalating, it will continue to be of major importance to guard our infrastructure and intelligence data.

**LONGEVITY**

Our population is aging. Baby boomers are entering their retirement years and are looking to both enjoy this next stage of their lives and stay in good health. On top of obvious healthcare implications that an aging population creates, retirees also face the challenge of protecting their accumulated savings while also ensuring that they are earning adequate returns to make their money last through lifespans that are commonly reaching into the 80s and 90s.

**TECHNOLOGY  
REVOLUTIONS**

Many science-fiction-type technologies in database and applications will become science fact over the next several years. We expect much of the growth in the overall market to come from this new wave of innovation. As the components that run these technologies continue to become cheaper, smaller and more powerful, we are likely to see a revolution across many different industries as data is more easily collected and analyzed. Additionally, companies will be divided into two distinct groups: the innovators who create better, faster and cheaper products and services; and those that just try to keep up and make money any way they can.

**FINANCIAL  
SERVICES**

The rising interest rate environment that is expected to arrive over the next few years should benefit banks and financial services companies, even as robo-advisors and online/mobile investing force these same companies to keep up to date with evolving client demands. However, more volatile markets and increasing life spans should make quality, individualized financial planning even more necessary despite an increased reliance on new technologies.

**DIVIDENDS**

Even though interest rates are expected to rise, it will likely still be a while before investors see the level of returns in high-quality fixed income products that are needed to fully meet their income needs. This means that dividend-paying stocks will continue to be a large part of many portfolios and, as we often point out, it has been those companies that regularly increase dividends that outperform. We expect this trend to continue.

# U.S. Equity in 2016: An inflection year

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

Since the March 2009 equity market low, the S&P 500 has returned an incredible 250% on a total return basis. While the bears claim that the strong appreciation has been driven solely by central bank stimulus, we believe a combination of improving fundamentals, notably corporate profits with S&P 500 earnings up 120% since 2009, and central bank liquidity provided meaningful support to the strong rally in asset prices.

With these two tailwinds waning, does this portend an end to the bull market? We don't believe so. Continued, albeit more modest, equity gains – fueled by positive earnings growth – are expected in 2016. We see this as an important inflection year as both the economy and stock market begin to transition away from central bank stimulus, and underlying fundamentals take on a larger role. This inflection point should result in higher volatility as the markets digest impending Federal Reserve (Fed) rate hikes, a potential peak in central bank stimulus and uncertainty over corporate earnings.

When all is said and done, further equity gains are expected in 2016, however, we caution investors to be vigilant and flexible in managing their portfolios, as the markets work through near-term uncertainties.

## A TECHNICAL LOOK BACK TO LOOK AHEAD

2015 will likely enter the record books as one of the most frustrating periods in stock market history. The S&P 500 stayed confined to a fairly narrow channel during this 12-month period despite experiencing its first 10% correction since 2012. If not for a few select mega-cap stocks that helped prop up the overall market, this lackluster performance could have been far worse.

“Historically, periods of inactivity have often been followed by periods of strong gains.”

Indeed, almost 60% of the largest 4,000 companies in the United States were down at least 20% from three-year highs at the lowest point of the August correction. This bifurcation suggests that many investors who were not heavily weighted in the basket of stocks that outperformed, probably lagged the major averages and will not look back at 2015 with fond memories.

Fortunately, there is a good chance that the general “side-ways” activity of the S&P 500 may actually bode quite well for stocks heading into 2016. Historically, periods of inactivity have often been followed by periods of strong gains. The high for 2015 was only 14.3% above the low for the year, the sixth-narrowest annual range since 1950, and narrow-range years have often acted as a base from which the market experienced meaningful price appreciation.

One caveat is that the S&P 500 did break down in June through a very long-term support line that connected the lows from 2009 and 2011, and the market has sputtered since that point. Consequently, if stocks fall beneath August's low of 1,867 – a key technical level – we are likely to become defensive in our positioning since this type of price movement is an indication of further potential weakness. Provided we remain above that level we will maintain our bullish technical stance, as the S&P 500 remains in a long-term uptrend that Jeff Saut and team state “keeps us bullish until proven otherwise.”

We still believe it's more probable that this sideways consolidation resolves itself to the upside, which could equate to a 12% to 15% run in performance before hitting the resistance lines that have held stocks in check for the last few years. From a market cycle perspective, the fourth year of the presidential

\*An affiliate of Raymond James & Associates and Raymond James Financial Services.



cycle has seen S&P 500 average returns of 6.1%, with positive price returns 76% of the time since 1945, and the long-term, secular bull market cycle remains firmly in place.

### CAUTIOUSLY OPTIMISTIC

As we've emphasized for some time, U.S. equities tend to trade in 13- to 15-year secular cycles, which we believe still has years to play out. Nothing goes straight up, and corrections will occur, but we still believe that this should result in above-average returns in the years ahead.

In conclusion, our base-case view is for equity gains in 2016, but we see a number of potential risks to our outlook. Investors should monitor the economy and stock market closely, and be prepared to adjust to changing market conditions. ■

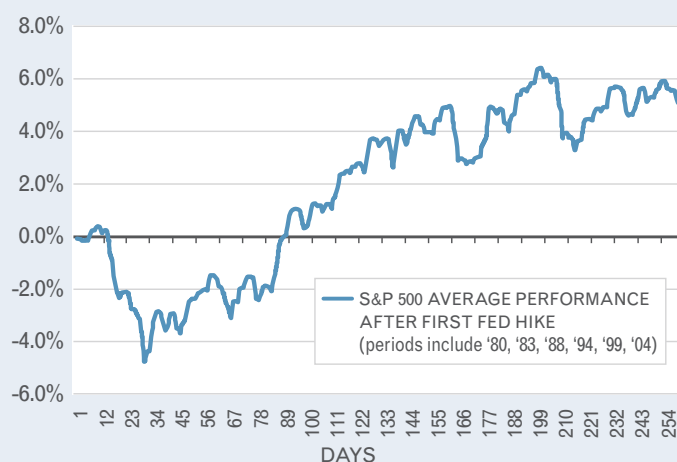
### KEY TAKEAWAYS:

- The general "sideways" activity of the S&P 500 may actually bode quite well for stocks heading into 2016. Historically, periods of inactivity have often been followed by periods of strong gains.
- Continued, albeit more modest, equity gains – fueled by positive earnings growth – are expected in 2016.
- We see this as an important inflection year as both the economy and stock market begin to transition away from central bank stimulus, and underlying fundamentals take on a larger role.

### S&P 500 TYPICALLY GAINS 5% IN THE YEAR FOLLOWING FIRST FED HIKE

With the Fed hiking rates for the first time since 2006, some believe this will derail the stock market. We disagree, and here's why.

- We expect the Fed to be very gradual in its tightening, which should result in a continued upward sloping yield curve through 2016.
- Upside in the U.S. dollar is more limited, which should represent less of a headwind for exports, manufacturing and corporate profits.
- History shows that while the S&P 500 initially comes under pressure following the first Fed rate hike, it then gains 5% on average in the year following the first increase. The reason the Fed is tightening is that the economy is getting stronger so, unlike others, we don't fear initial Fed rate hikes.



Source: Bloomberg, Raymond James Ltd.



## U.S. EQUITY IN 2016 (continued)

**2015's**  
S&P 500 RANGE

MARKED THE

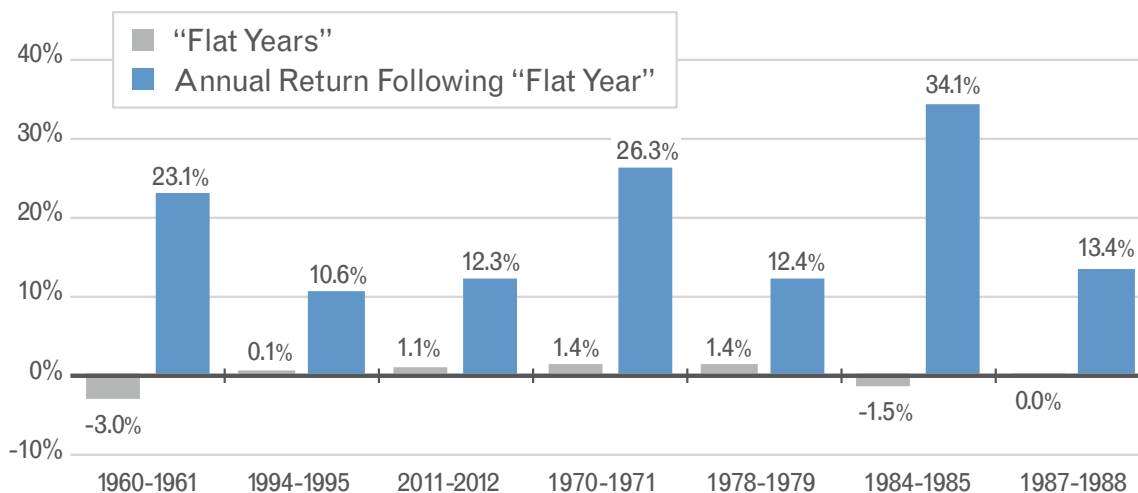
**6<sup>TH</sup>**  
NARROWEST

ANNUAL RANGE

SINCE  
**1950**

## LONG-TERM TREND SHOWS UPSIDE POTENTIAL

S&P 500 annual returns directly following "flat years" 1960-2014



With the S&P 500 down 0.7% in 2015, it could be an indication of additional upside since these "flat" years since 1960 have been followed by some very promising annual returns of 13%, 34%, 12%, 26%, 12%, 11% and 23%.\*\*

*A "flat" year is defined as a calendar year total return between -3% and 3%.*





**Nick Lacy, CFA**, chief portfolio strategist, asset management services, provides thoughts on portfolio allocations to international equities in 2016.

International equities present both opportunities and challenges for domestic investors going into 2016. Since they expose investors to both stock price movements as well as foreign currency movements – with underlying triggers including earnings growth, dividends, interest rates, inflation and sentiment – many factors and risk exposures must be examined closely to determine the appropriate allocation to non-U.S. equity in an investor's portfolio.

#### NEUTRAL ON INTERNATIONAL EQUITIES

Positioned to offer a potentially higher risk/return trade-off, valuations for international equities are currently favorable relative to their domestic counterparts. In addition, another six months of quantitative easing should provide tailwinds for euro zone equities as the benefits make their way through the system.

The euro zone Purchasing Managers' Index (PMI), a measure of the health of manufacturing activity, is expanding at a good pace. Real GDP, one of the main drivers of earnings growth, is expected to be slightly higher in 2016. As a result, euro zone earnings are also expected to improve going forward.

The potential for further appreciation of the U.S. dollar against the euro is a headwind in this space. Illustrating the effect of a strengthening U.S. dollar, French equities gained 12% in 2015 in local currency (the euro), yet returned 0% to the U.S. investor. At the time of this writing, the EUR/USD relationship is close to parity, a level not seen since 2002, and below fair value as indicated by the purchasing power parity. Due to the headwinds and tailwinds facing this asset class, we recommend a neutral weight.

#### BULLISH ON EMERGING MARKETS ... IN THE LONG TERM

Owning emerging market equities provides investors access to countries with potentially higher real economic growth, but doing so also exposes them to elevated stock market and currency volatility. For example, Brazilian equities lost 13% in 2015 in local currency terms, while the loss in U.S. dollars was a staggering 42%.

The emerging markets space is diverse and disproportionately impacted by idiosyncratic factors. Since trade represents a significant portion of many emerging markets' growth, the downturn in commodity prices has had a significant impact on these economies. While some countries, such as India, benefited from the steep decline in oil prices, crude oil exporters, such as Brazil and Russia, have been hurt.

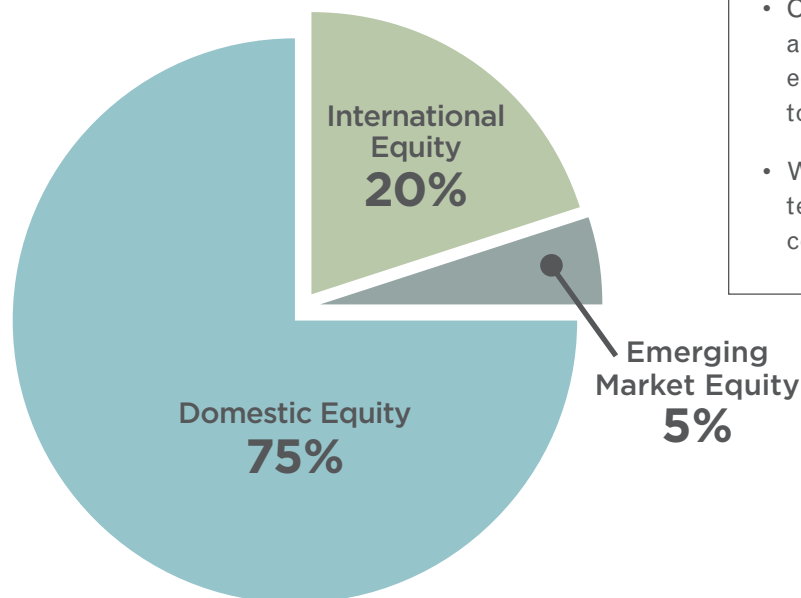
Slowing growth coupled with depreciating currencies has contributed to emerging markets' poor performance in 2015. However, we are still bullish on this space in the long term given the significantly higher growth potential compared to developed countries. A turnaround in investor sentiment, stronger economic growth, and a weakening of the U.S. dollar would all bode well for emerging market equity returns for domestic investors. For now, however, we recommend a slight underweight due to significant headwinds in the near term.



### ALLOCATION RECOMMENDATIONS

Our neutral baseline allocation is 75% domestic equity and 25% international equity. Within the international portion, we recommend a 20% default allocation to emerging markets, or 5% of the total equity portfolio. Given market factors such as valuations, sentiment and volatility, we currently recommend a neutral weight to international equities relative to domestic equities and a slight underweight to emerging markets equities. ■

### EQUITY ALLOCATION RECOMMENDATION



**NEUTRAL WEIGHT**  
INTERNATIONAL EQUITIES RELATIVE  
TO DOMESTIC EQUITIES

**SLIGHT UNDERWEIGHT**  
EMERGING MARKETS EQUITIES

### KEY TAKEAWAYS:

- Given valuations, market sentiment and volatility, we recommend a neutral weight to international equities relative to domestic equities and a slight underweight to emerging markets equities.
- International equities are positioned to offer investors a potentially higher risk and return trade-off since their valuations are more attractive relative to domestic equities.
- Owning emerging market equities provides investors access to countries with potentially higher real economic growth, but doing so also exposes them to elevated stock market and currency volatility.
- We are still bullish on emerging markets in the long term given the significantly higher growth potential compared to developed countries.



# Fixed Income Outlook: 2015 redux?

**Doug Drabik**, senior strategist for retail fixed income, talks about domestic and global factors affecting fixed income strategy this year.

In 2016, we expect the Treasury yield curve to continue to flatten, due in part to the Federal Reserve's (Fed's) "liftoff" intervention on the very short-end, but don't expect meaningfully higher intermediate or long-term rates. The fixed income outlook for the year may be a slightly refurbished version of its 2015 prototype: "Looking ahead for 2015, don't expect rates to rise." That foreshadowing proved accurate as beyond three years, there were immaterial changes in interest rates throughout the year. Despite small intermittent periods of volatility, the five- to 10-year part of the curve ended virtually unchanged for the year.

## GLOBAL FORCES AND FIXED INCOME

The bond market is now heavily influenced by global forces, economies, unrest and wars, in addition to more traditional factors such as domestic economic data, politics and central bank intervention. All of these factors are likely to play a part in how 2016 shapes up.

It may be wise to eliminate the use of historic occurrences and/or forecasting models when predicting the market's future. Formulas are changing. We have entered an era where worldwide central bank intervention is at an unprecedented level. The Fed's balance sheet has ballooned from \$880 billion in January 2008 to \$4.4 trillion in November 2015. At a time when the U.S. is beginning to raise short-term interest rates, a wide divergence with international monetary policy exists.

Interest rate nonconformity will likely tempt large institutions and/or sovereignties to seek the higher rates of U.S. Treasuries, pumping up demand and tempering any quick rise in the world's largest and most liquid market. In addition, Europe is increasing its quantitative easing program, and the general global policy outside of the U.S. is one of easing. One could argue that several Fed rate hikes would merely dampen U.S. easing policy and not yet be one of tightening.

## A LOOK AT SUPPLY

While demand may be ramping up, Treasury debt supply is anticipated to fall in 2016. Furthermore, supply that is issued is projected to be weighted more heavily to bills or short-term notes. The lower supply of long bonds in particular would also contribute to keeping interest rates low.

It's not just rates that remain subdued. After four significant rounds of monetary easing, economic growth remains positive yet muted, perhaps signaling a "new norm."

## THE FIXED INCOME OUTLOOK

It certainly can be argued that the markets have been propped up by artificial means by central bank intervention and limited investment options for those seeking income. Investors have endorsed greater asset-class risk, pressing to achieve higher yields while ignoring the safety and stability of traditional fixed income. This works until it doesn't and when it doesn't, the fallout can be significant loss of capital and wealth.

What bears repeating is that although rising interest rates are alleged to have a destructive total return impact to investment portfolios, in reality, they typically have no "real" negative impact on an investor's wealth. Individual bonds are perhaps the only investment that will provide continuous cash flow and income streams as well as return of principal at an agreed

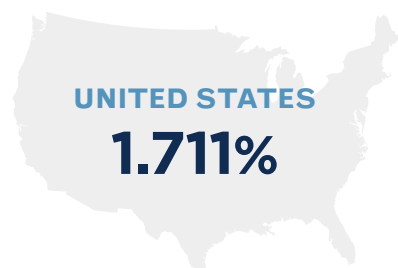


## FIXED INCOME OUTLOOK (continued)

## GLOBAL INTEREST RATE NONCONFORMITY

	FIVE-YEAR RATE	TEN-YEAR RATE
UNITED STATES	1.711%	2.220%
GERMANY	-0.085%	0.562%
ITALY	0.568%	1.539%
UNITED KINGDOM	1.278%	1.890%
JAPAN	0.014%	0.246%
HONG KONG	1.000%	1.488%

Source: Bloomberg  
As of: 01/04/2016



UNITED STATES  
**1.711%**



GERMANY  
**-0.085%**

Germany's  
five-year  
rate is  
almost  
**180**  
basis  
points  
**LOWER**  
than the  
**U.S.**

upon point-in-time, regardless of interest rate changes, thus being the ideal asset to safeguard one's wealth.

With all the world's headwinds, it can be anticipated that 2016 will present a large swing toward safety and preservation of wealth. The U.S. is poised to be the bond market of choice due to its size, liquidity and favorable interest rates. Beyond all the economic factors, the world is well entrenched with its war on terrorism. Nearly every western society and major economic power is affected. With commodity prices falling, MLP and other limited partnerships dropping in value, and the possibility of an equity pullback, there may be a considerable argument in 2016 to forgo "potential" appreciation and lock in cash flow and yield despite lower interest rates.

## STRATEGIES FOR 2016

A most appropriate plan of action for 2016 will continue to be a laddered fixed income structure, which mitigates interest rate risk. Providing continuous and controlled "roll-off" at regulated intervals diminishes the negative effects of rising interest rates. In addition, as interest rates rise, investors can take advantage of higher income/yield when reinvesting.

Credit and duration will continue to be important bond characteristics. Investors primarily focused on income and cash flow have been hampered by outside calls for higher interest rates and potential lower pricing. This has come with a rather large penalty: lower yield and forced reinvestment into continued flat or lower interest rates.

Being too conservative has proved to be a formidable adversary against appropriate portfolio distribution, which may capitalize on the belly of the curve. Sixty-seven percent of the curve's slope is captured at the 10-year; however this does not purport that the 10-year is a magical benchmark. Treasury rates are publicly touted as being low, but spread products such as corporate bonds, preferred securities and municipal bonds enjoy attractive yields.





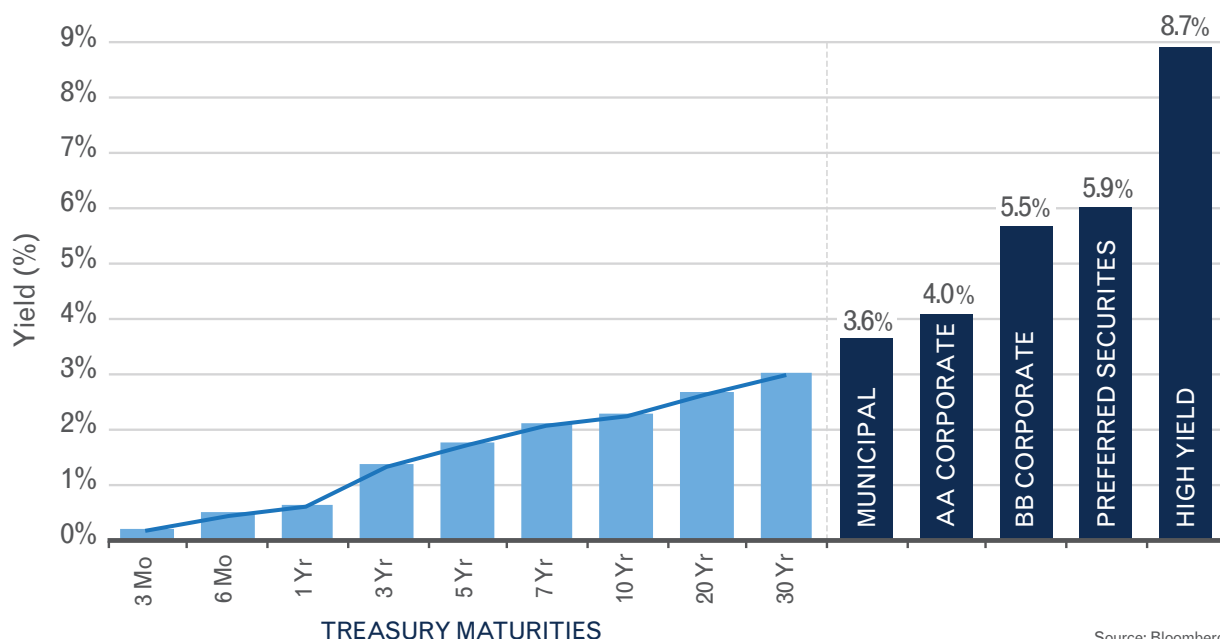
Lower-tier investment-grade corporate bonds provide sufficient yield pick-up to higher investment-grade alternatives with only a slight increase in risk. For risk tolerant investors, the high-yield corporate space is widening out toward more normalized levels. Supply will continue to challenge investors in 2016. This may be particularly true with longer maturing, credit safe municipal bonds (10 to 20 year) that provide higher tax-equivalent yields versus most fixed income alternatives.

Overall, successful fixed income strategies rely less on market timing and more on customization. As with last year, the most prominent fixed income dynamic will be the continuation of low interest rates. ■

#### KEY TAKEAWAYS:

- Individual bonds are perhaps the only investment that will provide continuous cash flow as well as return of principal, regardless of interest rate changes.
- The Treasury debt supply is anticipated to be lower in 2016, and what supply is issued is projected to be weighted more heavily in bills or short-term notes.
- Treasury rates are publicly touted as being low, but spread products such as corporate bonds, preferred securities and municipal bonds enjoy attractive yields.
- A most appropriate plan of action for 2016 will continue to be a laddered fixed income structure, which mitigates interest rate risk.

#### U.S. TREASURY YIELD CURVE VS. SPREAD PRODUCTS 12/24/2015



Sources: Yield Data: Federal Reserve, HY: Avg YTW on Barclays High Yield Very Liquid Index as of 12/28/2015, Preferred Securities: Dividend Yield based on Wells Fargo® Hybrid and Preferred Securities Aggregate Index as of 12/28/2015

Source: Bloomberg



# Light at the end of the tunnel for oil; natural gas still in the dark

**Pavel Molchanov**, energy analyst, equity research, sheds some light on the energy outlook for 2016.

The brutal 18-month downturn for the global oil market has a silver lining – as an old industry saying goes, “the cure for low oil prices is low oil prices.” A painful and protracted austerity – drilling halted, projects canceled, workers laid off, even outright bankruptcies – carries the seeds of an oil price recovery toward the end of 2016 and ramping up in 2017.

## **OIL RECOVERY NEAR, SUPPLY RISKS REMAIN ELEVATED**

The long-standing theme in commodity markets – energy and non-energy alike – is that they overshoot on both the upside and the downside. While it's hard to say for sure whether the recent market decline's brief encounter with below \$40 per barrel prices marked a long-term bottom, what is clear is that prices below \$50 do not generate acceptable drilling economics in the vast majority of non-OPEC geographies. The price environment will eventually have to recover to support a more sustainable level of industrywide investment.

Given the extent to which capital budgets were curtailed in 2015, and likely even more so in 2016, we think it will be essential for a higher level of spending to materialize in 2017. To enable that, prices will have to strengthen in advance. After lingering weakness in the first half of 2016, we project both Brent and WTI crude oil rebounding into the \$60-plus range in the second half.

Investors should keep in mind that stocks tend to react before the commodity does, so it's not advisable to get too cute with timing. We also think the risk of a potential oil supply disruption remains much higher than the oil market is currently discounting. Should unexpected supply disruptions emerge –

“After lingering weakness in the first half of 2016, we project both Brent and WTI crude oil rebounding into the \$60-plus range in the second half.”

in the Middle East, for example an all-out war with ISIS, or perhaps elsewhere – that would almost certainly create upside to our price forecast.

## **A BEARISH PICTURE FOR NATURAL GAS**

Natural gas presents a different picture for the coming year, in a decidedly bearish way. In North America, production growth is outstripping demand growth, and not by a small margin. On the supply side, increased pipeline takeaway capacity in the Northeast during 2016 to 2018 is

easing pricing pressures and inducing producers to complete more wells from inventory; and continued increases in well productivity and drilling efficiencies are allowing operators to maintain production with fewer rigs.

On the demand side, development of industrial gas demand has been frustratingly slow, and the ramp-up in solar and wind has been eating into gas's market share gains in the U.S. As such, we project a decline in Henry Hub gas prices in 2016 to a more than 10-year low of \$2.00/Mcf\* – in contrast to the recovery we envision for oil.

While gas prices are structurally higher in Europe and Asia-Pacific, market fundamentals in these regions are not in great shape either. European gas demand is languishing near 20-year lows – quite a stunning statistic. Japanese demand for liquefied natural gas (LNG) is under pressure as nuclear reactors are gradually brought back online, and Chinese LNG demand is not growing as robustly as the industry would have hoped.

In the meantime, six Australian LNG export projects will be starting up over the next 24 months, boosting global liquefaction capacity by nearly 20%. LNG exports from the U.S. Gulf Coast are also about to get underway, though it will not be enough to boost domestic gas prices until 2018 at the earliest.

\*Mcf is an abbreviation denoting a thousand cubic feet of natural gas.



## THE IMPACT OF REGULATION

Above and beyond the usual commodity price volatility, the increasingly widespread regulation of carbon emissions around the world is another important theme energy investors will need to be aware of in 2016 – and, even more so, in subsequent years.

Following the United Nations climate conference (COP21) in December, there is stronger international cooperation on emissions, encompassing both industrialized and developing countries. Individual countries will set their own policies on how to reduce emissions, such as carbon taxes (e.g., Japan and Mexico) and/or cap-and-trade policies (e.g., European Union and China).

Although the impact of such policies on specific energy sources is not always going to be predictable, in general the beneficiaries will be the zero/low-carbon sources, including various types of renewables, nuclear power in a limited number of countries and, in some cases, natural gas. For example, solar penetration in the U.S. electricity market is on the cusp of reaching 1%, while in Germany and Italy it is already above 7%. Energy efficiency and grid modernization investments are also likely to accelerate.

Given the supply glut going into 2016, energy prices should remain, broadly speaking, low. That said, we are more optimistic on a six- to 12-month recovery in oil prices as compared to natural gas prices. Selectivity is important when investing in this sector – but after five years of energy's underperformance versus the S&P 500, we think 2016 will, for the most part, be a better year for energy stocks. ■

## KEY TAKEAWAYS:

- Due to supply going into 2016, energy prices should remain low, and we are more optimistic on a six- to 12-month recovery in oil prices compared to natural gas.
- Selectivity is important when investing in this sector but, for the most part, 2016 will be a better year for energy stocks.
- An important theme, besides price volatility, that energy investors will need to be aware of is the increasingly widespread regulation of carbon emissions around the world.





# Looking ahead at housing

**Paul Puryear**, director of real estate research, shares his thoughts on real estate trends, inflation and rising rents.

The U.S. housing market continues a measured, albeit unimpressive, recovery and we expect this to continue into 2016. The prognostications of a ramp back to 1.5 million housing starts, which we never projected, have been pushed further out, and we now believe this economic cycle may well end before we get back to those “trend-line” levels.

## NEW TRENDS

Affordability issues continue to challenge first-time buyers, and the dramatic shift in housing preferences for the 80 million millennials entering their prime rental/ownership years is producing trends never seen in U.S. housing markets. On a positive note, the big surprise in 2015 was the acceleration in household formations, which jumped to 1.6 million households annually from run rates approximating 500,000 households during the trough period from 2006 through late 2014.

It is important to note that this robust level of net household formations is being driven entirely by rental households, both multifamily and single family. This is a trend that has reversed the dramatic owner-occupied housing bubble of the 2000 to 2005 period, which saw the rate of owner-occupied households top 69%. Since 2004, there have been 9.4 million rental household formations representing all of the U.S. household formations over that time, a trend we expect to continue. Therefore, we continue to favor rental housing investments as we enter 2016.

“Expect new and existing home prices to trend higher in 2016 at a 2% to 5% rate.”

## APARTMENT RENTS RISING

Rents continue to track higher as demand outstripped substantial construction deliveries of multifamily units in 2015. We expect similar levels of new construction and demand in 2016. On the single family rental front, any excess inventory is rapidly being absorbed and homebuilders are no longer building any material new supply of entry-

level “workforce” housing. This is creating a significant supply/demand imbalance for affordable single family homes with first-time buyers constrained by tight mortgage credit availability. More young families are renting as they move to the suburbs and face challenges with affordability.

## REAL ESTATE INFLATION

We often remind investors of the benefits of real estate inflation and nowhere is it more apparent than in single family housing construction. Homebuilders are seeing 5% to 6% increases in building costs, construction and land, with labor and lot cost driving the increases as commodity prices are holding most material costs in check.

Expect new and existing home prices to trend higher in 2016 at a 2% to 5% rate, well above current CPI projections. Housing starts and new home sales should also move moderately higher this year with single family starts growing at a low double-digit pace year-over-year. Existing home sales should also increase in 2016 at a low single-digit pace, as we have finally absorbed the excess single family inventory created during the over-leveraged housing boom that ended in early 2006. ■



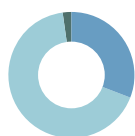


#### KEY TAKEAWAYS:

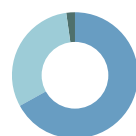
- The U.S. housing market continues a measured, albeit unimpressive, recovery and we expect this to continue into 2016.
- The robust level of net household formations in 2015 is being driven entirely by rental households, both multifamily and single family, a trend that has reversed the dramatic owner-occupied housing bubble of the 2000 - 2005 period.
- Homebuilders are no longer building any material new supply of entry-level "workforce" housing, creating a significant supply/demand imbalance for affordable single family homes with first-time buyers.
- We often remind investors of the benefits of real estate inflation and nowhere is it more apparent than in single family housing construction.

## STRATEGIC ASSET ALLOCATION MODELS

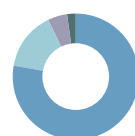
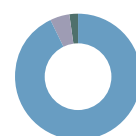
Raymond James asset allocation targets are based on the contributors' changing views of the risk and return in the various asset classes, looking out over three or more years. These models assume fully allocated portfolios and do not take into account outside assets, additional cash reserves held independent of these fully allocated models or any actual investor's unique circumstances. Investors should consult their financial advisor to decide how these models might assist in the development of their individual portfolios.



CONSERVATIVE

CONSERVATIVE  
BALANCED

BALANCED

BALANCED  
WITH GROWTH

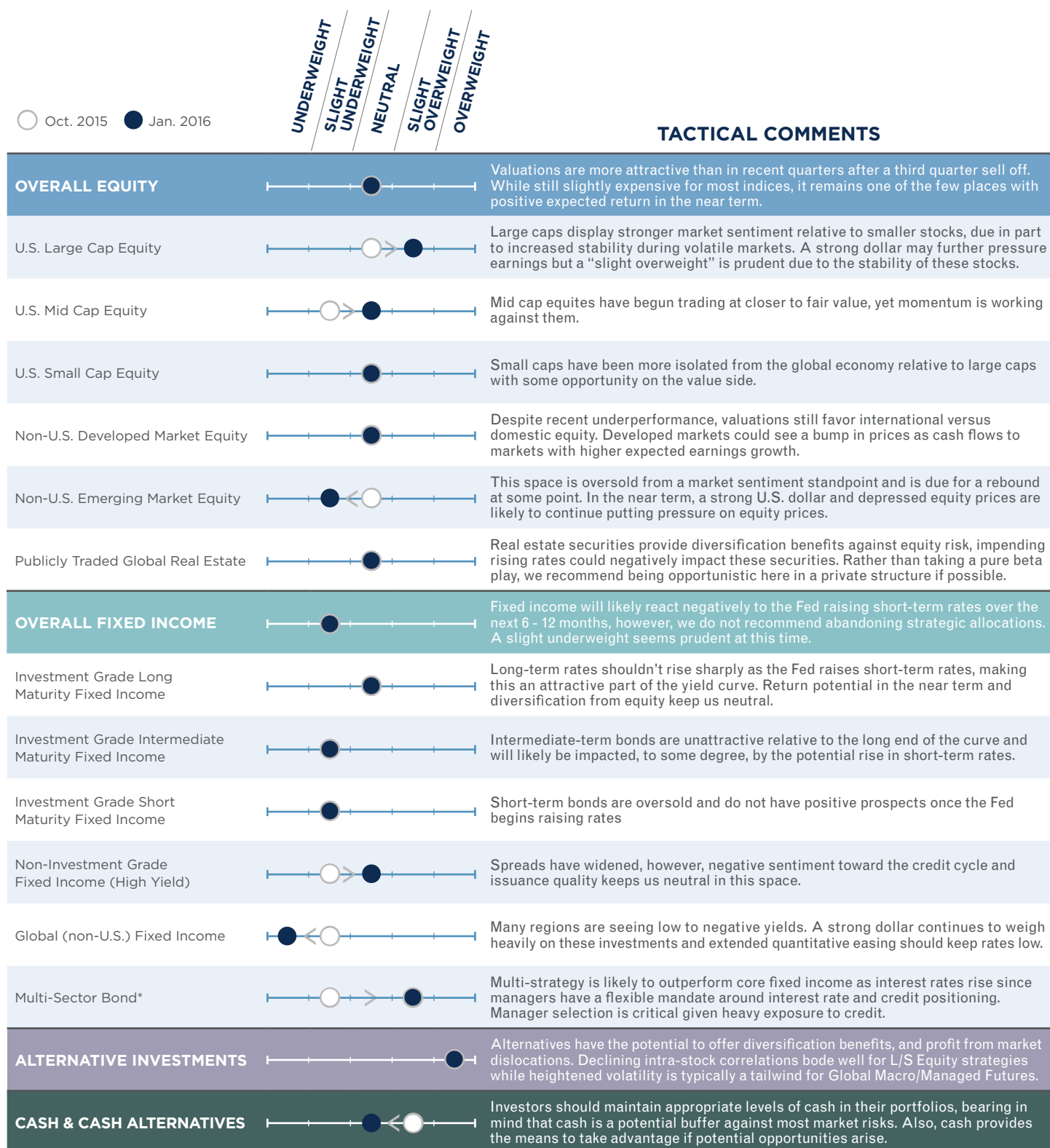
GROWTH

	31%	51%	67%	78%	93%
<b>EQUITY</b>					
U.S. Large Cap Equity	18%	31%	35%	35%	42%
U.S. Mid Cap Equity	4%	7%	9%	10%	11%
U.S. Small Cap Equity	2%	3%	5%	6%	7%
Non-U.S. Developed Market Equity	7%	10%	14%	17%	21%
Non-U.S. Emerging Market Equity	0%	0%	4%	6%	8%
Publicly-Traded Global Real Estate	0%	0%	0%	4%	4%
<b>FIXED INCOME</b>	<b>67%</b>	<b>47%</b>	<b>31%</b>	<b>15%</b>	<b>0%</b>
Investment Grade Long Maturity Fixed Income	0%	0%	0%	0%	0%
Investment Grade Intermediate Maturity Fixed Income	39%	27%	17%	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	4%	4%	4%	0%	0%
Multi-Sector Bond*	15%	11%	6%	0%	0%
<b>ALTERNATIVE INVESTMENTS</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>5%</b>	<b>5%</b>
<b>CASH &amp; CASH ALTERNATIVES</b>	<b>2%</b>	<b>2%</b>	<b>2%</b>	<b>2%</b>	<b>2%</b>

\*Refer to page 34 for multi-sector bond asset class definition.

## 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	Until mid-2015, correlation among stocks within the S&P 500 was notably above historical averages. This type of environment is challenging for long/short equity managers given that stock selection is not rewarded and short positions were increasing despite potentially poor underlying characteristics. Since the middle of the summer, correlations have decreased and managers have the potential to generate alpha on the short side of the portfolio. Managers are seeing a more robust opportunity set on the short side and have, in general, been proving that sentiment with lower net exposures than they have had in the past several years.
MULTI-MANAGER/ MULTI-STRATEGY	For investors seeking a lower volatility, lower beta strategy, the multi-manager strategy could be a good 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	A flurry of corporate activity over the past few years and an increase in Mergers and Acquisitions transaction flow point to a potentially lucrative environment for event-driven managers going forward. A continued rise in interest rates and corporate activity that is poised to remain strong provide good tailwinds for arbitrageurs, albeit successful deal selection has become more crucial as many large deals attempt to push regulatory boundaries. Credit-oriented managers are finding attractive opportunities in Europe and select sectors within the U.S., while on the activist front, the quest of activist investors to unlock shareholder value across various companies remains as robust as ever. A seemingly wider acceptance of activist practices by investors means that the strategy is likely to continue to enjoy increased flows, which, in turn, increases these managers' ability to effect change in companies of various market caps.
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.
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 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 12/31/2015*	4Q15 RETURN**	12-MONTH RETURN**
Dow Jones Industrial Average	17,425.03	7.70%	0.21%
S&P 500 Index	2,043.94	7.04%	1.38%
NASDAQ Composite Index	5,007.41	8.71%	6.96%
MSCI EAFE Index	1,716.28	4.71%	-0.81%
RATES	AS OF 12/31/2015	AS OF 9/30/2015	AS OF 12/31/2014
Fed Funds Target Range	0.25 - 0.50	0.00 - 0.25	0.00 - 0.25
3-Month LIBOR	0.60	0.33	0.26
2-Year Treasury	1.06	0.64	0.67
10-Year Treasury	2.27	2.06	2.17
30-Year Mortgage	4.01	3.84	3.83
Prime Rate	3.50	3.25	3.25
COMMODITIES	AS OF 12/31/2015	4Q15 RETURN	12-MONTH RETURN
Gold	\$1,060.00	-4.85%	-12.11%
Crude Oil	\$37.04	-17.85%	-30.47%

\*Price Level

32 \*\*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	20.9%	Tech remains one of our favored sectors. Relative to others, fundamental momentum supports an overweight position despite relative valuation levels that are approaching a 5-year peak. Relative performance remains strong. The recent pullback in prices looks like a buying opportunity.
	FINANCIALS	16.6%	Fundamental momentum is healthy relative to other sectors. Relative strength has improved slightly but has yet to turn positive. This could be a key sector in 2016 as interest rate movements will have a direct impact on most of the subsectors in the space.
	CONSUMER DISCRETIONARY	13.0%	Job growth and lower energy prices provide the consumer with more discretionary income. Fundamental results, valuation, and technical momentum all support an overweight stance. EPS growth should remain above average and valuations have retreated to attractive levels.
EQUAL WEIGHT	HEALTH CARE	15.0%	Healthy earnings growth is expected to continue and the recent give-back in stock prices leaves the sector attractive on a valuation basis. Relative price performance has stabilized. We remain equal weight until technical trends improve further.
	INDUSTRIALS	10.0%	We move to an equal weight (from an overweight position) in this sector. Expected improvements for the sector did not materialize due to macro challenges in manufacturing and transportation. Relative price performance has failed to improve as well.
	CONSUMER STAPLES	9.9%	Fundamentals have yet to improve. The path of the U.S. dollar will be key for this internationally-dependent sector. Relative valuation is slightly elevated vs. the 10-year average. Our equal weight is solely driven by the defensive nature of the sector due to the current challenging markets.
UNDERWEIGHT	ENERGY	6.5%	Industry adjustments to energy oversupply continue to weigh on fundamentals. With fundamentals and commodity prices in flux we remain underweight until signs that supply will clear.
	UTILITIES	2.9%	Relative valuation is attractive but growth is slow. Momentum remains weak as the fear of rising interest rates presents an overhang on this interest sensitive sector.
	MATERIALS	2.8%	Weak commodity prices continues to weigh on this sector. Although valuation is cheap relative to the 10-year average and earnings growth is projected to return in 2016, we remain underweight due to weak technical trends.
	TELECOM	2.4%	While relative valuation is well below the 10-year average, slow growth is expected in 2016. The sector has seen a slight uptick in relative performance yet the intermediate trend remains pointed down, leaving us negative on this sector.

## 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 S&P 500 is an unmanaged index of 500 widely held stocks.

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.

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