



## **Q1 Market Overview**

In a volatile first quarter, the S&P 500 fell 11% through mid-February as a global growth scare gripped the markets, but subsequently rebounded 12% amid improving economic data and a dovish Federal Reserve. For now the growth scare and recessionary fears seem to have ended, and despite a consensus view that global risk remains high, some glimmer of optimism and even animal spirits have appeared.

## **SIGNS OF SPRING**

China's economy appears to have stabilized, while U.S. growth remains slow but solid. Just as significant has been the policy coordination by the world's largest central banks to stop the U.S. dollar from strengthening and to stabilize major currencies. With recent signs of growth and monetary support, market confidence has improved and so has the economic outlook for the second half of the year:

- After a very hard and long winter for oil and commodities, oil prices have turned up 50% from the February bottom when they fell below the \$30 level.
- The dollar has stabilized and actually pulled back, providing a lift to oil prices (oil is a global commodity priced in dollars) and easing the pressure on U.S. manufacturers.
- Credit markets have improved and junk bond yields have declined.
- Emerging market stock markets have rallied and the Baltic Freight Rate (a shipping index and barometer of global trade) is up sharply from historic lows.

All of these favorable developments corroborate an improving global economy and possible end to global deflation. Here are three key implications:

1. If the U.S. and China economics are doing "ok", the dollar has stabilized, and oil has bottomed the outlook for S&P 500 earnings is better.
2. If the dollar has stabilized, the rig count decline is bottoming, and global demand improving, then the U.S. Manufacturing recession is likely over.
3. The Federal Reserve will need to tighten.

## **OUTLOOK**

Global growth remains challenged. The IMF, again, recently lowered its forecast for global growth to almost 3%. But despite slow growth, the outlook for earnings and for U.S. industrials is more positive than it was 2 months ago. Improving fundamentals, however, also means that the Fed will feel pressure to raise rates. Markets will have to come to grips with this if our economy is ever to normalize.

In regard to the equity market itself, stocks remain in a zone of reasonable valuation at about 15.5 times consensus estimates for 2016 operating earnings. It simply means stocks could easily go up or down by 10% depending on confidence.

Global Central Banks and policy makers remain stimulative. Janet Yellen and the Fed should remain in a dovish mode until the election, whether or not it manages to raise rates once before November. Little can or will get done in Washington prior to the election. All of this creates a broadly favorable backdrop for the U.S. equity market. Finally, the U.S. remains the best economy, best credit, but currency, and best market in an uncertain global environment. Over time, as more eloquently expressed below by Warren Buffet, this make U.S. equities the best and perhaps the only real choice for investors.

**While we do not often quote other investors, we thought it would be particularly valuable to leave you with Warren Buffett's recent market observation in this election year. It is good for many reasons, not the least of which is his well-grounded short and long term analysis of the positive elements of the market, our economy, America's current prospects and, importantly, his view of an American future.**

*It's an election year, and candidates can't stop speaking about our country's problems (which, of course, only they can solve). As a result of this negative drumbeat, many Americans now believe that their children will not live as well as they themselves do.*

*That view is dead wrong: The babies being born in America today are the luckiest crop in history.*

*American GDP per capita is now about \$56,000. As I mentioned last year that – in real terms – is a staggering six times the amount in 1930, the year I was born, a leap far beyond the wildest dreams of my parents or their contemporaries. U.S. citizens are not intrinsically more intelligent today, nor do they work harder than did Americans in 1930. Rather, they work far more efficiently and thereby produce far more. This all-powerful trend is certain to continue: America's economic magic remains alive and well.*

*Some commentators bemoan our current 2% per year growth in real GDP – and, yes, we would all like to see a higher rate. But let's do some simple math using the much-lamented 2% figure. That rate, we will see, delivers astounding gains.*

*America's population is growing about .8% per year (.5% from births minus deaths and .3% from net migration). Thus 2% of overall growth produces about 1.2% of per capita growth. That may not sound impressive. But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in real GDP per capita. (Compounding's effects produce the excess over the percentage that would result by simply multiplying 25 x 1.2 %.) In turn, that 34.4% gain will produce a staggering \$19,000 increase in real GDP per capita for the next generation. Were that to be distributed equally, the gain would be \$76,000 annually for a family of four. Today's politicians need not shed tears for tomorrow's children.*

*Indeed, most of today's children are doing well. All families in my upper middle-class neighborhood regularly enjoy a living standard better than that achieved by John D. Rockefeller Sr. at the time of my birth. His unparalleled fortune couldn't buy what we now take for granted, whether the field is – to name just a few – transportation, entertainment, communication or medical services. Rockefeller certainly had power and fame; he could not, however, live as well as my neighbors now do.*

*Though the pie to be shared by the next generation will be far larger than today's, how it will be divided will remain fiercely contentious. Just as is now the case, there will be struggles for the increased output of goods and services between those people in their productive years and retirees, between the healthy and the infirm, between the inheritors and the Horatio Algiers, between investors and workers and, in particular, between those with talents that are valued highly by the marketplace and the equally decent hard-working Americans who lack the skills the market prizes. Clashes of that sort have forever been with us – and will forever continue. Congress will be the battlefield; money and votes will be the weapons. Lobbying will remain a growth industry.*

*The good news, however, is that even members of the "losing" sides will almost certainly enjoy – as they should – far more goods and services in the future than they have in the past. The quality of their increased bounty will also dramatically improve. Nothing rivals the market system in producing what people want – nor, even more so, in delivering what people don't yet know they want. My parents, when young, could not envision a television set, nor did I, in my 50s, think I needed a personal computer. Both products, once people saw what they could do, quickly revolutionized their lives. I now spend ten hours a week playing bridge online. And, as I write this letter, "search" is invaluable to me. (I'm not ready for Tinder, however.)*

*For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honored and perhaps made more generous. And, yes, America's kids will live far better than their parents did...*

Warren Buffett  
2015 Berkshire Hathaway Annual Report