CORRIGAN FINANCIAL, INC.

Market Update: August 2016

Global stock markets were unusually quiet during August … almost an eerie calm. Trading ranges were the narrowest in decades, with benchmark returns, both domestic and foreign, ending the month essentially unchanged.

Low interest rates continue to dominate investment returns. Recent comments from Janet Yellen, Federal Reserve Chairwoman, have raised expectations of at least one rate hike before the end of the year. Expectations of rising interest rates caused bonds and *bond like proxies* to fall. Utility stocks, for example, were the worst performing sector in August with losses of over 6% … after entering the month up 20% for 2016.

Searching for Yield:

The stampede into dividend-paying stocks has been nothing short of amazing. According to Morningstar, assets under management of mutual funds and exchange-traded funds focused on dividend paying shares have more than doubled over the past five years. While valuations in this sector have become stretched, the income from dividend stocks remains attractive in comparison to the low yields offered by the bond market.

> **It is a common belief that aggressive pursuit of risk is the major cause of financial mishaps, but the desire for safety can be a big problem, too. It is when investors believe something is basically safe – whether that is Mexican government bonds in 1993 or investment-grade mortgage-backed securities in 2006 – that things can go awry.**
>
> **Mike Bird – WSJ 8/22/16**

S&P 500 companies collectively returned 112% of their earnings through dividends and share buybacks during the first half of 2016. That is well above the 82% average over the past 15 years … and not realistically sustainable.

> **When the music stops, there could be substantial fallout.**
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> **Alexander Paulsen, Parametric Portfolio Assoc. – WSJ 8/27/16**

In summary, even as investors dial-up portfolio risk levels, the markets appear quite peaceful. Don't be fooled by the serenity. Complacent investors eventually get burnt.

News from the Economic Front:

- Bolstered by job gains, along with low interest rates and gasoline prices, consumer spending rose for the fourth straight month.
- GDP for the second quarter was revised to 1.1% - down from last month's 1.2% estimate.
- The Commerce Department released revised corporate profit figures showing after-tax unadjusted profits increasing 2.5% during 2014 … but falling by 8.5% for all of 2015.
- According to Labor Department data, wages were up for all private-sector workers, with growth rates reaching seven-year highs. Workers at the bottom quarter of the income scale saw the highest overall pay increases in July, with gains driven by competition for workers and minimum wage hikes.

> **If you ask franchisees what the biggest issue they have right now is, it's finding people.**
>
> **Nigel Travis CEO, Dunkin Brands Group – WSJ 8/23/16**

- The Congressional Budget Office forecasts the U.S. budget deficit for this fiscal year (which ends September 30) to climb to $590 billion, or 3% of GDP. Federal spending expanded by 5% against only a 1% increase in revenues. Last year's deficit was $438 billion, or 2.5% of GDP.

> **Mandatory spending today amounts to nearly 70% of federal spending, a record, and is rising. In short, the federal budget deficit is about to explode … The problem is that government debt is simply bad for growth.**
>
> **David Ader –Barron's 9/5/16**

In response to the financial crisis and recession, central bankers effectively choreographed a *race to the bottom* with global interest rates. The result being propped up asset values for investors (stocks, bonds, real estate), while savers (savings, money markets, CDs) have been left out in the cold.

The tailwind to asset prices from falling interest rates is largely behind us.

PIMCO (Key Investment Themes) – 8/24/16

With stock valuations strained, where do we go from here? Working our way *up from the bottom* could prove to be a challenge. Investors will need to expand their investment tool-kit beyond traditional asset classes, become a little more defensive, and lower their overall return expectations for the foreseeable future.

Justifications for the continued run-up in the S&P 500 Index over the past few years have been many, but the one constant has been this: Just look at how low the 10-year U.S. Treasury yield is! This relative return framework can be a dangerous one and can lead to perverse conclusions about capital markets.

GMO Commentary – August 2016

For now, we can expect any rate increases by the Federal Reserve to be small and gradual at best. The U.S. economy continues to *plod along*, and stronger growth is expected for the third quarter.

Global debt levels, relative to GDP, are still on the rise. Excessive debt restrains economic growth … it's almost like trying to run a marathon with a refrigerator tied to your back. So, until budget deficits for the developed world are at or below GDP growth rates, it will be extremely difficult for the global economy to reach escape velocity.

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