Inside Views From an Investment Management Leader

UPDATE

July 2016

About our Company

Company Profile:

Concord Investment Counsel is a private, boutique investment firm who has helped our clients grow and protect their wealth since 1991.

Key Offerings:

- *Personal wealth management*
- *Proactive investment strategies*
- *Proprietary research*
- *A professional team*
- *Fee-only services*

Distinguishing Values:

- *Passion for excellence*
- *Strategic focus*
- *A disciplined process*
- *Prudent risk management*
- *Comprehensive client care*
- *Superior long-term performance*
- *Sound judgment*
- *Objective Analysis*

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In the News

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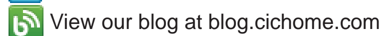
Why wait for paper when you can get the latest thoughts from your wealth manager in real time? Economic updates from Mitch Pletcher are seen first in real time by following Concord Investment Counsel around the web. Tune in for our exclusive up-to-the-minute commentary!



Economic Review & Outlook

U.S. Consumer takes back Role as Workhorse

The US has been the consumption engine for the world's goods and services since this great economic cycle began in 1982. It wasn't government spending, or Corporate spending that led this great cycle of consumption, but in fact was individual Americans consumers who were the fuel for the engine. The US consumer was refined into high octane fuel with easy access to cheap debt by the federal reserve. This dangerous fuel mix ultimately became the consumer's undoing. The cycle ended in a horrible bust in 2008 with the financial industry virtually bankrupt from high exposure to distressed debt, and consumers and governments around the globe virtually handcuffed with debt loads that were difficult to service.

The US consumer has been retrenching now for eight years as well as the rest of the globe. Overall consumption remains weak globally but notably is recent trends in US consumption with steady and accelerating consumption from the US consumer. The US consumer, who was the workhorse for the global economic engine for 25 years, has returned to lead the globes consumption trends.

Mitch Pletcher
President
Chief Investment Officer

The Chinese economy has softened due to overconsumption by the state and the related debt and now political problems in that nation as the Chinese demand for democracy and accountability for the debt creates unrest. China is consuming more and more goods and services from America but it is still not meaningful to America's $17 trillion economy. Approximately 1.5 trillion of America's $17 trillion in annual production of goods and services is exported. (pg. 4, fig. 1). Less than 80 billion of that 1.5 trillion goes to China. This number has been growing rapidly over the past decade and may well become meaningful over the next decade.

Despite the very difficult environment, the American consumer lives within optimism in America remains quite high and as a result consumption trends are encouraging. A quick review of overall consumption of US

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Economic Review & Outlook (continued)

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goods and services confirms this statement.

Mitch Pletcher
President
Chief Investment Officer

US personal consumption currently stands at 12.7 trillion annually 30% or more above its 2008 low of 9.7 trillion. (pg. 4, fig. 2). US government consumption has been flat since 2010 at approximately 3.2 trillion per year. Consumption by US Corporations has likewise been flat as corporate spending tends to lag economic growth. US exports which are the smallest of the group have been in decline since October 2014 and are currently averaging approximately 120 billion per month. This is partially due to currency conditions but also related to a dampened appetite for US goods as global growth muddles along.

The earnings outlook for US stocks has not improved and earnings for the S&P 500 have been flat since 2014. Last quarter earnings expectations rose modestly for the consumer discretionary sector, industrial sector, utilities, and consumer staples. Earnings expectations fell in the quarter for energy, technology, financial, and healthcare sectors.

While the US consumer is still carrying a mountain of debt, the near zero interest rates have allowed the service of this debt to remain manageable and somehow the US consumer remains confident despite an extreme debt problem, political leadership problems, terrorism, and racial tensions. The resilience of the American consumer is clearly the best in the world.

The financial markets performed well in the second quarter of 2016. The S&P 500 gained 2.5%. Concord's Diversified Equity portfolio gained 2.7%, and Concord's Dynamic Growth portfolio gained 1.6%.

We remain optimistic!

Table 1: Stock & Bond Market Returns *6/30/16*

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	0.6%	2.8%	Small Cap Value (IWN)	4.4%	-2.5%
Large Cap Value (IWD)	4.5%	2.7%	Small Cap Growth (IWO)	3.4%	-10.5%
Europe Asia Far East (EFA)	-0.3%	-9.5%	Emerging Markets (EEM)	1.1%	-11.2%
Invest Grade Bonds (LQD)	4.1%	9.5%	High Yield Bonds (HYG)	5.1%	1.0%
Interm Treasurys (IEF)	2.8%	9.5%	Mortgage Bonds (MBB)	1.0%	4.2%

Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

Table 2: Real Estate & Commodity Returns *6/30/16*

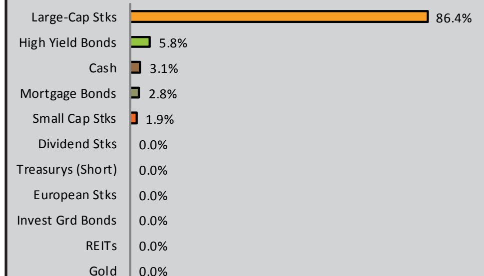
	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	6.7%	20.5%	DJ Commodity Index (DJP)	15.0%	-14.9%
Int'l Real Estate (IFGL)	0.8%	1.1%	Goldman Commodity (GSG)	12.5%	-26.5%
NAREIT Residential (REZ)	3.1%	25.4%	Gold (GLD)	7.5%	12.5%

Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

CIC Managed Accounts

Growth Portfolios

Dynamic Growth
A dynamic blend of stocks, bonds, commodities, REITs, and cash for growth investors with a bias toward timely asset classes.



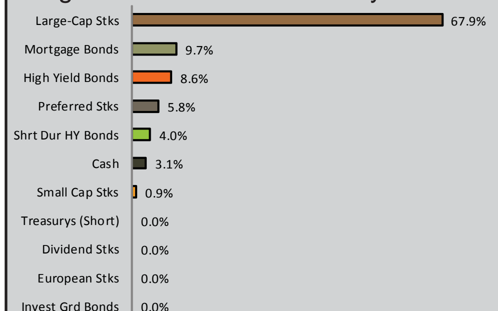
Growth
A portfolio of large- and mid-cap US stocks that are industry leaders with strong brands and timely products.

Diversified Equity
A global, all-cap equity portfolio following economic trends across capitalization and geographic ranges.

Focused REIT
A portfolio of companies whose primary business is owning and leasing real properties.

Balanced Portfolios

Asset Allocation for Income
A portfolio of stocks, bonds, and cash for moderately-conservative investors seeking income and growth with relative stability.



Equity Markets: Consumption Drives Growth

Earnings growth drives leadership in the stock market, while consumption generally drives earnings. Every market cycle has consumption themes which are either secular or cyclical in nature. Here's what is active in this market cycle.

Secular Consumption Themes:

- **Theme:** Global demand for wireless devices, digital media and cloud computing power. Demand growth is a product of industry's ability to innovate. Sector: Technology
- **Theme:** Global demand from wealthier and growing emerging market populations for meat and poultry to support more "western-like" eating habits, as well as growing demand for technologies that provide greater agricultural yields.
  Sector: Materials
- **Theme:** Global demand for energy as population grows as well as increasing demand for the technologies that make it viable to extract natural resources from the farthest reaches of the earth. Sector: Energy
- **Theme:** Increasing demand for healthcare as population ages, as well as growing demand for new and better products provided by innovation in the development of life-saving drugs, devices, and services. Sector: Healthcare

Cyclical Consumption Themes:

- **Theme:** The return of mild consumer discretionary spending balanced against purchasing decisions based on need instead of want. Sector: Consumer Discretionary/Staples
- **Theme:** Pent-up demand within the enterprise upgrade cycle. Sector: Technology
- **Theme:** The re-surfacing of emerging market infrastructure spending. Sector: Industrials
- **Theme:** Credit market stabilization and a return of demand for investment banking products and services. Sector: Financials
- **Theme:** The return of demand for manufactured products.
  Sector: Industrials, Energy

Commentary: Safe-Haven Sectors Remain in High Demand

Safe-haven sectors lead for the second quarter in a row, as investors digested mixed U.S. economic data, global growth fears, and the widely unanticipated Brexit vote. Utilities, Telecom, and Consumer Staples were again among the top performing sectors. Healthcare also performed well, although energy lead the way for equities as oil prices rebounded sharply during the quarter from the prior February lows. Safe-haven sectors have clearly become richly valued relative to the market as a whole. If strong U.S. consumer trends remain, more modestly-valued sectors like consumer cyclicals likely present good opportunities going forward.

Sector Performance Review *6/30/16*

	Quarterly Change	Trailing 12-Months
Energy	11.2%	-6.7%
Telecom	7.3%	23.3%
Utilites	7.0%	31.5%
Healthcare	6.2%	-3.4%
Consumer Staples	4.7%	17.4%
Materials	4.2%	-1.1%
Financials	2.6%	-2.7%
Industrials	1.3%	5.3%
Consumer Discretionary	-1.2%	2.0%
Technology	-2.3%	3.6%

Data based upon Russell 1000 Index and GICS sectors. Source: Bloomberg Financial

Fixed Income Review

By Kyle Aron

U.S. Resilience Shines

Kyle Aron
Senior Analyst

U.S. markets were a bright spot in the globe this past quarter, showing resilience through the seminal Brexit vote at the close of June. In fact, the S&P 500 is now up approximately 15% from its February lows. U.S. stocks have, to an extent, shaken recession fears alongside confidence in domestic economic resilience.

However, economic data in the U.S. continues to be mixed, as most recently evidenced in the employment sector. Jobs data reported this past June showed May job gains of only 38,000 – the lowest monthly gain since the recession, and well below the post-recession average of approximately 200,000 per month. In conjunction with continuing global economic uncertainty, the Federal Reserve has retrenched into its dovish posture. Notably, the Fed declined to raise interest rates at this past June meeting, and the odds of a rate hike this coming September are now only half of where they stood at the end of the first quarter in 2016 – currently 18%. Nonetheless, U.S. consumption and GDP growth remain the strongest of developed nations around the globe.

Alongside the Fed's dovish maneuvering and tumult in other developed economies, investors steadily bought into U.S. equities in the second quarter, particularly non-cyclicals like healthcare and consumer staples. The S&P 500 ended the quarter up 2.5%. Meanwhile, amid the Brexit fallout, European equities ended the quarter down nearly 4.0% (EZU). Japan and China ended the quarter down 6.9% and 1.6%, respectively, as China continues to struggle with its cooling economy and Japan deals with negative government bond rates and almost no GDP growth. Gold rallied amid the global turmoil tied to Brexit, which was further bolstered by the Bank of England's anticipated move expanding quantitative easing to dampen near-term Brexit damage. Gold ended the quarter up 7.5%, and is up nearly 25.0% for the year. Oil rallied strongly after touching mid-$20 lows last February, getting as high as $51 in late June before closing the quarter just over $48/barrel. REITs, predictably, notched gains similar to investment grade fixed income, up strongly with a 6.8% gain for the quarter (IYR).

Fixed income performance was strong nearly across the board during the second quarter, for a variety of reasons. Long Treasurys (TLT) performed the best (+7.0%), fueled by global unease along Brexit, dovish U.S. monetary posture, and continued low rates among other developed nations' government bonds. At quarter end, both German and Japanese government bonds up to 10 years in maturity were selling with negative yields. Global investors seeking relatively good yield from high quality bonds have few places to turn outside U.S. Treasurys. Expectedly, mid-term U.S. Treasurys (IEF) also performed well for the quarter, up 2.8%.

High-yield corporates (HYG) saw strong performance for the quarter (+5.2%), as the beleaguered energy issuers looked more favorable alongside the surge in the price of oil. Worth noting, defaults in the high yield space have been highly concentrated over the past year, to the tune of almost 90%, in the energy and metals/mining segments. With oil up roughly 100% from its mid-February lows, and metals like gold up nearly 25% YTD, high yield's strong recent performance has been well deserved. Low global yields and unease in other large economies outside the US also led investors to investment-grade corporates, which were up over 4.0% for the quarter.

(continued on pg. 4)

Fixed Income Review (continued)

(contined from pg. 3)

Financial preferred securities (PGF) did similarly well, up approximately 3.5%. Mortgage bonds (MBB) were the poorest performers of the bunch, up just under 1.0% for the quarter.

With U.S. equity markets back near all-time highs, it remains to be seen whether the U.S. can continue to show strength with global conditions seemingly so weak and uncertain. To be sure, the US has led the developed world in growth since the recession. Given this backdrop, however, fixed income segments like high yield offer good opportunity as they will likely see further support alongside stabilizing commodity prices, which may offset any turbulence markets experience if U.S. growth falters. Overall, with U.S. debt offering some of the highest relative yields in the developed world, it is likely that demand for U.S. debt across the quality spectrum won't be facing any abrupt pullback in the near future.

A Word From Our Advisory Team

Jill Pletcher
Vice President
Senior Financial Advisor

The Cost of Retirement Goes Up!

While the inflation rate has been subdued for over 20 years there has been significant inflation in some assets and services. Further, the cost of retirement has been rising at a concerning rate over the last 10 years. While the expenses we incur in everyday retirement life have not risen measurably, our ability to generate fixed income in retirement has diminished considerably. For those of us who locked into pension payments years ago when interest rates were much higher than today this problem has not been noticeable. However, for those of us who live primarily off of the income generated from their investments, the last few years of modest income has become concerning.

Japan has experienced this problem for decades and it has changed the lifestyles of retirees and forced people to work longer and harder before entering retirement.

The problem is all about ultra-low interest rates that seem to be here to stay. Ten years ago a 10 year treasury note yielded 5% and a AAA rated IBM 10 year corporate bond returned 5.7% . Today the yield is 1.4% and 2.3% respectively. The income on a treasury portfolio is 72% lower and a corporate bond portfolio is 60% lower. To generate $100,000 of income in today's environment from a corporate bond portfolio you would need capital of over $4.3 million. Likewise, in an ultraconservative treasury portfolio you would need over 7.1 million to generate $100,000 a year in income. This is a real problem as very few people who plan for retirement put away enough money to generate the income they need based upon today's interest rates. For the last few years investors had hoped that the ultra-low interest rate environment was only temporary and would subside. It is becoming clear that ultra-low interest rates are likely here to stay for a long period of time.

This problem has caused alternative investments to run up in value. Investors hungry for yield have driven up valuations on other income vehicles. REITS, utility stocks, and high-yield debt are all trading at all-time highs for prices and all-time lows for yield.

Investors are now being forced to deal with the reality that the luxury of days of old where high income could be achieved from relatively low risk investments are gone. To achieve a 5 to 7% income today requires risk. This involves market risk, credit risk, or duration risk.

The harsh reality of this analysis is that an investor today must plan to use his principal throughout his retirement and will no longer be able to live from the income alone.

Economic & Financial Market Charts

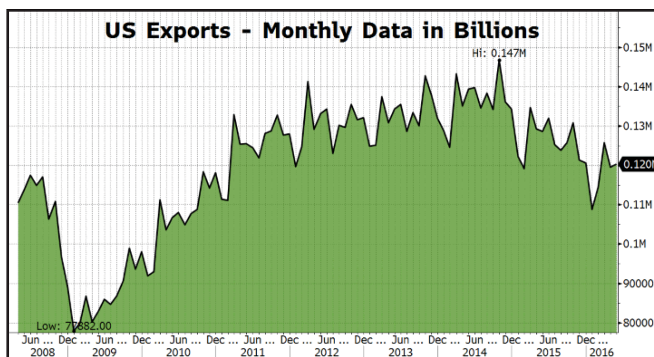


Figure 1 - Source: Bloomberg Financial

Graph of U.S. Exports, showing total export value as approximately 9% of current U.S. GDP

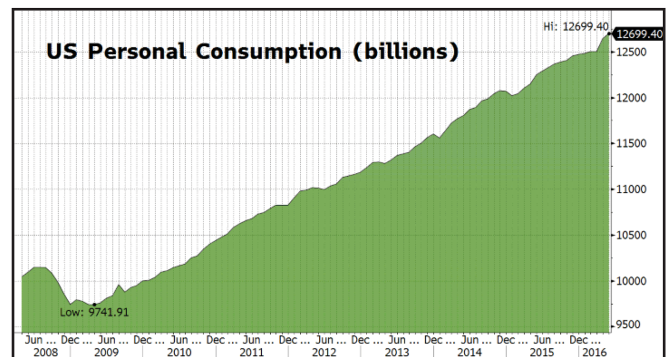


Figure 2 - Source: Bloomberg Financial

Graph of US Personal Consumptions Expenditures, showing significant gains since 2009 recession lows