CAHABA Wealth Management Inc.

Quarter in Review

It was a tale of two halves in the first quarter of the year for financial markets. Stocks plunged early on, falling 10-15% or more, but then sharply reversed, staging a furious rally into quarter-end. Emerging-markets stocks led the charge, gaining 5.9% for the quarter. Larger-cap U.S. stocks finished in the black, up 1.3%, though domestic small-cap stocks trailed, down 1.5%. Foreign stocks failed to keep pace in the rally, ending with a 1.9% loss for the quarter. And while the 10-year Treasury yield rose from its mid-quarter low, it still finished 49 bps below where it started the year. As such, core bonds are up 3.1% year to date.

March Benchmark Returns (Preliminary)			
Large Cap Benchmarks	**Mar**	**1Q**	**YTD**
Vanguard 500 Index	6.8%	1.3%	1.3%
iShares Russell 1000	7.0%	1.2%	1.2%
iShares Russell 1000 Growth	6.7%	0.7%	0.7%
iShares Russell 1000 Value	7.3%	1.6%	1.6%
Mid-Cap Benchmarks			
iShares Russell Mid-Cap	8.1%	2.2%	2.2%
iShares Russell Mid-Cap Growth	7.2%	0.6%	0.6%
iShares Russell Mid-Cap Value	9.2%	3.9%	3.9%
Small-Cap Benchmarks			
iShares Russell 2000	8.0%	-1.5%	-1.5%
iShares Russell 2000 Growth	7.6%	-4.6%	-4.6%
iShares Russell 2000 Value	8.3%	1.8%	1.8%
Other Benchmarks			
Vanguard FTSE Developed Markets ETF	7.2%	-1.9%	-1.9%
MSCI World ex USA Index	6.9%	-1.8%	-1.8%
Vanguard FTSE Europe ETF	7.0%	-2.2%	-2.2%
Vanguard FTSE Emerging Markets ETF	12.7%	5.9%	5.9%
Vanguard REIT Index	10.4%	6.2%	6.2%
Vanguard Total Bond Mkt Index	0.9%	3.1%	3.1%
BofA Merrill Lynch U.S. High Yield Cash Pay	4.4%	3.2%	3.2%
Vanguard Intermediate-Term Tax-Exempt	0.3%	1.6%	1.6%
S&P/LSTA Leveraged Loan Index	2.8%	1.5%	1.5%
Citigroup World Govt. Bond Index	2.7%	7.1%	7.1%

Broadly speaking, the stock market decline in the first half of the quarter was due to:

- *ongoing fears of a hard landing in the Chinese economy*
- *a continuing plunge in oil prices to under $30 per barrel*
- *some weaker-than-expected U.S. economic data and growing fears of a global recession*
- *a contagious loss of market confidence (whatever little remained) in the ability of global central banks to stimulate real economic growth*

On the last point, the Bank of Japan surprised markets by joining the negative interest rate policy (NIRP) club at the end of January. The BOJ pushed its policy rate down to negative 0.1%, joining the European Central Bank, which later lowered its rate to minus 0.4% in March.

A Tale of Two Halves			
Asset Class	**1/1/16–2/11/16**	**2/12/16–3/31/16**	**YTD 2016**
U.S. Stocks	-10.3%	+12.9%	+1.3%
Developed Int'l Stocks	-12.2%	+11.8%	-1.9%
European Stocks	-12.1%	+11.3%	-2.2%
Emerging-Markets Stocks	-10.9%	+18.8%	+5.9%
Core Bonds	+2.4%	+0.7%	+3.1%
High-Yield Bonds	-5.1%	+8.8%	+3.2%
Floating-Rate Loans	-1.4%	+3.0%	+1.5%
Managed Futures	+9.0%	-5.4%	+3.1%

Then, beginning February 12 everything changed. Oil prices spiked higher. Stock markets started moving higher.
High-yield bond prices started moving higher. Core bonds fell and the 10-year Treasury yield moved higher. These broad market trends continued through March, as shown in the table at the bottom of the page.

In the United States, the Federal Open Market Committee held its mid-March meeting and did not raise rates, stating that "global economic and financial developments continue to pose risks." But it also highlighted solid U.S. economic fundamentals. Financial markets responded positively to the Fed announcement, with stocks and commodities continuing to rally.

Our investment outlook—both in terms of potential return and risks—has not materially changed over the past quarter. But in the context of the market's recent gyrations, we'd like to highlight reasons for optimism. In short, the post-financial-crisis period has been dominated by a few very strong market trends. It is important to view these for what we believe they are—cycles that will eventually turn and may be in the process of turning. Our next section discusses the concept of cycles as well as several very specific cycles we've experienced in recent years.

Cycles of Investor Behavior

We often talk about cycles when discussing our investment philosophy and asset allocation approach. This is because financial market and economic history is a series of multiyear cycles. These cycles are driven by natural human behavior, and from that we expect *markets* to continue behaving in a similar manner to that which they've always done.

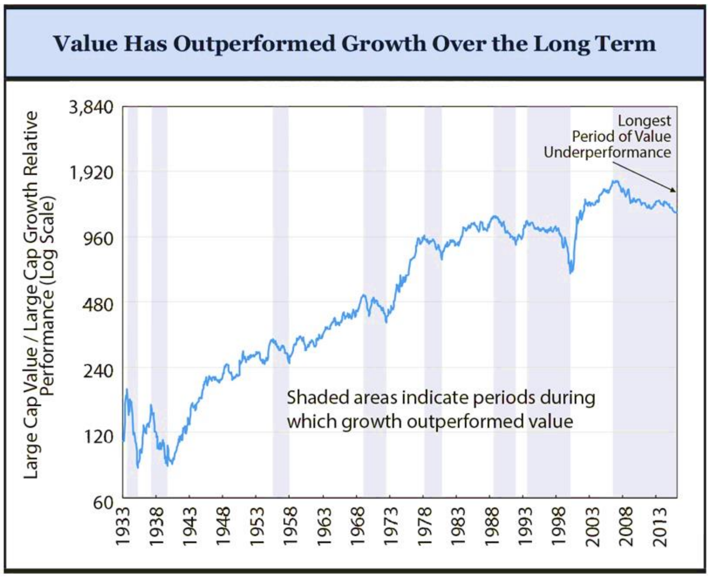
The existence of market cycles creates significant risks for investors who ignore them (i.e., the "this time is different" syndrome) and great opportunities for disciplined long-term investors. But while this time is rarely different when it comes to investing, neither history nor cycles repeat in exactly the same manner. It is therefore critical that investors have the ability to withstand meaningful market volatility and short-term losses in the pursuit of higher long-term returns. This is precisely why more conservative risk-averse clients have portfolios with lower allocations to stocks. Most importantly however, all client portfolios regardless of their risk tolerance are diversified across many investment styles and strategies in order to minimize risk and maximize potential return.

It is impossible to consistently and accurately predict exactly when a cycle will turn or when the pendulum will start to swing back the other way. But with our long-term analytical framework and forward-looking assessments that are informed by and grounded in market history, we can position client portfolios to benefit from the cyclic swings of the pendulum. This requires having a long-term perspective and the discipline to stick to and execute your process over time, especially when the cycle and pendulum are swinging to extremes.

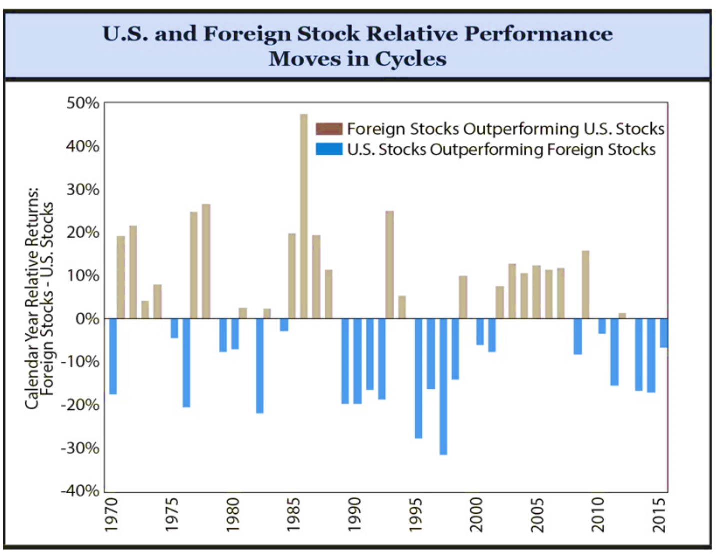
Market Cycles and Portfolio Positioning

In recent years, markets have been positioned for a turn in some cycles that haven't yet changed course, namely U.S. stocks versus foreign stocks, and value versus growth stocks. The charts below show the relative performance cycles for both of these markets.

U.S. Versus Foreign Stocks—over the next 5-10 years, U.S. stocks are likely to deliver underwhelming returns (low single digit), while foreign stocks are poised to produce much higher returns. U.S. stock outperformance versus foreign stocks now ranks as the longest relative performance streak for U.S. stocks since the inception of the international stock index in 1970.



Source: Morningstar and Kenneth French. Data as of 2/29/2016. Data prior to 1979 is from Kenneth French's database. Value is defined as high book-to-market ratios and growth as low book-to-market ratios. From 1979 onward we use the Russell 1000 Value Index and the Russell 1000 Growth Index.



Source: Morningstar. Data as of 2/29/2016. Foreign stock returns tracked using the MSCI World ex USA Index from 1970 to 1987 and the MSCI ACWI ex USA Index from 1988 onward.

Here are just a few points that illustrate why we believe this cycle will eventually turn:

- *U.S. profit margins have been coming down, but are still high relative to history and are likely to continue lower as the labor market tightens.*
- *Meanwhile, the 12-month trailing price-to-earnings ratio for the S&P 500 is 24x, and the 12-month forward P/E ratio is 18x.*
- In contrast, foreign stock markets are almost a mirror image of the U.S market, with below-normal earnings and the potential for faster earnings growth from current levels.

Value Versus Growth Stocks—In another unusually long cycle, this has been the longest run of underperformance for value stocks on record going back to 1930, at nearly 10 years (outlasting the six-and-a-half years of the Internet/tech stock bubble). The flipside has been that growth and momentum stocks experienced unusually strong returns.

The chart above shows that over the long term a value investment approach has meaningfully outperformed a strategy of buying expensive (growth) stocks. But there are cycles. Value investing has had several periods of significant underperformance. The inability of most investors to stick with a value approach during such cyclical reversals is likely what enables the "value premium" to persist over the long term. And the short-term performance-chasing tendencies of most investors pushes the pendulum still further.

Concluding Comments

Markets are cyclical, and for the past several years these cycles have continued to levels not seen in a generation. As discussed above, the sharp reversal in the markets beginning in the middle of the first quarter may indicate the current market cycles are coming to an end. However, even if the recent positive market trends turn out to be short term or reverse course, we remain confident that a disciplined investment and risk-management process, consistently executed over time, will pay off over the completion of many market cycles. It is impossible to consistently time short-term market moves, trends, and reversals. As always, patience, discipline, and fortitude remain key to achieving one's long-term investment goals, and to avoid getting swept away by the pendulum's unceasing swings.

-We thank you for your continued support!