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Issue 93 ***Fall Quarter, 2015***

It looks like a good time to be a buyer of equities. They certainly have been on sale in recent weeks. The third quarter was a rough quarter for stocks. The S&P 500 dropped 6.9%, European Stocks fell 8.8%, and China plunged 28.6%, while Emerging Markets as a whole sank 18.5%. Even Japan, a recent safe haven, lost 14.1%. Commodities also finished lower, though we believe oil may have bottomed for this cycle.

Bonds fared better, actually earning a positive return. The Barclay's U.S. Aggregate Bond Index closed up 1.3% for the quarter.

As we indicated in our last newsletter, we were anticipating the long-awaited 10% correction. It has occurred. For most accounts with equity exposure, we sold stock funds to raise cash in July with the intention to seek investment opportunity by reinvesting the funds at lower levels. We reinvested a great deal of that cash back into stock funds in early October. Historically, for U.S. markets, 10% corrections have occurred every eighteen months or so on average. This time we went four years before experiencing a downturn of that magnitude. We believe the Federal Reserve's Quantitative Easing (QE) helped delay this process.

As of the writing of this newsletter in early October, it appears that a market reversal occurred on Friday, October 2. And while we feel there will be continued volatility, we nevertheless believe this correction phase may be over for the most part. A majority of corporate earnings are due to be released before November, and other than unknowable geopolitical events, we believe earnings will have the greatest impact on fourth quarter performance.

Some domestic economic weakness should be expected due to foreign weakness. One example of this would be Canada. It is in recession due to the fact that Canada is a major natural resource exporter of oil, gas, coal, iron ore, copper, etc.; all these commodities are out of favor (natural resource mutual funds fell 21% on average last quarter).

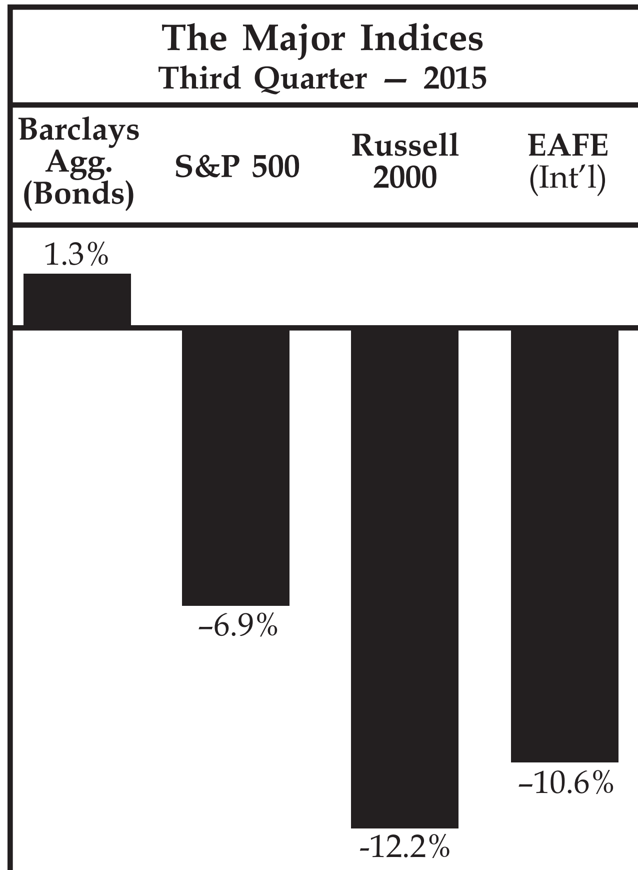
Historically, the fourth quarter is quite good. Since 1990, the S&P has gained an average annual return of 5% during the last 90 days of the year. December has historically been the best month of the year for market performance. We are guardedly optimistic that this historical trend will once again help move the market higher.

Staff Change. Our wonderful receptionist and administrative assistant Julie Coffey has taken a job with Wake Forest. Her degree from UNC-G will be put to better use in her new position there, but she will be missed here. We have filled her position with a terrific young lady from here in Davie County, Marci Howard, who will join us beginning October 19. Please join us in welcoming Marci. She will often be the first voice you hear when calling our office.

Fall Open House. We hope to see you at our fall open house on October 23 from 4:00 to

6:30 p.m. here at our office. We look forward to seeing you.

Market Review and Forecast. Yuk! Maybe that one word sums up concisely most investors' reactions when they look at last quarter's statements this month. The market's quarterly results were the worse since 2011: the Dow fell 7.6%, the S&P 500 declined 6.9% percent, and the small-cap Russell 2000 cratered 12.2%. (The average U.S. stock fund lost a little more than 8%.)



Diversification overseas made matters even worse. The EAFE international index plunged 10.6%, as the dollar remained high against foreign currencies. (One estimate is that the largest 800 U.S. corporations lost $85 billion in overseas profits the first six months of this year due to the strong dollar.)

One of the biggest quarterly losers was, of course, the energy sector, which fell 18%. With oil prices per barrel now in the $40s, almost 5 percent of oil companies have defaulted on their loan payments this year, the highest since 1999 when oil plunged briefly to $10 a barrel. The number of oil rigs now operating in the U.S. is at a five-year low.

One oil company CEO quoted last month in the Wall Street Journal said: "Frankly, at the end of the day, none of us have a great sense for where oil prices are going." (We don't either, but our best guess is that prices will stay in a $40 - $55 per-barrel range for the rest of the year.)

Of course, continuing lower energy prices have helped increase consumer confidence that has certainly contributed to the highest new-home purchases in eight years and an all-time record for new car sales. Last month's new car sales, reported last week, jumped 17% over 12 months ago.

An astute reader might ask: If consumer spending is strong, the unemployment rate is down to 5.1 percent, and GDP (revised) grew a surprisingly high 3.9 percent during the second quarter, why did the market have it first "correction" in four years? (A "correction" is a decline of 10 percent or more but less than the 20 percent or more loss that creates a "bear market.") From its May all-time high to its closing low of August 25, the S&P 500 fell 12%.

We can cite four reasons that may explain our sell-off. Most importantly, we think, is slowing global growth, particularly in China, as it transitions from a former manufacturing-export driven economy to one based more on consumer spending.

The September Chinese manufacturing index came in at 47 (a 50 rating indicates neither growth nor decline), its lowest level since 2009. However, the Chinese consumer market continues its rapid expansion: for example, Apple now sells a third of its high-priced I-phones there. Also, Disney and its Chinese partners will open a $5.5 billion park in Shanghai next year where there are 32 million people in the urban area. China has an expanding middle class that is

becoming increasingly urban as illustrated by the fact that China has 160 cities with a population of one million or more. By contrast, the U.S. only has 16.

After more than doubling in less than a year, the Chinese market declined about 30% last quarter, but is still up over 20% this year. Chinese authorities made their "bear market" even worse by trying to manipulate the market (forbidding short sales, ordering purchases, and even briefly jailing a hapless forecaster who predicted the market would decline).

Slowing global growth was one reason the Fed did not raise interest rates September 17 as many had forecast. At first the market rallied almost 200 points as Fed Chief Janet Yellen held a news conference that afternoon where she seemed fairly upbeat on the U.S. economy. Then, in the last hour of trading, the market fell 258 points as traders focused on the Fed's statements about declining global-growth rates. (The International Monetary Fund is predicting an overall 3.1% growth rate for the world's economies this year, down from its 3.3% forecast six months ago.)

A second reason for our third-quarter losses is the uncertainty about when the Fed will raise interest rates. A USA Today headline on September 18, "Uncertainty Reigns Supreme," said it all. Virtually everyone expects that the Fed will raise interest rates, either before year-end or early next year, but no one knows when. Given very little inflation, predictions of U.S. economic growth for the last two quarters of this year down to the 2% range, and the strong U.S. dollar, a valid argument can be made that the Fed should not raise rates.

Reason number three is the decline in U.S, corporate profit growth. Profits are expected to be 5% less than a year ago and about 10% less than originally forecast last January. Mostly, the pessimistic profit picture is caused by the stronger dollar and plunging oil-company profits. (Energy is about nine percent of the U.S. economy.) The good news is that it seems doubtful that oil prices will fall much farther and the dollar may not appreciate much more against foreign currencies.

The final reason for the market's dismal performance in the third quarter is the least important, but historic. The 6½ year bull market that began in March, 2009 has produced stellar returns. Furthermore, we had gone four years since the last correction, a 19% drop in 2011. Thus, we were long overdue for a 10% decline. Since World War II, U.S. stocks have averaged a 10% or more correction about every 18 months. When we hit our low for this year on August 25, the S&P 500 was down more than 12% from its May record high.

Going back both 50 and 100 years, September is the only month that records an average monthly loss for U.S. stocks. This year, the S&P 500 fell 2½% last month after declining 6% in August. Often, market rallies begin in mid-October and we know that historically November and December have by far the best two-month returns. And despite convincing evidence of a slowing economy, we believe the same thing is unfolding this year. The fourth quarter could bring a nice rebound for stocks.

Our major domestic concern is the summer slowdown in manufacturing that has contributed to fewer new jobs. Non-farm payrolls increased a disappointing 142,000 last month when a 190,000 increase was forecast. The monthly average for the third quarter at only 167,000 is 48,000 below the average for this year's first six months.

Even though the unemployment rate stayed at 5.1% for September, the workforce continues to shrink and is now at its lowest percentage level since 1977. Yet paradoxically, there were 5.7 million job openings ads in July, about a million more than 12 months earlier and almost 2 million more than in the summer of 2013.

It is also somewhat disconcerting that almost all of the 17 chief economists at the biggest brokerages and banks are extremely bullish -- most of them predicting that we will reach or exceed our all-time May highs by year-end. To get back to our May high, the S&P 500 must gain 12.5% this quarter. That seems too optimistic to us. So often, when there is an "expert consensus," the consensus predictions are simply wrong. Hopefully, our consensus at Woodard and Company for a positive fourth quarter will prove correct.

Interest Rates. The Federal Reserve in fact did not raise interest rates in September as we and many other professionals in the investment industry previously predicted. This decision to abstain on the first rate increase in close to ten years caught many "experts" by surprise. After all, the Fed has been indicating all year the economy was strong enough to support an interest rate increase, most likely in September of 2015. However, after citing global concerns as the reason for not raising rates, some members of the Fed are indicating rates will still be hiked this year, either this month or in December. Who knows at this point? The Federal Reserve may have painted itself into a corner and become part of the problem, creating more market uncertainty, instead of a solution. (Markets abhor uncertainty.)

The 10-Year Treasury closed the quarter yielding 2.06%. Over the last 52 weeks the yield has seen a high of 2.48% and a low of 1.66%, with 1.66% being the lowest in three years. The Barclays Aggregate Broad Market Index year-to-date is positive 1.1%, while intermediate-term corporates over the same time frame are up 1.5%. Overall, treasury bonds had a nice third quarter, returning on a broad level approximately 1.8% over that time.

Inflation expectations by bond investors have drastically subsided, which contributed to good performance for higher-quality bonds. Because of the lowered inflation expectations, Treasury Inflation Protected Securities have taken a beating, dropping 1.2% last quarter.

Some of our clients with fixed income exposure may notice some excess cash in their accounts. The most likely reason for this cash is that back in late summer we sold our high-yield bond funds. It is our opinion that bond investors in general have more exposure to credit risk rather than term risk. As a result, after having liquidated clients' high-yield positions, we will very soon be transitioning that cash into intermediate-term, high-quality bond funds. This should bring additional stability to portfolios with fixed income allocations and provide a modest return.

Commodities were generally soft in the third quarter of 2015. Domestic crude oil production has fallen to the lowest level in over a year and prices continue to remain below $50 per barrel. While that translates into less pain at the pump for consumers, the short-term effect on domestic oil and energy producers is certainly negative. As events occur in the Middle East involving Russia, Syria and Iran, it will be very interesting to see how the unfolding of those events impacts the global pricing of oil. We look for a slight rebound in oil prices as we move into the colder winter months, but we believe that black gold will remain range bound for the next year, most likely staying below $60 a barrel.

Please let us know if your circumstances, needs, risk tolerance, or objectives shift which may have an impact on the way we manage your assets. We can and will respond to your needs by tailoring the allocation to meet your criteria. We look forward to hearing from you and discussing any issues that would relate to our management of your assets. Please call us at 336-998-7000; we always look forward to talking to our clients.