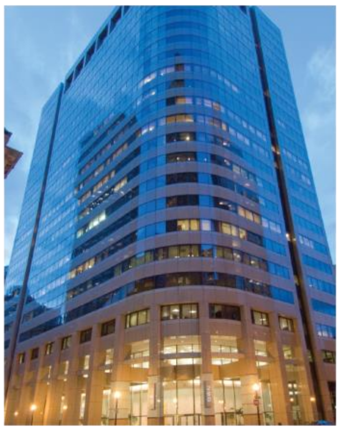
TFC FINANCIAL
The Financial Counselors

MARKET UPDATE
AUGUST 25, 2015

OUR VIEW



Temporary Correction or Signal of a Bigger Problem?

Longer term, bear markets usually precede economic recessions. At the moment, according to most economists, in the US no such reversal is in prospect (see J.P. Morgan chart which follows this letter). But as our elected solons and appointed bureaucrats in DC have ceded all fiscal responsibility to our central bankers (Federal Reserve Bank, or Fed) the Fed finds itself with an empty toolbox as it tries to clean up its stimulus excesses of the past 6-7 years. Relying solely on monetary policy to reinvigorate and reflate the US economy has been a risky platform on which to build a sustainable economic recovery. As we have suggested in past communications, this approach has been adopted more or less universally outside the US, so a worldwide glut of cheap money is roaming the globe seeking return.

Reasonably free financial markets generally reflect the combined wisdom at any given moment of those who place their money at risk. For the most part, aside from the currently underway mainland China "learning experience," our global investment markets are relatively efficient. These information discounting mechanisms that have evolved worldwide provide both simple and complex proxies for individuals and institutions to vote instantaneously with their capital. But, of course, putting money at risk in free market environments entails uncertainty, exposure to geopolitical conflicts, politically compromised, often unsound, policy decisions, and sometimes just bad luck.

Rising markets ascend slowly, reversals are usually precipitous

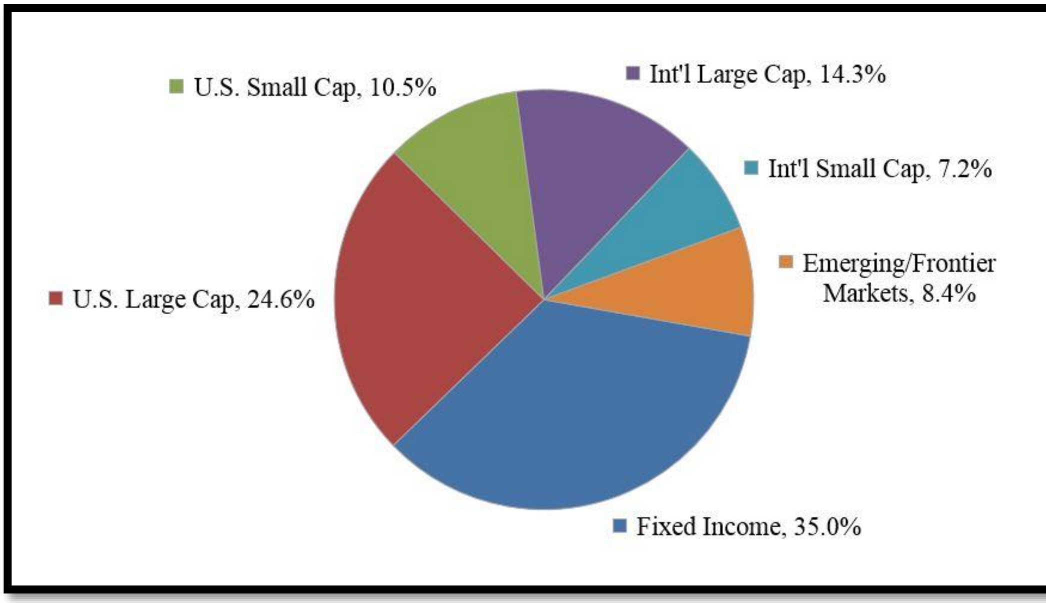
Rising equity markets, long-term bull markets, ascend slowly, usually stealthily against the disbelief of the majority. This recent upturn, which in retrospect began in March of 2009, until the past two weeks had gone 1,418 calendar days without a 10% correction—the third longest such streak in the last half-century.* Throughout the past 6+ years, stock market price volatility has been remarkably muted. *Investors remained invested throughout*; speculators, high frequency traders, and momentum riders played their computerized financial modeling games. Hedge fund managers followed their own "unique" strategies.

Behind the curtain, our Federal Reserve Board, absent any constructive fiscal discipline from the Federal government, supplied unparalleled amounts of cheap cash to prop up both the US housing market and reflate the nation's institutional and personal balance sheets. During this 7-year *emergency period* monetary policy has been aggressively accommodative; massive amounts of new money have been forced into the banking system, but most has found its way into domestic and global financial markets, not lent out to support growth in the REAL economy. The result has been that having trotted out all the past known, and in some cases experimental monetary policy innovations (e.g., Quantitative Easing or QE), the Fed finds itself with an empty bag void of remedial monetary policy tools.

* J.P. Morgan, e-mail August 21, 2015

So it's left to the global financial markets to sort through the variety of possible outcomes. As this occurs, it's important to keep in mind not to panic, and to beware of anyone who professes to know what will happen next! Diversification globally, perseverance and discipline at times like this are an investor's best tools. (See typical TFC account asset class diversification illustration below).

Global Diversification remains the best investment policy



As markets continue under stress, it would not be surprising to learn that a number of alternative fund constructs (e.g., hedge funds) might fail due to counterparty contract fulfillment problems. Similarly, exotic investment funds holding high yields bonds or leveraged floating rate notes and bank loans could run aground.

Don't Just Sit There, Do Something

At instances like these, the urge to "do something constructive" is often irresistible. But it strikes us that although it's a reasonable reaction to the pressures of the moment, the essential question which matters is what was done in anticipation of this. Over the past 12 months, our proactive adjustments have included:

The urge to act is hard to resist

- Periodic rebalancing of client portfolios to their appropriate asset mix of stocks and bonds which has meant adding to cash and bonds during rising stock markets;
- December 2014-January 2015 – sold remaining position in global natural resources equities, reduced emerging market exposure by 30% (from 14% to 10% of combined portfolio value), plus increased US equity allocation;
- Trimmed exposure to direct mainland Chinese stocks to less than 1.5% of equities;
- Where appropriate and tax-efficient, offset equity risk exposure with shorter duration, top-quality, highly liquid fixed income positions, and
- In instances where portfolio cash outflows could reasonably be anticipated, early this year, built cash reserves to cover estimated needs.

If equity markets are even remotely efficient, then, of course, there are no free lunches to be had. But anomalies occur and markets overreact, often violently on the downside. So, there are times when price is not indicative of value. Reading and tracking this dynamic relationship between price and value is a discipline carried out incrementally over time. Trying to just do something in the heat of the crucible when what behaviorists term the "activity bias" intrudes, may result in less-than-optimal decisions.

As always, we welcome your comments and questions.

Sincerely,

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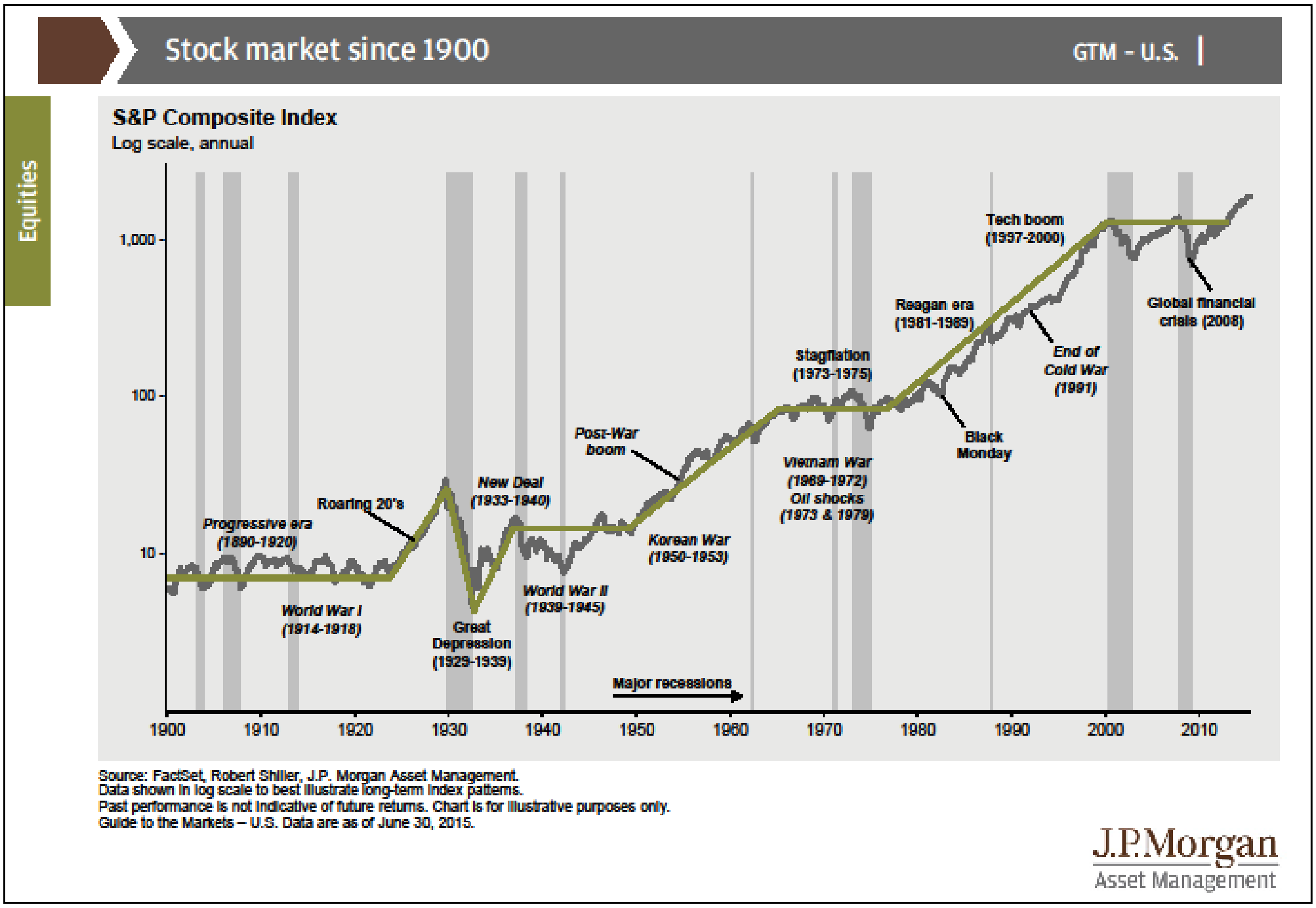

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