F.L.PUTNAM
INVESTMENT MANAGEMENT COMPANY

MARKET INSIGHT
MARCH 2016
VOLUME 15, ISSUE 1

R. THOMAS MANNING, CFA
Chief Executive Officer and President
tmanning@flputnam.com

ELLEN FLAHERTY
Sr. Vice President, Chief Operating Officer
eflaherty@flputnam.com

ROBERTSON P. BREED, CFA
Sr. Vice President, Portfolio Manager
rbreed@flputnam.com

ELLEN K. HAZEN, CFA
Sr. Vice President, Portfolio Manager
ehazen@flputnam.com

STEVEN N. VIOLIN, CFA
Sr. Vice President, Portfolio manager
sviolin@flputnam.com

D.J. SHAUGHNESSY, CFA
Vice President, Portfolio Manager
dshaughnessy@flputnam.com

ANDREW B. WETZEL, CFA
Vice President, Portfolio Manager
Senior Research Analyst
awetzel@flputnam.com

MICHELLE M. BUCKLEY
Research Analyst
mbuckley@flputnam.com

JOHN V. CARBERRY
Senior Advisor
jcarberry@flputnam.com

SUSANNE STAUFFER
Senior Portfolio Advisor
sstauffer@flputnam.com

CHRISTIAN D. MCVEY
Sr. Vice President, Marketing
cmcvey@flputnam.com

WENDY M. BUSH
Vice President, Development
wbush@flputnam.com

A TALE OF TWO MARKETS

Charles Dickens began *A Tale of Two Cities* with the famous line, “It was the best of times, it was the worst of times.” No truer words could describe the markets during the first three months of 2016. After falling nearly 11% in the first six weeks of the year, U.S. equities have rallied since a mid-February low and by quarter’s end the S&P 500 was back to positive territory. Global markets have since followed suit: European equities have posted low double-digit gains and emerging markets have also appreciated by more than 20% these last seven weeks. The rebound at quarter end does not the year make, however, and the debate over the direction of the global markets, with the U.S. at the forefront, rages on.

Relative to their fixed income counterparts, stocks still appear somewhat cheap, and with yields on stocks comparable to those on bonds, the case for an equal or slightly overweight position in equities relative to fixed income seems reasonable. In the corporate bond market, the significant year-to-date widening of corporate spreads over treasuries illustrates the stress that has recently befallen the market and has particularly impacted the energy sector. Of greatest concern is a fear that bankruptcies within this sector could impair the credit markets and ultimately impact the broader economy.

The early 2016 fears that corporate credit headwinds would send the economy reeling have given way: credit spreads have materially narrowed, the U.S. labor market has continued to strengthen, and monetary policy here and abroad has become more dovish. With the unemployment rate just below 5% and jobless claims at record lows, arguments for a consumer-led recession are weakening. Despite corporate profit challenges, employment agencies report increased demand for workers and wages are on the rise. Though fears of a U.S. slowdown linger, nothing about the current environment resembles previous recessions; key indicators suggest either expansion (supported by low inflation, the shape of the yield curve, housing starts and strengthening labor) or the status quo (reflected in manufacturing and capacity utilization).

Of the expansionary indicators, perhaps inflation and the yield curve are the most critical. U.S. inflation remains significantly below mandated levels. Should current levels persist through 2017, the Fed will have undershot its inflation goals for ten consecutive years. The media focuses much attention on the inevitability of Fed rate hikes, but in so doing, the central bank would break an historical rule of thumb: when inflation is low and expectations are not rising, do not raise rates.

Complicating issues further is the state of the natural interest rate. A post-crisis change in consumers' savings preferences, with average savings now up to 5%, along with cautious business investment has stymied a rise in the natural real interest rate. Investors may interpret rate hikes above the natural rate as problematic; they could potentially cause economic contraction. Lastly, the Fed has recently become more vocal about international factors influencing its decision making and global economic health remains precarious. Take all three together and the expectation of multiple rate hikes in 2016 has now dwindled to possibly two 25 basis-point hikes by year-end.

So, how will this all play out? Right now the bulls appear to have the edge (the market is after all positive for the year). They point to the constructive aspects of the current market environment: the Federal Reserve has seemingly backed off from rate hike rhetoric; the dollar climb has slowed and may reverse (potentially creating a tailwind for multinational corporate profits); inflationary pressures remain muted; monetary policy in Europe and beyond is accelerating; and commodity prices have rallied significantly off the lows. The bear case remains largely unchanged: global economic growth is well below capacity and, in particular, China continues to slow; the U.S. election is polarizing the country and fiscal policy is an unlikely lever to pull the economy out of its malaise; valuations are stretched; earnings are declining, etc.…

Our view of the world and the markets is largely unchanged. We began the year with the expectation of mid-single-digit returns for the S&P 500 (worse than average) with the potential for higher volatility on both sides of the ledger. Through the first half of the quarter, our outlook for equities may have appeared too optimistic, but at quarter's close, we still view these prospects as most likely. However, we admit uncertainty remains high and as such, we will look for opportunities throughout the year to reposition portfolios across asset classes, geographies and sectors to reflect the evolving nature of the markets.

2016 Market Diary

U.S. Equities	Last 3 Months	Last 12 Months *
S&P 500	1.6%	2.0%
Dow Jones Industrials	2.4%	2.3%
Russell 2000	-1.9%	-10.1%
Russell 3000	1.1%	-0.2%
International Equities		
MSCI All Country World Index ex-US	0.0%	-8.4%
MSCI Emerging Markets	5.3%	-12.0%
Fixed Income		
Barclay's U.S. Gov't/Corporate	2.4%	-0.3%
Barclay's U.S. High Yield	-3.9%	-4.5%

Source: *Bloomberg Capital Markets*

* Includes dividends for equity indices

20 WILLIAM ST., SUITE G40
WELLESLEY, MA 02481
781.235.6323
800.344.3435

155 FLEET STREET
PORTSMOUTH, NH 03801
603.766.4971

245 COMMERCIAL STREET, SUITE 500
PORTLAND, ME 04101
207.775.3197
800.356.1781