

Quarterly Market Commentary

Perspective on the economy and trends in the marketplace.

The stock market rally turned seven this year amid shifting global trends. Up until now, the U.S. has been the best house in a bad neighborhood, posting moderately positive growth that looked good in the context of weaker global growth and whose equity market outperformed every other asset class. This changed significantly during the first quarter as Europe took the lead and the U.S. faltered, with lackluster market returns. European equities surprised to the upside, buoyed by quantitative easing and a weaker Euro, while U.S. corporations got hit by weaker consumer spending and a strong dollar. Interest rates made history by turning negative in Europe and falling further in the U.S., as concerns over a lack of global growth drove investors to the safety and security of U.S. fixed income. For similar reasons, oil remains 50% off its 2014 highs, which continues to have a negative impact on energy related companies, but is supportive of the global consumer. In lieu of poor economic data year to date, caused by rare forces, including the coldest February since 1979, we believe these one-time economic events will have a diminishing impact and data will improve throughout the rest of the year.

■ U.S. Equities

As we anticipated, volatility increased this quarter with the S&P 500 returning -3% in January, +5.75% in February and -1.58% in March. In what has been a relatively unabated 6+ year bull run, the S&P 500 threatened to have its first negative quarter since 2012, but proved resilient, finishing the quarter up 0.95%. This volatility can be attributed to speculation around the timeline of the Federal Reserve raising interest rates, mixed economic data and continued weakness in the oil markets. The biggest news this quarter came out of the March Federal Reserve Meeting, in which Janet Yellen made dovish statements that reduced the probability of a rate hike until later this year. We feel this will provide a positive tailwind for stocks, as the Fed will not raise rates until they feel the economy is healthy enough to endure a tightening of monetary policy. Stocks will be additionally supported by a strengthening U.S. consumer, which make up the largest portion of the U.S. economy, and have benefited from a stronger labor market and low oil prices. The volatility we've seen throughout the quarter proved beneficial to our approach to equity diversification. A stronger dollar provided a boost to smaller companies, as large cap companies derive nearly 40% of their earnings from exports abroad. Small Cap Stocks (Russell 2000 Index) and Mid Cap Stocks (Russell Mid Cap Index) finished the quarter up 4.32% and 3.95%, respectively, far outperforming the S&P 500.

■ International Equities

Despite a strengthening U.S. dollar relative to foreign currencies, International Markets rallied in the first quarter, with the MSCI EAFE Index up 4.88%. International markets were bolstered by the announcement of a 60 billion Euro bond buying program by the European Central Bank (ECB). The ECB purchased over

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\$10.3 billion of bonds within its first three days and recent Eurozone data has suggested that QE is working, as lending to firms and households rose in February. We believe Europe is still in the early innings of their economic recovery, similar to how the U.S. looked in 2011. Europe today has low valuations, a weak currency, low GDP and an early state Quantitative Easing program. The stimulus in Europe has also trickled into strong performance in Emerging Markets, which were up 2.24% in the 1st quarter. Many emerging market countries drive a large percentage of their revenues from exports to Europe, which should increase as the ECB's stimulus program increases spending in Europe. Similar to International Developed equities, Emerging Markets have lower valuations relative to the U.S., but we are still mindful of the negative impacts of a strong U.S. dollar and low oil prices.

■ Fixed Income

Bond yields remained low with the 10 year U.S. Treasury rate falling for the fifth consecutive quarter, from 2.17% to 1.92%, due to low inflation and global rates at near-zero or negative levels. For the first time in history, German 5 year bonds were issued at a negative yield, in part due to the ECB's newly implemented quantitative easing program. This has pushed up demand for U.S. debt, increasing the price of U.S. bonds and keeping a lid on yields. While the rest of the world lowers interest rates to stimulate their economies, the Fed is on track to begin hiking interest rates here in the U.S. later this year. Once this begins, we don't expect a sharp rise in rates as long as the situation overseas remains unchanged. Most areas of fixed income posted positive returns for the quarter due to the decline in interest rates. The Barclays Treasury Index gained 1.64%, the U.S. Corporate Index rose 2.16% and the High Yield Index was up 2.52%. To benefit from falling interest rates, we lengthened the maturities of the LAMP portfolios and added an allocation to high yield, which generated increased income throughout the quarter.

■ Alternatives


As crude oil fell another 6.81%, Master Limited Partnerships (MLPs) lost 5.23% as measured by the Alerian MLP Index. Midstream MLPs are energy companies that primarily process, transport and refine crude oil and natural gas with revenues tied to the volume, not the price, of the actual commodities. As long as production remains stable or rises, the toll road nature of these businesses should support their values. Production has continued to rise and so we believe that this is an overreaction by the market. MLPs continue to provide a dividend of over 6% and have not declined during this period of turmoil, further proving that the underlying fundamentals are intact.



■ Real Estate

Home prices rose at a 4.5% annual pace in the first quarter, high enough to support homeowner confidence, but at a slow enough rate to keep affordability in check. Housing starts drastically slowed to 897 million, compared to the 1 million we had been seeing in the second half of 2014, but much of that can be attributed to the abnormally harsh winter weather in the Northeast. Contracts to purchase homes have been higher than expected, signaling optimism about housing once the spring thaw sets in. There remain many headwinds for potential buyers, including high debt levels and strict lending standards, but with an improved labor market for younger workers, we expect housing to steadily improve for the remainder of the year.

■ Conclusion

As we move forward, we expect the first quarter's earnings season to disappoint due to the underperformance of energy related companies and the negative effects of an exceptionally cold winter. Adding to this, uncertainty around Fed policies, global growth and mixed U.S. economic data will continue to be items of focus. As monetary policy diverges between the U.S. and the rest of the globe, we may see international markets outpace the U.S. for the first time since 2012. Despite the volatility surrounding the U.S., we still expect domestic equities to be resilient and fixed income to remain range-bound, as the strengthening consumer drives the U.S. through its seventh bull market year. We believe diversification will continue to be key in navigating these volatile times, bringing credence to our investment philosophy. 

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