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It feels like longer than four months ago when financial markets were obsessed by worries over an economic slowdown in China, the collapse in the price of oil and the prospect of a series of interest rate hikes by the Federal Reserve. As things stand today, however, the economy in China is showing early signs of recovery, energy prices have rebounded sharply from their February lows and discussion about increases in the discount rate have all but disappeared. In retrospect, the early year anxiety was overblown and those investors who avoided panic have been amply rewarded.

Despite periodic volatility, in 2016 financial markets have performed with remarkable stability. The S & P 500 Index increased 2.46% during the second quarter and 3.84% for the first six months of the year. Dividend paying stocks were especially strong and, as a result, value stocks outperformed growth stocks. Small caps, as measured by the Russell 2000 Index, recovered from a difficult first quarter to advance 3.79% in the second quarter. The NASDAQ Composite continued to underperform and was down 2.66% through June 30. And in a story that apparently doesn't want to end, the bond market outperformed equities. The Barclay's U.S. Aggregate Bond Index was up 5.31% through the second quarter. Remarkably, bond yields around the world hit all-time lows as the second quarter came to a close and then, on July 5th, the 10 year treasury closed at the historic low of 1.4%. We are happy to have the boost given to our investment portfolios from declining intermediate term interest rates, but do not expect bonds to continue their stellar performance in the second half of the year.

The final week of the quarter was extremely volatile as voters in the UK stunningly voted to exit the European Union. The initial reaction to the vote caused a violent two-day global sell-off in stocks which was immediately succeeded by a very impressive rally, particularly in the U.S. Nevertheless, worries about the effect of Brexit persist. While the full effect may not be known for years, there seems to be a near unanimous opinion that Brexit will, at the least, result in a reduction of global economic growth. As its effect on the U.S. economy is expected to be more muted, our path to an underwhelming 2% annual rate of growth appears on track. Despite the continued weak recovery from the great recession, major U.S. stock indices have now reached all-time highs. That milestone may not be enough to cheer impatient investors though, because despite the rally, the stock market has been largely treading water for the last 18 months.

Next, we look forward to the earnings season and the looming presidential election. Earnings, year over year, are expected to be good, as U.S. multinationals gain the advantage of a comparatively weaker U.S. dollar. Improved earnings and an accommodative Federal Reserve could lead to complacency about equity performance in the second half of the year. We intend to stay true to our portfolio allocations. The bull market in equities, despite the aforementioned leveling off in the last year and a half, is now technically seven years old. By historical standards, a seven-year advance places this bull market in its latter stages. We will also be interested to see how the race to the oval office plays out. Up to this point, the market has seemingly shaken off the spectacle. That could change, particularly if opinion polls begin to suggest that the party of the likely successful presidential candidate may also gain control of both houses of the Congress.

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