It's All about Earnings and Interest Rates

The equity markets have had significant swings, both up and down, in the first six months of 2016. Despite some negative data points, lower interest rates and the prospect of better second half earnings have moved the equity markets higher. We believe these gyrations are here to stay for the foreseeable future. Fear of a recession and the possibility of slower corporate earnings growth are the root causes of this volatility.

Most strategists and economists now expect sub-par global growth over the next few years. Indeed, the U.S. economy, growing at around 2%, is the strongest within the developed nation universe. Most developed nation markets are now expected to grow about 1% for the balance of 2016 and all of 2017.

Economists and Federal Reserve officials will continue to hope for an acceleration in economic growth now that interest rates are at extraordinarily low levels. In reality, the aggressive monetary easing in the U.S. and abroad has not fostered such an environment. The aggressive quantitative easing has resulted in global bond yields that are considerably lower than anyone ever really expected. Moreover, the 10 year yield is significantly lower than the Fed's own expectations of higher yields long term. Clearly, either the fixed income market or the global monetary authorities are wrong.

Chart I

GLOBAL RATE MATRIX (% Terms)

	3 Month	1 Year	2 Year	5 Year	10 Year	30 Year
Australia	1.72	1.64	1.65	1.65	1.99	-
Belgium	-0.61	-0.60	-0.59	-0.46	0.23	1.10
Canada	0.46	0.55	0.58	0.67	1.10	1.71
France	-0.59	-0.57	-0.55	-0.37	0.21	0.99
Germany	-0.74	-0.60	-0.66	-0.57	-0.03	0.50
Italy	-0.29	-0.16	-0.05	0.32	1.24	2.28
Japan	-0.29	-0.34	-0.33	-0.31	-0.23	0.19
Netherlands	-0.60	-0.63	-0.61	-0.59	-0.43	0.60
Norway	0.51	0.44	0.61	0.56	0.95	-
Spain	-0.30	-0.19	-0.12	0.27	1.22	2.32
Sweden	-0.65	-0.50	-0.63	-0.28	0.19	-
Switzerland	-	-0.90	-0.97	-0.93	-0.55	-0.06
U.K.	0.41	0.17	0.15	0.38	0.81	1.68
U.S.	0.30	0.50	0.67	1.12	1.57	2.28

Source: Strategas

No less than nine countries now generate negative yields for bonds of two-year duration or less. Four countries (Germany, Japan, Netherlands and Switzerland) have negative 10 year yields! With Germany representing the growth engine in Europe, a negative 10 year yield seems extraordinary. Very low to negative global bond yields should be viewed as an experiment by the global monetary leaders in their respective countries. This is an example where global central banks may be out of touch with real world economic growth issues. Only time will tell if this bold new monetary experiment will be effective. At this juncture, we sense that this strategy may be counter-productive.

The alternative is for a more stimulative fiscal policy. We are seeing some signs in the U.S. and elsewhere (possibly Japan) that elected officials may be finally willing to address the need for fiscal policy spending programs. We emphasize that a significant increase in fiscal spending will be needed to generate a meaningful acceleration in GDP growth.

Overall, we tend to believe that the global bond markets have got it right. Thus, expectations of unusually low long-term interest rates now seem to be priced into the equity and fixed income markets. When utility stocks are the best acting group for more than two years in a row, it is a good bet that something has changed dramatically. The change is a shift by investors into perceived "safe" stocks that generate a yield greater than 2% and have the prospect of some stability and growth through an economic cycle. The move traditionally favors utilities, REITS and staple goods. We believe money is flowing into these vehicles since long-term investment grade bond yields are extremely low. The question now is if this is creating a valuation bubble in certain investment assets.

Chart II

S&P 500 Current and Historical Valuations

Sector	NTM P/E	15-Year Avg	Ratio	Relative P/E	15-Year Avg	Ratio (sorted)
Energy	45.4x	14.4x	3.16	2.733	0.958	2.854
Utilities	18.5x	14.4x	1.28	1.112	0.945	1.176
Staples	21.0x	16.1x	1.30	1.263	1.120	1.128
S&P 500	***16.6x***	***14.0x***	***1.19***	***1.000***	***1.000***	***1.000***
Financials	13.3x	12.4x	1.07	0.798	0.837	0.953
Materials	16.3x	14.7x	1.11	0.980	1.041	0.942
Industrials	15.9x	14.4x	1.10	0.955	1.039	0.919

Source: Strategas

As Chart II indicates, utilities and staples are selling above their historical normal valuation to the S&P 500. However, the premiums over their respective 15-year averages do not appear excessive at the moment ***when viewed in the context of historically low global interest rates***. If this was a normal economic cycle, these valuations would be troublesome, particularly for utilities. However, given the absolute level of global interest rates, we are not surprised that valuation levels are higher than usual. While investors have sought out high quality, low cyclical equity investment alternatives in their hunt for yield, this trend bears watching. Any strong re-acceleration in GDP growth and/or rise in interest rates would result in a valuation contraction in these groups.

This makes for a bifurcated market outcome. If the economy accelerates and the Fed increases rates, cyclicals, commodities and financials should benefit at the expense of defensive high quality sectors. Should interest rates continue to stay benign, defensive stocks are likely to continue to do well. Currently, we do not expect GDP growth in the U.S. and overseas to materially accelerate. Thus, we remain in the camp of low GDP growth and low interest rates.

It's All about Corporate Earnings Growth Now

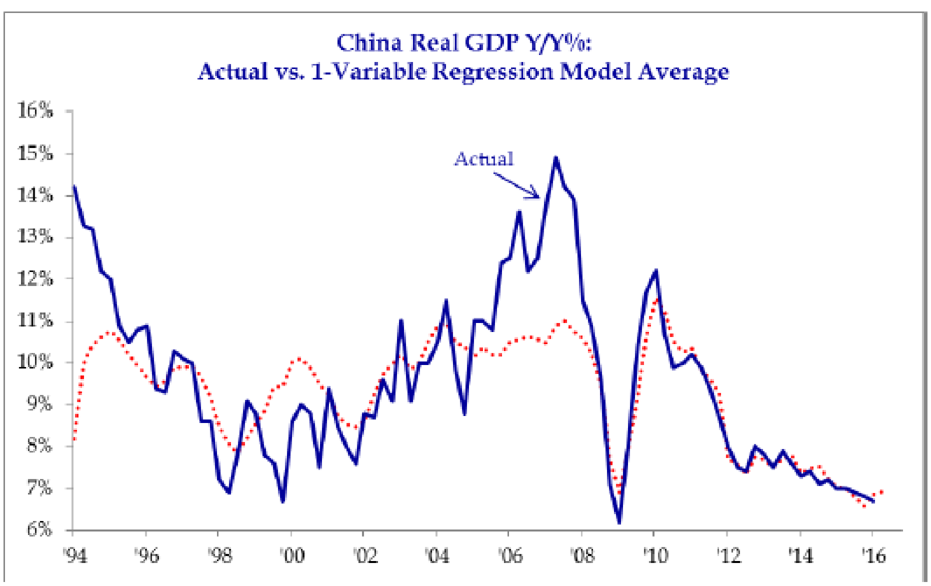
Within that scenario, ***corporate profit trends are therefore likely to dictate the overall equity markets trends in 2016 and 2017***. Companies continue to focus on cost reduction and productivity issues, which should be of value in periods of modest revenue growth. Foreign currency should be relatively neutral or only a minor headwind to profit growth versus the severe 5-10% headwind to corporate earnings in 2015. Finally, comparisons against weakening revenues last year should be easier. Thus, we expect earnings for most companies to recover and grow modestly to moderately for the balance of 2016 and into 2017.

We emphasize that the outlook for earnings should be the most important factor to equity market gains since valuation expansion opportunities appear limited.

China Continues to be Critical

With limited growth globally, China continues to be a pivotal factor to sustaining or improving the growth in developed nation markets.

Chart III



Source: Strategas

We certainly don't hold any greater degree of expertise in forecasting economic trends in China than other economic commentators. Suffice it to say, the general consensus of experts following Chinese economic trends seem to have shifted a bit from "potential recession" to "encouraging signs of growth" when discussing this critical economic powerhouse. As Chart III demonstrates, GDP growth in China has slowed to about 6 - 7%. We point out that its GDP growth bottomed at 6% in the global recession of 2009. Thus, unless the Chinese government changes strategies near term, we expect China to continue to grow at this rate. This should help sustain modest to moderate growth in developing nation markets.

The Role of Media in the Political Process

As we enter the period where candidates are preparing to campaign for various federal, state and local elections, we can't help but reflect back to September 1960 when America was first exposed to a televised presidential debate. We are referring to John F. Kennedy opposing the sitting Vice President at the time, Richard Nixon.

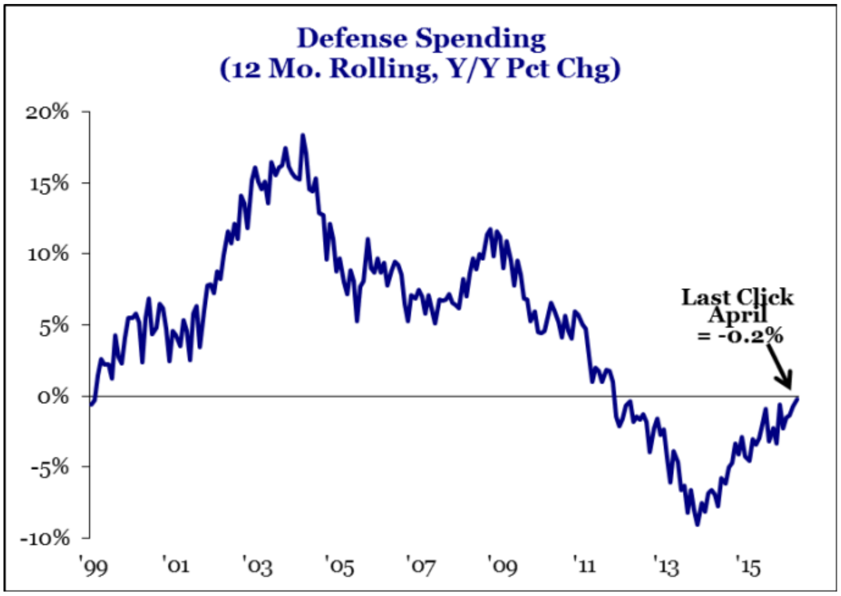
Most historians would say this debate solidified media as a potent force in impacting political voting patterns. The charismatic, youthful Kennedy clearly captured the American voter's attention as they contrasted him with Nixon. Nixon chose not to wear makeup for the debate and his dark shadow of a beard and his sweating on live TV were cited by many. Clearly, media from that point forward began to have a new impact on our political process. Fast forward to 2016. The internet, social media and a new generation of voters that walk everyday with their cellphone in constant hand have again started to reshape how we view our political process. We wonder if future election outcomes will be determined more by a candidate's savvy use of media than their legislative and political skills.

Portfolio Strategy

We have embraced two broad investment themes in the last 12 months. These themes work well in our sensitivity toward companies that generate superior returns on invested capital and shareholder friendly use of free cash flow.

The first is our recent theme of investing in service-based companies that target fast growing global markets. Some of these companies possess subscription-based models (such as Nielsen Holdings PLC), which further insulates earnings from economic cyclicality. We continue to seek companies with a strong service-based component.

Chart IV



Source: Strategas

The second theme has been to seek out companies with defense exposure. This strategy is based on two overriding factors. First is that many of these companies fit very well into our goal of strong free cash flow organizations. The second is the expectation that the U.S. government will have to increase its efforts to stimulate the economy by increasing fiscal policy spending. This should benefit the defense industry in particular. As Chart IV reveals, defense spending has been in a 10 year decline. Indeed, defense spending moved negative in 2011-13. We believe the recent recovery should accelerate to modest growth in the next few years. Our positions include Boeing, Lockheed Martin and, more recently, the government consulting firm of Booz Allen & Hamilton. We continue to view this sector as an attractive area for investment.

As always, if you wish to discuss any positions in your portfolio, our principals are available to chat about your investments.

Jack L. Salzman
Senior Managing Partner

Jeffrey P. Bates
Managing Partner

John A. Marshall, IV CFA, CFP®
Managing Director

Nathan T. Fend
Investment Advisor

Jason D. Beaird, CFA
Investment Advisor

QUARTERLY LETTER DISCLOSURE

The information in this letter has been developed internally and/or obtained from sources which Kings Point Capital Management LLC ("Kings Point") believes to be reliable; however, Kings Point does not guarantee the accuracy, adequacy or completeness of such information nor does it guarantee the appropriateness of any investment approach or security referred to for any particular investor. Kings Point, its affiliates and/or its clients may have an investment position in a security or strategy (or related or opposing security or strategy) discussed in this letter, and may change that position without notice at any time. This material is provided for informational purposes only and is not advice or a recommendation for the purchase or sale of any security.

This letter includes commentary by Kings Point. This information reflects subjective judgments and assumptions, and unexpected events may occur. Therefore, there can be no assurance that developments will transpire as forecasted. This material reflects the opinion of Kings Point on the date made and is subject to change at any time without notice. Kings Point has no obligation to update this material. Kings Point does not suggest that the strategy described herein is applicable to every client of or portfolio managed by Kings Point. In preparing this material, Kings Point has not taken into account the investment objectives, financial situation or particular needs of any particular person. Before making an investment decision, you should consider consulting a professional advisor and whether the information provided in this material is appropriate in light of your particular investment needs, objectives and financial circumstances. Transactions in securities give rise to substantial risk and are not suitable for all investors.

The strategies described represent Kings Point's current intentions. These are only general guidelines that Kings Point expects will be approximate over time, but portfolios that it manages may not meet any of these characteristics. Kings Point may pursue any objectives, employ any techniques or purchase any type of financial investment that it considers appropriate and in a client's best interests.

It should not be assumed that investments made in the future will be profitable or will equal the performance of investments discussed in this letter. On request, Kings Point will provide to you a list of all of the investments made by it in the last year.

06144\001\4129366.v1

t: 516.439.5100 f:516.439.5102
111 Great Neck Road, Suite 310, Great Neck, NY 11021
t: 800.259.1331 t: 615.620.3900 f: 615.620.3920
112 Westwood Place, Suite 210, Brentwood, TN 37027
www.kingspointcap.com