2nd Quarter 2016 Market Overview

The High Performing Portfolio

A high performing portfolio has a dual mandate to generate growth and minimize setbacks *at the same time.* A high performing portfolio strikes a balance that reflects the natural condition of the overall economy and has suitable diversification so that at least some investments within the portfolio will flourish given whatever circumstances occur.

To create a high performing portfolio, the construction process means a "pinch of this and a pinch of that," culminating in an account that provides superior investment performance. Sometimes this process can take a while and test our patience. Ultimately, these carefully chosen components will reflect the good things happening in the investment ecosystem and the portfolio will deliver long term growth.

A high performing portfolio needs to own the **most relevant companies** in industry that shape the business landscape. These companies are recognizable names and their products and services are well known. Amazon, Facebook, Federal Express, Honeywell, John Deere, and Union Pacific are examples of holdings that we might use for client portfolios. These companies are impossible for investors to ignore.

A high performing portfolio needs stocks that hold the best **relative strength**. These are companies that have the best recent relative price performance compared to all other stocks. They may *not* be immediately recognized as household names. We currently own Acuity Brands in this category (up 50% since the February 11 low for the market). Ulta Salon and Equinix are also great examples of relative strength in the current market.

A high performing portfolio has investments that are complementary to the **macro-economy**. These investments benefit from prevailing economic themes. For example, the current economy is marked by low interest rates, muted economic growth, and central banks that are printing money. Under these economic conditions, dividend paying stocks, utilities, and gold, are more desirable to investors and will work well.

A high performing portfolio needs **diversification**. This means investing in areas which are out of favor or neglected by the investment mainstream. We invest in companies that are substantially down from historic levels as potential turnaround candidates. These investments give clients diversification because stocks that are oversold are more resilient, withstanding market downturns more readily. We also inject diversification by investing in foreign markets because these markets can perform differently than the US markets.

Finally, a high performing portfolio must generate **profits**. Our client investments need to be fruitful so this means selling stocks for gains. Stocks typically top out and decline at some point, so investment gains need to be harvested.

The construction of a high performing portfolio will lead to good long term growth for our client assets.

Lower Interest Rates Hikes Stocks

The markets have been getting good traction since June 16 and the S&P 500 has broken out to new all time highs in recent days. Despite this, the *earnings reports* from the S&P 500 companies are estimated to *decline* 6% in the quarter ending June 30. Generally, sales and earnings are actually *falling, year over year*. Furthermore, our economy is barely growing. Nevertheless, stocks are doggedly moving higher due to lower interest rates and highly accommodative central banks around the world.

Since stock valuation models are determined by interest rates, when interest rates decline, stock valuations rise. So, even if earnings decline, which is happening now, prices can rise due to lower long term interest rates.

We are relieved at the recent market rally but we realize these levels are only fractionally above the late 2014 levels. In addition, many broader market measures like the Russell 2000 and the New York Stock Exchange index rest below their 2013 highs. These lagging indices also might point to a catch up phase where the market rally broadens to include smaller companies. If recent gains hold and the market doesn't slip back to its old range, we could really enjoy some momentum to the upside.

Brexit

Amidst the acrimony over this politically charged event, Brexit has not carried an enduring consequence to the US stock market.

Peregrine Portfolios

Client portfolios are on a path for a good year. Our Equity Composite gained 4.35% for 2016 through June 30. Our Balanced Composite is up 4.63%. The S&P 500 was up 2.7% for the first half of 2016. Further gains have happened in July. This strength can feed on itself as the market breaks out of its range.

Many companies present exciting opportunities. Along with Acuity Brands (mentioned above), bright prospects exist in Facebook, select steel companies, gold mining stocks, energy pipelines, foreign bonds, mortgages, real estate companies, and housing companies.

It is important that high performing portfolios earn compensation from interest and dividends. Many stocks offer dividends far above the yield on Treasury bonds and CDs so it is natural for us to invest in these companies for clients. In addition, many ETFs offer dividend yields which can give clients good returns with low risk.

Portfolio Manager
07/18/16

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