SOUND INCOME STRATEGIES

May 2016

Index	Month / Year to Date
Dow Jones	**+0.48% / 3.27%**
S&P 500	**+1.87% / 3.56%**
NASDAQ	**+3.82% / -0.59%**
10yr Treasury	**+0.08% / current yield 1.84%**

Markets:

Never let truth get in the way of a good story - Mark Twain.

Of the S&P 500 companies, 99% have reported their first quarter numbers for 2016 and aggregate sales are down by -2.24% and aggregate earnings are down -8.35%. These are actual sales and earnings vs. the previous quarter. However, equity prices are still showing a positive correlation to oil, which touched above $50 per barrel on May 17th - the first time this year. Although the IMF and World Bank have lowered their domestic and global GDP growth rates for 2016 and beyond, domestic equities increased during the month.

Federal Reserve talk about possibly increasing rates in June or July has also calmed some investors into believing that the economy is doing well and an increase in rates will be easily absorbed without any issues of disruption. Lack of "bad news," outside of earnings of course, seems to be leading the risk markets higher. Perhaps markets were too anxious during the first few months of the year and now lack-luster earnings, geopolitical risk, and another possible Federal rate hike in the headlines has little effect on investors. Similar to gamblers or "gamers" walking into a casino, they understand that the odds might not be in their favor, but hey, you get free drinks!

One interesting issue is new information about Saudi Arabia's holdings of US assets, which is estimated to be over $750 billion. Some estimates are as high as $200 billion in U.S. Treasury bills, notes, and bonds alone. The Saudi government is "threating" to liquidate their U.S. assets in retaliation to legislation before Congress that will allow international law suits over the September 11th terror attacks. Due to the Freedom of Information act, there could be 28 pages that were not disclosed on the 9/11 report that could become public record soon and open up the Saudi government to lawsuits. While the U.S. Treasury market could probably handle any volume the Saudi's dump in the market, it could be a buying opportunity for corporate bonds. We would actually welcome an increase in rates as an opportunity to invest into higher yielding securities.

Another potential threat is China's growing debt burden. We've all heard for years how China has such a huge foreign currency reserve due to manufacturing products for the world, but that surplus is at the Federal level. What we don't hear too much about is the corporate and municipal debt levels in China, which could become an issue. Société Générale, a French multinational bank with large operations in Asia, believes that Chinese banks may face $1.2 trillion in losses from bad corporate (state owned) debt. A basic measurement for private sector leverage is the "credit-to-GDP" gap, which, for China, is showing 28%, but anything over 10% is a warning sign. Just like banks in the U.S. levered up by offering credit to anyone who wanted a home pre-2008, China's banks have offered credit to corporations and individuals. These banks are moving these liabilities off-balance sheet to hide the true amount of risk on their books. As Americans and Europeans already know, moving liabilities off-balance sheet to hide risk never ends well. Unfortunately, China's economy is massive and will affect markets globally when it falters, as we already saw during August's 2015 semi-meltdown.