Golden Capital Management
Market Review and Outlook
As of September 30, 2016

Market Review

During the third quarter of 2016, there was a great deal of anticipation related to the September 21st meetings of the U.S. Federal Reserve (Fed) and the Bank of Japan. U.S. stock markets traded in a tight range throughout late July, August, and September in advance of these two meetings. At its September meeting, the Fed held the federal funds rate target at 0.25% to 0.50%. Uncharacteristically, three voting members dissented, favoring a 25 basis point increase. Although the Fed seems on track for a rate increase in December, Fed officials' projections for future rates were revised downward. The Bank of Japan meeting did not result in any market-moving policy changes. The markets continue to be buoyed by the "lower-for-longer" interest rate stance of the Fed and the loose monetary policies of the major global central banks. For the quarter, U.S. small cap stocks outpaced large caps. Outside the U.S., emerging markets performed slightly better than developed markets.

Index	**Q3 2016 Return**
Russell 1000®	4.03%
Russell 2000®	9.05%
S&P 500®	3.85%
MSCI All-Country World	5.30%
MSCI EAFE	6.43%
MSCI World Ex-U.S. Small Cap	8.00%
MSCI Emerging Markets	9.03%

Sources: IDC and APX

As for the U.S. economy, the third estimate of the second quarter's GDP growth was a disappointing 1.4%. Manufacturing reports generally indicated weak expansion; retail sales contracted in August; the economy continued to add new jobs at a slow pace; the unemployment rate hovered at 4.9%; headline consumer price inflation was 1.1% year-over-year in August while core consumer prices excluding food and energy were up 2.3%; and consumer confidence surveys continued to register high readings. The broad trade-weighted U.S. dollar strengthened slightly in the quarter.

Market Outlook

For the remainder of 2016, the U.S. presidential election, geo-political risks, and potential financial market contagion effects from European financial firms are notable concerns for investors, though the emphasis these concerns have garnered may be overdone. In the near term, the modest improvement in the global economy and a potential upswing in corporate earnings should be supportive of equity markets.

There are risks investors should monitor, but we think the likelihood of significant near-term market decline triggered by the onset of a recession is low. We think one of the key geo-political risks is the rise of populism and trade protectionism. These movements can be seen in the U.S. presidential election and in the "Brexit" vote in the United Kingdom. The impacts of trade protectionism are likely to be longer-term in nature through lower returns on capital due to decreased economic efficiency. As for contagion risks from a hypothetical collapse of a systemically important European financial firm, it appears the financial system is better prepared to withstand the next crisis as a result of increased capital requirements and central banks' willingness to provide liquidity and other more direct interventions.

While global economic growth is weak, it appears to have stabilized. Obviously, robust growth would be preferred; however, slow and steady growth is enough for corporations to generate cash flows to sustain and grow their businesses and return capital to investors through dividends and share buybacks. We have experienced an earnings recession marked by five consecutive quarters of year-over-year S&P 500 earnings declines and a consensus expectation for a third quarter S&P 500 earnings decline of -2.1%. However, over the last several years, reported earnings have exceeded the consensus estimate by approximately 4%, and third quarter earnings will likely be higher than third quarter 2015 earnings if the pattern holds. A return to earnings growth should improve investor sentiment, help draw in the current elevated valuation multiples, and buffer the markets in the case of a federal funds rate increase in December.

As the market expands beyond its recent narrow focus on low volatility, dividend yield, and defensive stocks, we believe there are opportunities in relatively undervalued stocks that may be perceived as more cyclical. With a reduction in the level of macroeconomic uncertainty and an improvement in corporate earnings, investors will be able to focus on company fundamentals in the coming months. As always, we will continue to seek fundamentally sound companies that trade at reasonable valuations with a higher likelihood of producing earnings growth ahead of expectations.
