<u>Monthly Outlook - October, 2015: "When you get to a fork in the road, take it!"</u>

The sports world lost a real luminary last month with the passing of ***Yogi Berra***, the famous New York Yankee catcher to whom the above quote has been attributed. Yogi's sense of direction was not flawed: The directions to his home in Montclair, NJ did include a fork in the road – but either fork, as it turns out, led to his house! The quote does have an ***important message for market participants*** as well, given what has transpired in global financial markets lately.

The US economy added ***142,000*** jobs to nonfarm payrolls in the month of September which trailed expectations for a gain of 203,000. Of the 142,000 jobs added, 118,000 came from the private sector and the rest from government. In addition, July and August accounted for a net ***downward*** revision of ***59,000*** jobs. The headline unemployment rate held steady at ***5.1%,*** while the U-6 (which is a more robust measure of labor under-utilization) dropped three tenths to ***10.0%***.

Job growth has slowed in 2015 as the average monthly job gain of ***198,000*** is significantly less than 2014's average monthly gain of ***260,000***. The bulk of the slowdown is attributed to declining ***commodity*** prices (especially those relating to mining and oil and gas extraction) and an increase in the ***U.S. Dollar*** which makes US exports more expensive on a relative basis.

What is missed in this report is the number of job openings available to those searching for work. The Labor Department's Job Openings and Labor Turnover Survey (a separate survey that is released later) reported ***5.7 million*** job openings in July; a strong indication that employers are ***willing to hire***, but qualified candidates appear to be in short supply.

In ***contrast*** to the manufacturing sector, which has been stagnant for most of the year, the ***services sector*** of the US economy continues to grow. Healthcare added 34,000 jobs, information services increased by 12,000, and professional and business services were up a solid 31,000. The Institute for Supply Management's survey of non-manufacturing posted an activity level of 56.9, which indicates the sector continues to expand at a reasonably healthy pace.

The services sector remains a ***bright spot*** in the US economy and currently is at a level that does not signal an imminent recession. It is important to remember that the US economy is not the manufacturing hub it once was, unfortunately. In fact, manufacturing accounts for a smaller and declining portion of GDP with the bulk of economic activity being driven by ***consumer spending and services.***

The third (and final) estimate of U.S. Gross Domestic Product indicated that the economy ***grew by 3.9%*** in the second quarter (on an annualized basis), which was slightly higher than the previous estimate of 3.7%. Consumer spending was strong in the second quarter along with a better than expected reading on nonresidential fixed investment. Expectations for third quarter growth are more ***subdued*** with preliminary data pointing to a 2.0% growth rate.

The Bureau of Economic Analysis announced a few weeks ago that after-tax corporate profits were ***up 8.5***% in 2Q2015 compared to 2Q2014. Also, as reported earnings for the S&P 500 finished ***up 1.3%*** on a year over year basis for 2Q2015. If you recall, at one point expectations were for a ***decline of 6.0%*** for the same period***.*** The discrepancy from initial estimates to final results seems to be playing out again in the run-up to third quarter earnings season: The latest estimates are calling for a ***decline of 5.1%*** in 3Q2015 (year over year) for the entire S&P500 companies in aggregate.

In our opinion, 3Q2015 earnings will likely surprise on the ***upside*** as analysts have become too pessimistic in their expectations on corporate profits – this is primarily due to companies issuing mostly ***negative guidance*** to help manage expectations (a classic game played on Wall Street). We do believe that given the beaten down expectations for the quarter, the bar has been lowered sufficiently for most corporations to be able to beat such expectations handily.

The Federal Reserve's decision last month to hold off on raising interest rates for the first time in nine years had little to do with concern over its Congressionally mandated goals of "maximum employment" and "stable prices." The real reason they postponed the rate hike was concern over how ***global*** credit and financial markets would react, namely in emerging markets and China. Which begs the question, when did the Federal Reserve add a third objective to their Congressional mandate – ***promoting global financial market stability?***

At the press conference immediately following the FOMC meeting, Fed Chairwoman Janet Yellen sounded ***quite dovish*** and appeared to be loath to raising interest rates. With both equity and bond markets selling off on the news, Aunty Janet had to do some serious back-pedaling at a speech in Massachusetts entitled "Inflation Dynamics and Monetary Policy". Subsequent speeches by other voting members of the FOMC have sounded more ***"hawkish"*** causing more uncertainty, leaving many confused about the Fed's intentions for the rest of 2015 and beyond.

Regardless of the timing of the first rate hike (despite the parlor game that this seems to have evolved into), what is more important for financial markets is the ***pace and trajectory*** of interest rate increases over time. We do believe that the Fed is likely to be gradual in its pace of increase and the ***ultimate terminal rate*** will likely be lower than the previous peak in 2006/07.

Historically, September and October have been ***difficult months*** for equity markets, as businesses are building inventory for the holiday season, and credit demands increase into the winter months. While there is no question that some borrowers in the high yield market will find that they are in trouble (as they are over-extended), it is hard to imagine the entire market being in difficulty. After all, seasonal factors do eventually work themselves out, and for the ***long-term*** investor, sticking with a well laid out plan is usually the surer way to a better outcome.

Throughout the first half of 2015, your international positions performed quite ***well*** relative to domestic markets. However, during the market "correction" in September, developed international markets took the ***brunt*** of the selling as investors sold some of these positions in truly ***irrational*** fashion. This is a classic case of throwing the baby out with the bath water, and little to do with the fundamentals themselves.

We believe Europe's ongoing implementation of ***quantitative easing*** will provide a much needed boost to consumers and businesses as credit becomes cheaper and banks are more willing to lend. There is also renewed hope that governments will enact tough, but necessary reforms to social programs and regulations. We are already seeing the benefits of tough austerity measures in places like Spain and Ireland where the financial sector seems to be performing much better.

Volatility appears to have returned with a vengeance in the past few months in equity and bond markets. While rising volatility and the attendant change in portfolio values does feel ***uncomfortable***, we do believe that the environment of low inflation, slow growth and reasonable valuations implies little need to tinker with positions: Except for a ***thoughtful rebalancing*** to areas that have been sold off beyond what is justified by fundamentals. So, when you get a fork in the road, you will know what to do!

This report was prepared by

Suresh Raghavan, CFA, and Clark Blackman III, CFA, CPA/PFS
MBR Financial
2000 West Loop South, Suite 1510
Houston, TX 77027

www.mbrfinancial.com

For further information please contact us at
Voice: 832.667.8787
Fax: 281.974.2108
Email: contactus@mbrfinancial.com

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