FAIRPORT ASSET MANAGEMENT
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The Compass

Wealth management tips, trends and articles that provide confident navigation for high net worth clients.

May 2016

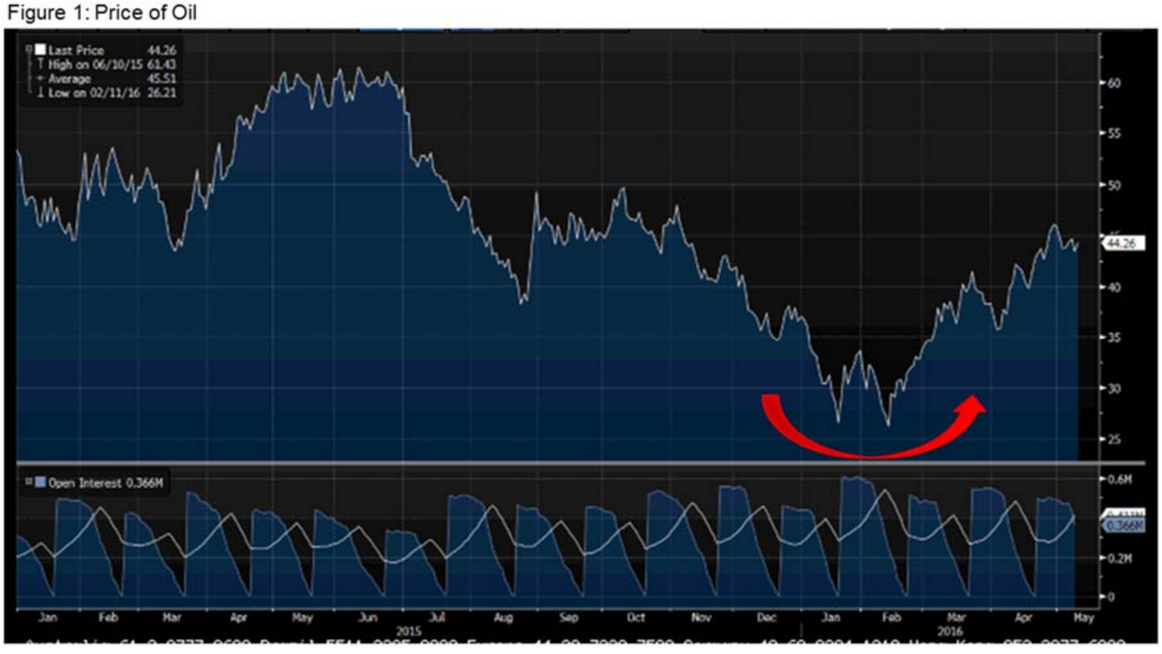
As always, we encourage you to share this newsletter with friends, family members and colleagues.

Mid-Quarter Commentary as of May 20, 2016

John M. Silvis, CFA
Chief Investment Officer

The French journalist Jean-Baptiste Alphonse Karr was credited back in the 19th century with coining the term "the more things change, the more they stay the same." That saying could easily describe the equity markets over the last twelve months as we have reached the anniversary of the all-time high in the S&P 500 Index (it hit the high of 2,134.72 on May 21, 2015). The benchmark index is less than 4% on a price basis from its high reached a year ago, and year-to-date has a total return of 1.34% making it essentially flat for the year. But I would say a lot has changed over the last year. We have experienced two corrections in excess of 10%, once back in August falling over 12% and again earlier this year with a correction of over 13%. Keep in mind we went over four years without a correction of that magnitude (a point we mentioned on several occasions) making us well overdue for a pause in the positive trend over the last few years. We also have seen oil drop -18% over the last twelve months, after falling to a low of nearly $26 per barrel or -57% from the price a year ago (see Figure 1 below). The dollar, which had booked steady gains for nearly two years, has changed direction over the last year and been virtually flat after reaching a low of -2% earlier this month. The MSCI All-County World Index, a global equity benchmark, hasn't fared as well over the last year falling -8.63%, while notching a return of -0.13% so far for 2016.

Figure 1: Price of Oil



Source: Bloomberg

On the economic front, the familiar pattern of weak first quarter GDP (or gross domestic product) growth continued again in 2016 with growth coming in at a measly 0.5% on an annualized basis. If the pattern holds, we should see a bounce in the second quarter, which has gotten off to a good start. The average bounce or difference from the first to second quarter has averaged over 3% recently. Employment continues to improve with the unemployment rate hovering around 5% for the last several months. According to Cornerstone Macro, the rate is likely to fall closer to 4.5% later this year as a result of a strong jobs market. To that point, unemployment claims continue to hover around 40 year lows while wages are steadily improving. The Atlanta Fed's wage tracker has shown that median employee pay has risen 3.4% since last year. Another bright spot for the economy is the resiliency of the housing market. Housing starts remain above an annual rate of over 1 million units and prices, as measured by the Case-Shiller Home Price Index, have rose 5.5% over the last year. One area of concern has been the softness in the manufacturing sector which represents about 20% of the economy. The stronger dollar and the steep drop in oil prices have been two of the bigger culprits in the weakness.

The Federal Reserve remains on the fence about raising rates as we move to the midpoint of the year. They recently lowered their forecast from four to two interest rate hikes in 2016. The next meeting is in June and the odds are still less than 50% that they will increase rates at that meeting, but it remains a fluid situation and has the markets on edge. Since increasing the Federal Funds rate in December, yields on the 10-year treasury have actually declined, likely reflecting the slower pace of growth in the first quarter. While global issues such as the pending Brexit vote in the U.K. (the European Union membership referendum) and the impeachment saga in Brazil remain, global growth should see a pick-up in the coming months. The U.S. Leading Economic Indicator Index is pointing to better prospects to come.

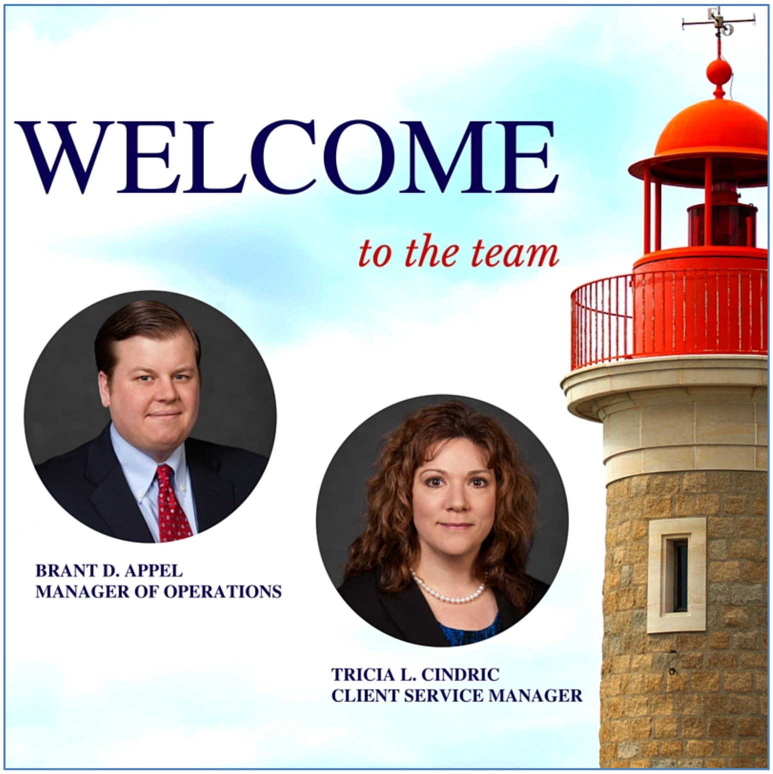
One of the possible reasons for a sluggish market over the last year could be the stagnation in earnings during the period. With first quarter earnings season pretty much over, the aggregate earnings of the companies in the S&P 500 Index were down around -7% since the same period last year, marking the first decline since the financial crisis in 2009. One of the reasons for the decline has been the drop of oil prices and its effect on earnings for the energy sector. 2016 earnings for the sector are projected to be down over 90% from the highs in 2014, likely marking the bottom. While the dollar has been a drag on earnings over the last year, going forward it may actually turn into a tailwind as a weaker dollar benefits earnings of multinational companies that make up the majority of the index. Since the bottom in early February, the cyclical sectors of Energy, Materials and Industrials have lead the markets shifting away from the defensives such as Utilities, Staples and Health Care which have lagged over the time period. If the economy improves and the dollar stays flat or weakens, look for the cyclicals to maintain leadership going forward.

The rally earlier this year in emerging markets has faded as of late with the MSCI EEM near even, declining -0.54% so far this year. A lot of the move was fueled by the rally in Brazilian equities as the market was encouraged by the increasing likelihood of impeachment of the unpopular president and rising oil prices for the exporting country. China has seen better growth over the last few months with a rise in the PMI and Leading Indicators. However, fears are rising that they may be entering another housing bubble which could have disastrous implications. We remain cautious on emerging markets and maintain a neutral weighting versus the global benchmark. Across the pond, all eyes are on the Brexit vote on June 23rd. Polls indicate it should be a close vote with economic ramifications for both sides of the channel.

Fixed Income Commentary as of May 20, 2016
Rick D'Amico, CFA
Manager of Investments

April's FOMC minutes released Wednesday, May 18th proved to be more hawkish than the market anticipated and put a June or July rate increase back on the table. The FOMC minutes explicitly stated that "most participants judged that if incoming data were consistent with economic growth picking up in the second quarter, labor market conditions continuing to strengthen, and inflation making progress toward the Committee's 2 percent objective, then it likely would be appropriate for the Committee to increase the target range for the federal funds rate in June." As of now, all three of these conditions appear to be on their way to being met. The Fed's view of the appropriate number of rates hikes in 2016 remains at two, with a solid possibility of rate increases in June or July and December. We continue to expect increased volatility in the equity and fixed income markets around FOMC meetings and communications, especially if the Fed chooses not to correct market expectations sooner should they fall out of line. For instance, prior to the release of Wednesday's FOMC minutes, the Fed Funds futures markets implied only a 4.0% probability of a rate increase at the June 15th meeting and as Roberto Perli from Cornerstone Macro noted, "The sudden backup in policy expectations in reaction to the minutes had repercussions across currency, equity, and fixed income markets."

The Barclays U.S. Aggregate Bond Index has posted solid returns thus far, returning 3.23% YTD through May 19, 2016. Returns have been driven by a .42% decline in 10-year yields since the beginning of the year, along with spread compression in the corporate credit markets, most notably in the energy and basic materials sectors where spreads have contracted roughly 200 basis points from their highs. Given the absolute low level in yields domestically, (e.g., 1.85% yield on the 10-Year U.S. Treasury), and the recent spread compression in corporate credit, there is a good probability that the bulk of returns from fixed income this year have already been realized.



Meet Brant and Tricia
In the first quarter of 2016, we welcomed two new professionals to our team.

Brant Appel recently completed the University of Akron's College of Business Administration's MBA program with a concentration in Finance. Prior to attending the University of Akron, Brant received his Juris Doctorate from the University of Illinois, College of Law cum laude and a bachelor's degree from The Ohio State University. A licensed attorney in both Illinois and Ohio, Brant brings a unique perspective to his role at Fairport as Manager of Operations.

With over 20 years of client service experience, **Tricia Cindric** brings a wealth of knowledge and competence to her role as a Client Service Manager. Tricia joined Fairport from Gates Group Capital Partners, where she worked for over ten years serving as the main point of contact between the firm's top executives and outside parties. She was also the lead contact in charge of investor relations, in addition to handling operations and cash management for the firm.

Friendly Security Reminders
Pamela S. Dagostino
Client Service Manager

We live in a social media world and, for fraudsters, this is good news. Here are a few examples that will help to protect your personal information:

1. Don't use the same user ID and password for multiple websites.
    a. Make your password strong by using upper/lower case letters, numbers and symbols. Don't incorporate your date of birth, kid's names, anniversary, etc., into your password.
    b. Many custodians offer two step verification. Schwab and Fidelity, for example, will send clients a security token for 2-factor authentication.

2. Don't share your life story on social media.
    a. Your friends and family know where you live, went to school, your dog's name, etc., so don't list personal information on social media. Fraudsters are looking for ways to get to know you in order to impersonate you.
    b. When traveling and even in your own neighborhood, don't connect to wireless networks (hotels/cyber cafes/libraries) as they typically do not have appropriate virus protection.

3. It's the I.R.S. calling…not really.
    a. Never give your personal information over the phone (social security numbers, bank account numbers, date of birth, etc.). The I.R.S. will send you a letter if they require something. Your bank already has this information.
    b. If you are not sure if that call is really from your grandson asking for money to get out of jail (true story), then hang up. One of two things will happen: He will clean up his act and serve his time or the call is a scam and the fraudster will move on to someone else who will hopefully hang up, too.

4. Treat e-mail like a post card.
    a. Be careful what you send via e-mail. Never list confidential information in an unsecured e-mail. If your account is hacked then the fraudster has access to any information you've sent or received.

b. Many times fraudsters employ “Phishing” by posing as a reputable entity to trick you into thinking you need to take action by opening/downloading an attachment/link. These attachments install malware on your computer and voilà the fraudsters have access to your login/password.

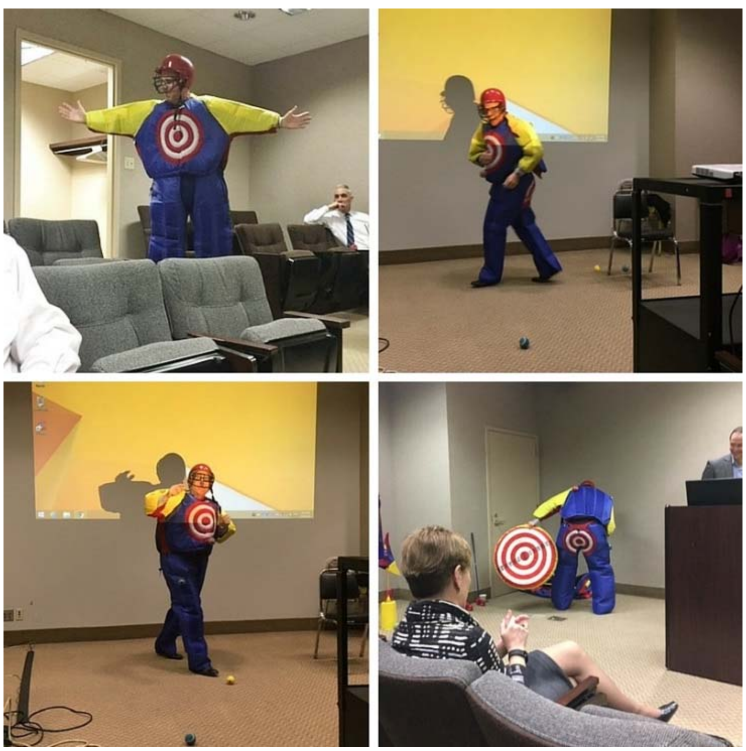
c. Delete your e-mails on a consistent basis, especially those that might include financial information.

We regularly attend cybercrime webinars and workshops and are happy to offer proactive tips, best practices and resources. If at any time you think your information has been compromised or you find yourself the unfortunate victim of identity theft, do not hesitate to contact a member of the Fairport team for guidance.

2016 Community Beacon – The First Tee of Cleveland

Fairport has selected The First Tee of Cleveland as the firm’s 2016 Community Beacon recipient. Desiring to unify our efforts to provide meaningful support to the Northeast Ohio community, Fairport selects one charitable organization per year that reflects our firm’s values. We are proud to join our clients and friends who are active supporters of The First Tee of Cleveland as board and advisory members, donors and staff.

The mission of The First Tee of Cleveland is to positively impact the lives of young people from greater Cleveland by providing educational programs that build character, instill life-enhancing values and promote healthy choices through the game of golf.



The First Tee of Cleveland Executive Director, Patricia LoPresti, and Director of Player Development and Opportunities, Brian McFarland, visited Fairport in February to “kick off” the partnership with an overview of their programming and proven curriculum. The Fairport team learned the importance of having a target in life (on the golf course, in school, in community) with a playful, interactive activity that involved hitting human “moving target” Managing Partner Ken Coleman with tennis balls. Co-managing Partner Heather Ettinger *may* have hit Ken in the helmet.

Outside of participating in their annual fundraising events, Fairport will have several opportunities to engage with The First Tee youth participants. In April, we visited with the impressive past participants of the Patty Wood Girls Leadership Academy. We look forward to promoting this important program that teaches girls to stand up and speak up as leaders. We are also planning a summer outing in which The First Tee players teach us lessons on the golf course, while we hold a session for their parents on raising financially responsible kids.

Visit our website for more on The First Tee of Cleveland and our Community Beacon program. We will continue to share our experiences with you throughout this year and look forward to raising awareness for this remarkable youth character development program.

Fairport News

Read about our most recent community involvement, speaking engagements, conferences and continuing education.

Brant Appel joined The First Tee of Cleveland's Ambassadors Committee. This dynamic group of young professionals is actively involved in new and exciting ways to build awareness and spread the impact of the organization.

Andrew Connors participated on a panel discussion on family governance at the Markets Group's Private Wealth Ohio Forum. The panel explored the best practices for creating an effective governance structure, how and when to educate children about their family wealth and the components of a successful family meeting.

Pamela Dagostino along with **Brant Appel**, **David Bosak**, **Tricia Cindric**, and **Paul Zappala** attended a presentation hosted by Fidelity for operations and compliance managers on "The Evolving Threat of CyberFraud." The interactive discussion covered prevalent scams targeting advisory firms and necessary tools to effectively deal with this threat.

Several of our CPAs - **Peter DeVito**, **Chris Isabella**, **Tom Seifert** and **Emily Shacklett -** attended the Estate Planning Council of Cleveland's March Continuing Professional Education program "2016 Federal Legislative Update – Prospects for Tax or Estate Planning Changes in 2016-17" at the City Club.

Heather Ettinger was invited to speak at Barron's inaugural Top Independent Women Advisors Summit in New Orleans in May. Her breakout session was entitled "Effective Marketing Strategies - Innovate Your Brand, Market Your Mission." Heather will also be a table facilitator at our local Crain's Women of Note Leadership Summit this week.

Janet Havener was a featured alum in "College directors, then and now" in the spring issue of Lake Erie Magazine. She discusses how her MBA education at Lake Erie College helped advance her career. She also received a mention in the University Hospitals newsletter regarding her involvement in a client's gift to the health system.

Aaron Nuti has achieved the Certified Financial Planner (CFP®) professional designation. The CFP® designation requires in-depth knowledge in financial planning, taxes, insurance, estate and retirement planning. In the past few years, Aaron also earned both the Chartered Financial Analyst® designation and Chartered Alternative Investment Analyst designation. According to Aaron, there are no new designations on the horizon. Well done, Aaron!

Tom Seifert was the co-chair of this year's Beech Brook Beech Ball on April 15th, raising over $190,000 for the organization. He also served as Beach Brook Board representative and race committee member for the Beech Brook Fleet Feet 5K held on Mother's Day where over 200 runners helped raise $16,000.

John Silvis was elected President of CFA Society of Cleveland for the upcoming year, beginning July 1st. The CFA Society Cleveland was founded in 1950 and provides investment related programs and services to its Northeast Ohio-based membership of approximately 510 members. Earlier this year in March, John attended the 2016 CFA Institute Americas Regional Leadership Meeting at the Loews Coronado Bay Resort.

Newsletter Disclosures

This newsletter represents an assessment of the economic and market environment at a specific moment in time and is not intended to be a forecast of future events or any guarantee of future results. It is for informational purposes only and should not be relied upon as research or investment/ financial planning/tax advice. It should not be considered as a solicitation or recommendation by Fairport to buy, sell or continue to hold securities or other investments. Past performance is not a guarantee of future results, and is not indicative of any specific investment. It should not be assumed that the investment process and strategy discussed herein has been or will prove to be profitable. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.