DANN ASSET ADVISORS, LLC

Second Quarter 2016 Update

July 15, 2016

2Q16 Highlights

- U.S. economic growth modestly accelerates following a weak first quarter
- Fed acknowledges slow growth may continue for the foreseeable future
- Britain votes to leave the European Union, further increasing economic uncertainty and throwing markets into a sharp but brief tumble
- Bond yields reach record lows in many leading developed economies
- U.S. stocks end the quarter with a small gain and reach new highs in July

The table below summarizes the performance of some key indices during the second quarter and year to date:

Market Performance		
Index	% Ch. 2Q16	% Ch. YTD
S&P 500	2.5	3.8
MSCI Developed Markets (excl US)	(1.2)	(4.0)
MSCI Emerging Markets	0.7	6.4
MSCI All Country World	1.2	1.6
US Aggregate Bond (1)	2.2	5.3
Liquid High Yield (1)	4.8	8.3
US Dollar Emerging Markets Bond (1)	5.3	10.9

(1) Barclays indices

Equities. The second quarter was quiet and modestly positive until the results of the British vote to leave the European Union hit the markets on June 24. In response to Brexit, the market (as measured by the large cap S&P 500) declined 5% in two days but then promptly recouped nearly all the loss in the next three days to quarter end. Despite the late quarter volatility the S&P 500 returned a respectable 3.8% over the first half of the year and moved to new highs in the second week of July. The index is currently trading at a moderately expensive 17.8x estimated 2016 earnings.

Non-U.S. developed markets in aggregate fell roughly 10% (more in local currencies) in response to Brexit and regained just over half the drop by quarter end. The U.K. market (as measured by the FTSE 100) actually gained in its local currency due to the 10% drop in the pound post-Brexit. Emerging markets indices fared better, probably due to less of a perceived negative impact from Brexit on emerging market economies.

Fixed income. It's only a slight exaggeration to say that 10-year U.S. Treasury bond yields have done nothing but go down in 2016. It's not an exaggeration to say that the decline in yields has been significant, with the 10 year beginning the year at 2.27% and falling to 1.51% on June 30. The decline has continued into the current quarter, with the 10 year yield hitting record lows of 1.37% last week. Despite a relatively stronger economy, throughout the year U.S. yields have been moving down with yields in most other important developed market economies such as Japan, Germany and the U.K.

Reflecting the foregoing, high quality bonds (as represented by the Barclays U.S. Aggregate

Bond index) returned 2.2% during the quarter. The longer duration iShares 20+ Year Treasury Bond exchange traded fund (ETF) returned 16.1% over the first half of 2016 and has compounded at an 11.1% rate over the past three years. As indicated in the table, high yield bonds and dollar denominated emerging market debt also have been strong year to date.

General comments. Even before Brexit we'd been feeling uneasy about the Fed's: 1) seeming inability to promote long term, sustainable growth and 2) recent comments that slow growth, at best, may be the new normal for the U.S. Similar to many others, we believe better fiscal policies are needed to strengthen the economy but that seems unlikely over the near term given the election and the way Washington has been operating in recent years.

We're also concerned by the substantial decline in bond yields worldwide. Often yield declines such as happening this year signal an oncoming recession. However, given the low starting point for yields, significant central bank easing, and the intertwined nature of the global bond market we believe it's impossible to know if bonds are signaling a recession. With unprecedented central bank policies things actually may be different this time.

Putting the foregoing together with a stock market on the expensive side of fair value, we continue to see limited near-term upside despite current record highs. Best case, in our opinion, is that clarification around the election and easier earnings comparisons may be enough to move stocks modestly higher by year end. We appreciate that central banks always can step in and provide short-term boosts to the markets (we believe central bank statements help explain July's move up) but for sustainable market appreciation earnings need to begin increasing more significantly and consistently. We hope we end up being proved too conservative in our outlook.

Portfolio Positioning

The fixed income component of most diversified (fixed income and equity) portfolios remains largely in short duration (three years and under), investment grade corporate and municipal bond funds. Complementing this conservative positioning is still modest exposure to intermediate term (five-to-six year duration) investment grade funds and small positions in more aggressive, credit-sensitive short duration funds.

We took no significant actions in fixed income during the quarter. While having greater exposure to longer duration fixed income would have been a positive for 2016 to date, we're reluctant to increase exposures at current rate levels. We know from watching 10 year bond yields in Japan and Germany that rates can go to 0% and lower. But given where U.S. rates are currently we believe the upside to bond prices (potential for even lower rates) is dwarfed by the risk of lower bond prices (higher yields) in the event that there is any sign of stronger economic growth or inflation in U.S. and other developed nations' economies. Accordingly we believe it makes sense to continue with only modest exposure to intermediate term fixed income.

The best performing broad U.S. market sectors during the second quarter were energy, utilities and telecommunications. Energy stocks rebounded with the price of oil, bouncing off the extremely depressed levels reached when oil bottomed below $30 per barrel during the first quarter. Utilities and telecommunications continued their strong run of the first quarter and were the two best performing sectors year to date, each up on the order of 20% during the first half. The stocks of both of these sectors benefit from falling interest rates as their dividend yields become more attractive relative to competing fixed income investments. Both groups seem expensive to us at this point. Energy was the third best performing sector year to date.

The worst performing second quarter sectors were technology, consumer discretionary and industrials. Weak economic growth hurts each of these sectors, which likely explains why each was either down or up only slightly during the second quarter. Year to date technology was third worst performing sector, with only financials and healthcare faring worse. Financials performed poorly as interest rates declined significantly. We've been a little surprised by the disappointing 2016 performance of healthcare (normally considered a defensive sector that does well in slow economies) and attribute the weakness to the potential for greater pricing pressure on the group's products.

We had a very quiet quarter for equity-only accounts. For many clients we initiated no new positions and retained existing holdings. Where we did trade it was a switch in the international stock allocation, selling out of a small position in an indexed developed markets (excluding the U.S.) ETF with the proceeds going into an actively managed, value-focused mutual fund investing in the same geographies.

Economy

U.S. GDP growth slowed from 1.4% in the fourth quarter of 2015 to 1.1% in the first quarter of 2016. Consumer spending growth at 1.5% was the weakest in two years, but spending appears to have picked up this spring with autos and housing strengthening. The first quarter was restrained by a sharp drop in business investment spending, exacerbated by weakness in the energy sector. First quarter growth numbers generally have been weak in recent years and the government now believes its seasonal adjustments may be understating first quarter growth.

Analysts currently are projecting second quarter 2016 GDP (to be reported later this month) to increase to 2.5%-3.0%, led by stronger consumer spending. Recently reported June employment numbers were strong and a good sign that May's weakness was an aberration. This reinforces the view that second quarter growth did pick up.

Economic growth in most other substantial developed economies continues to lag the U.S. The recent decision by British voters to exit the European Union adds uncertainty to business' decision-making processes, and this likely will dampen European and especially U.K. growth over the near term. However, Britain and all its trading partners have a common interest in doing what's best for their economies; accordingly, once the processes for the British exit are worked out, the final, continuing impact of Brexit may not be too significant. However, if additional countries begin questioning the value of belonging to the EU and/or if Donald Trump becomes president, the trend of increasing global economic integration would be weakened and economic uncertainties increased.

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