MERITAS ADVISORS
Comprehensive Wealth Management

MONTHLY INVESTMENT OUTLOOK

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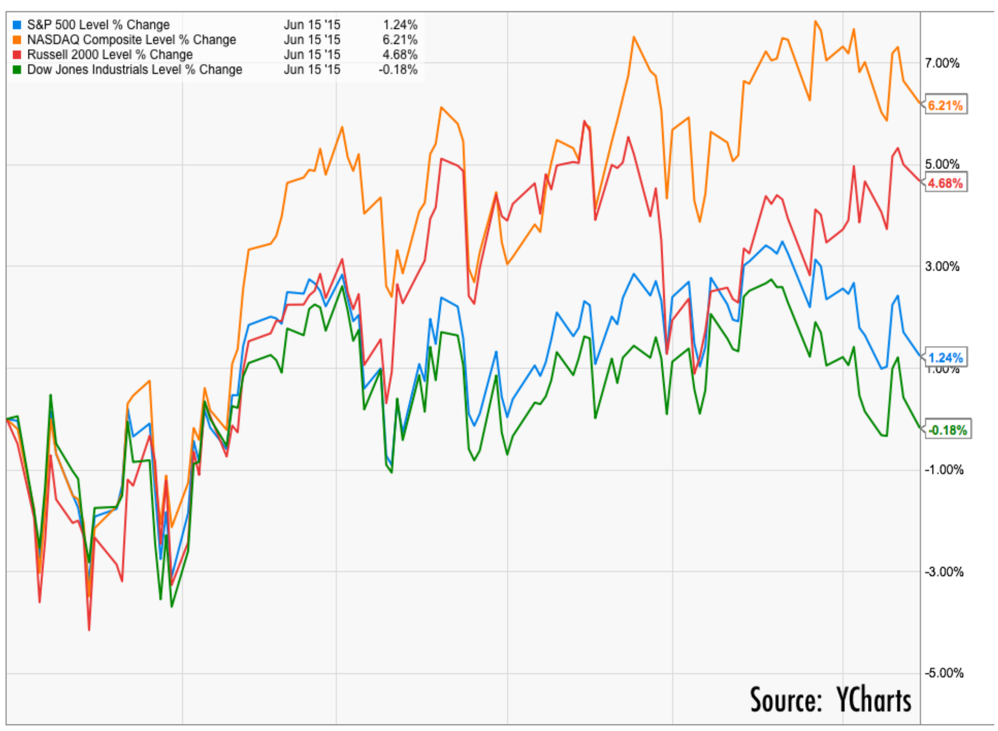
Dear Clients and Friends:
As of the writing of this month's piece, Greece is back in the headlines with a Grexit (exit from the Eurozone) becoming more of a possibility every day. On Wednesday the Fed gave the markets an, "Um… never mind," on its earlier hints at raising rates in June. The U.S. equity markets have continued to vacillate up and down much more than in prior years, while still not moving much in any one direction while the economic data coming in over the past few months and weeks has been flashing more warning signs, giving us a lot to cover this month!
--- *Lenore Elle Hawkins, Meritas Advisors Partner, economist and writer wondering how did my shorts shrink over the winter? #HelpmeCrossfit!*

Market Update

It has now been over 185 days since we've seen a 2% move in either direction for the S&P 500. This is an incredibly narrow range to move within for quite some time, which is particularly noteworthy given the volatility we have seen in other markets such as bonds, commodities and currency/exchange rates. As of the market's close on June 15th, the Dow Jones Industrial Average had fallen back into negative territory for the year, the S&P 500 was barely positive, up just a little over 1%, while the Russell 2000 and NASDAQ were up 4.7% and 6.2% respectively.



MORE FROM MERITAS

You can read more from our chief economist Lenore Elle Hawkins at TheStreet.com where she publishes articles individually and along with co-author Chris Versace, (not affiliated with Meritas Advisors). Lenore and Chris are also writing Cocktail Investing, scheduled to be published in the fall and is currently available for pre-order from Amazon. In addition to her frequent television appearances, Lenore also gives a radio update Monday mornings on America's Morning News, click here for local stations.

Meritas Advisors structures portfolios to meet our clients' personal goals and preferences within the scope of their risk tolerance. We strive to manage risk most effectively by utilizing a wider blend of asset classes, with the objective of achieving our client's goals with a reduced amount of overall portfolio volatility.

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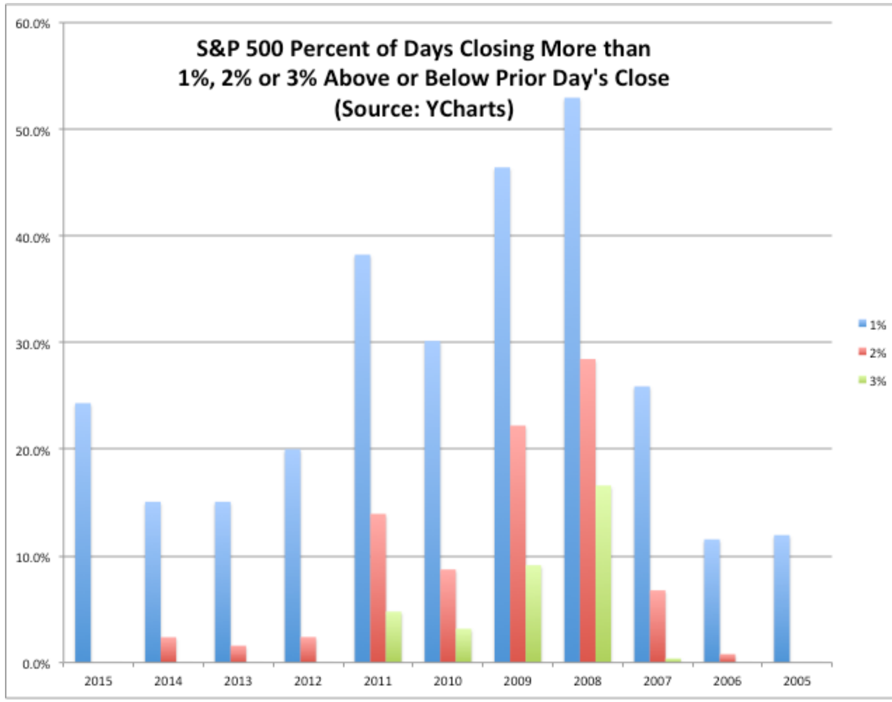
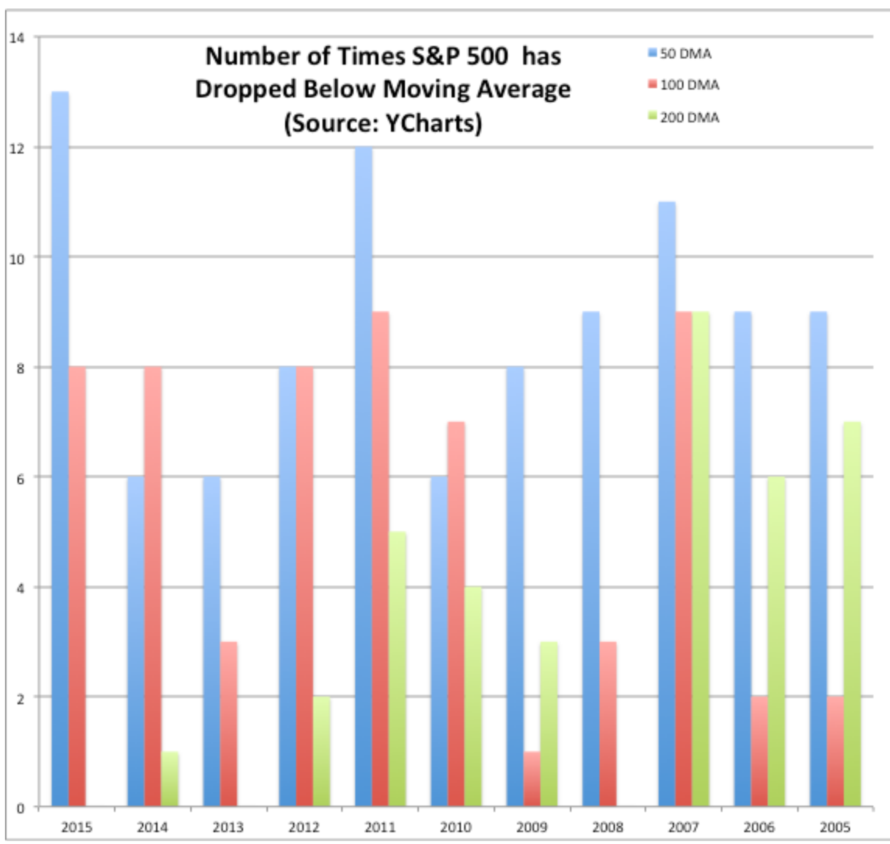
For equity markets, the number of stocks making new highs has been shrinking throughout 2015, in what can be visualized as a stock market game of whack-a-mole. Towards the end of last year the average daily number of stocks in the S&P 500 making *new highs* less those making *new lows,* (this is referred to as net new highs) was around 55, which is 11% of the index. Today, the whack-a-mole whacker's skills have improved so much that we're now closer to less than half that at 20 and the number continues to decline. *Normally, in a rising market the net number of new highs is rising, rather than falling.*



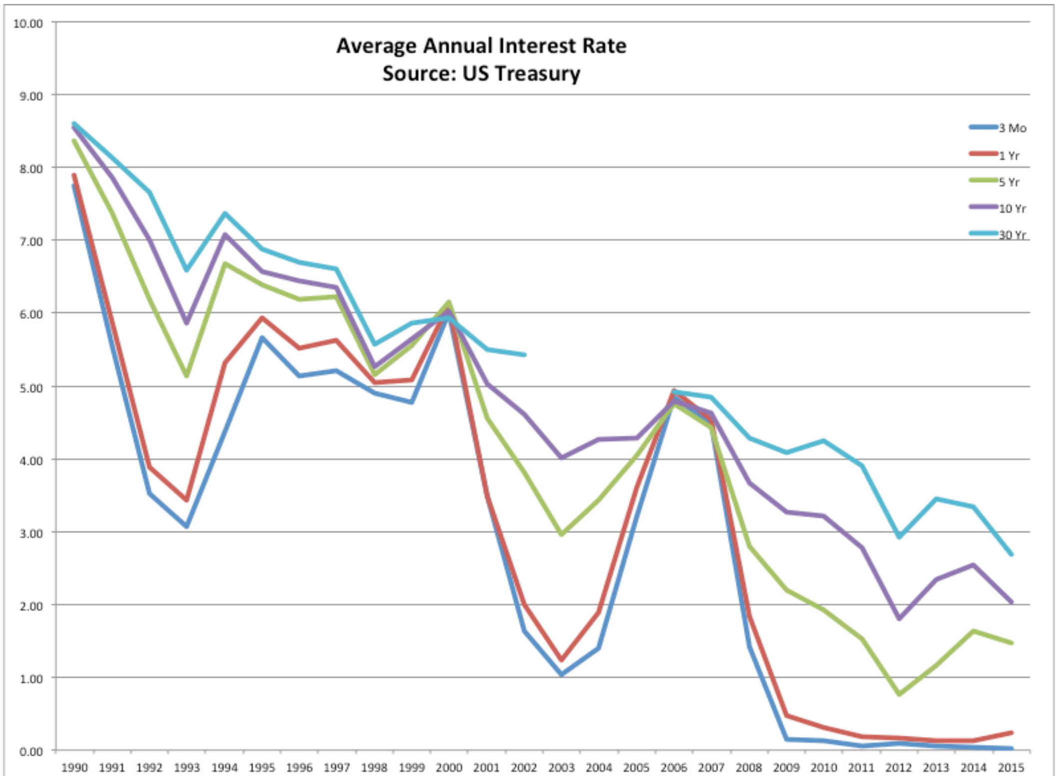
In addition to the declining number of new highs, the market has been gyrating back and forth a lot in an exceptionally tight range, a dance reminiscent of Will Smith's advice to Albert in the movie Hitch. The chart at right shows that the number of times the S&P 500 has moved 1% up or down from the prior day's close is already well above what we've seen since 2011, but those gyrations have remained tightly bound as we've seen no moves of 2% or greater, unlike in prior years.



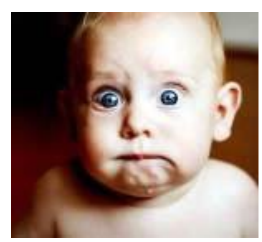
More of those moves have been to the downside, in fact the S&P 500 has dropped below its 50-day-moving average 13 times already this year, compared to just 6 times in both 2014 and 2013! The market hasn't dropped below its 50-day-moving average that many times since 2005. The next most frequent was in 2011 when it fell below that mark 12 times. Even during the insanity of 2007 and 2008 it dropped below the 50-day only 11 and 9 times respectively. The chart at right shows just how often the S&P 500 has dropped below its 50, 100 and 200-day moving averages every year over the past decade.

This looks to us like nervous market without much conviction in either direction, most likely thanks in part to the intentionally vague statements coming out of the Fed and the ongoing Greek drama.

The bond world has been getting seriously wiggly, with the German 10-year government bond dropping to a record low of 0.05% in April, only to then rise 20 fold to sit at over 1% just last week; 20x increase in interest rates! Can you imagine that happening to your mortgage? Let's take a step back and look at what's been happening in the US bond market over the past few decades by taking a deeper dive into historical Treasury yields.



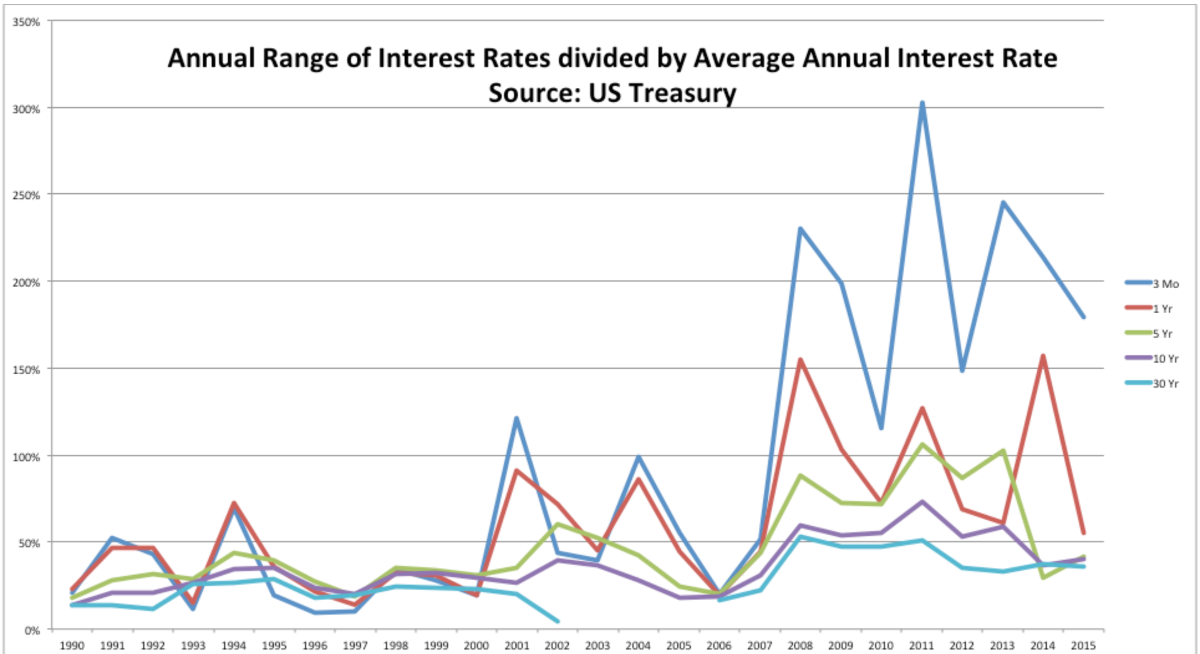
The chart above shows the average annual interest rate for 3-month, 1-year, 5-year, 10-year and 30-years U.S. Treasuries from 1990 through June 15th, 2015. Notice how during that time all rates have been moving lower. Notice too that *the Great Recession was preceded by the largest increase in rates seen for the entire period*. During this time former Federal Reserve Chairman Ben Bernanke decided that in order to combat what he saw as an overheating economy, the Fed would increase the Federal Funds rate target by 425 basis points (4.25%) between June 2004 and July 2006. You can bet your sweet corn muffins that current Fed Chairman Janet Yellen is painfully aware of what happened as her predecessor raised rates and also knows that the markets are likely going to be quite sensitive to the potential impact of rising rates. My bet is on her treading cautiously and slowly.



This also highlights the reality that nearly *every person working on Wall Street today has never lived in a rising rate environment,* but I'm sure that's nothing to be concerned over.

Bond investors have enjoyed one hell of a good ride over the past 25 years, granted with the occasionally period of serious rough roads, but overall it has been a money-making trip for decades. *Remember that as bond yields (interest rates) fall, bond prices rise, but here we sit as exceptionally low rates, so what does that mean going forward?*

This next chart shows the magnitude of fluctuations at the various maturities from 3 months to 30 years. This is illustrated by dividing the range of interest rates by the average interest rate for that year.



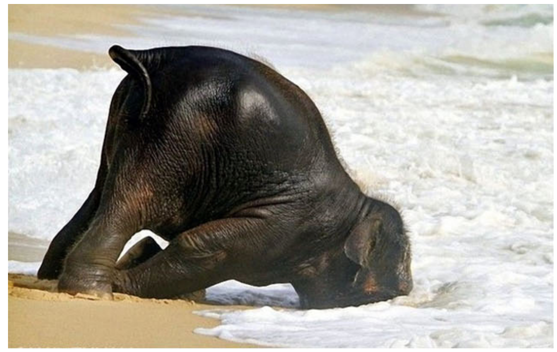
As rates have declined, it is of no surprise that volatility has grown dramatically. In 1990, the average interest rate for the 3-month was 7.75%, today it is 0.02%! The range of rates, meaning the spread between the highest rate and the lowest rate in 1990 for the 3-month was 1.63% in 1990 and just 0.04% today.

Bottom Line:
With the bull market now more than six years old and without a correction, meaning a 10% or more decline, in over three years, investors are as jumpy as the FCC whenever Miley Cyrus graces the small screen, with many on the lookout for a pullback. If we dive a tad deeper into the domestic equity market we can see material divergence between the different sectors. Consumer staples is showing signs of weakening while the energy sector, desperately in need of some Red Bull, is finally showing some signs of stabilization. Industrials, telecoms, materials and utilities are limping around while healthcare and technology have clearly been eating their Wheaties, with financials maybe starting to get a footing, but it is too early to tell just yet if that was premature joy over a potential rate rise.

As for bonds, the implication for investors is that while bonds for decades have been considered one of the most stable investments, at these ultra-low interest rates, small fluctuations can have big impacts; an upward change on the bathroom scale that can leave me whimpering over celery and water for a week would be an afternoon snack for the Sun's 375 pound former point guard Oliver Miller!

Given the economic weakness, that we'll discuss next, coupled with the defacto rate rise from a strengthening dollar, we believe it is unlikely that the Fed will be raising rates anytime soon. We correctly predicted no increase in June, believe it highly unlikely the Fed would do anything over the summer, and suspect that by September the economic data may indicate further signs of weakness. No Fed official would want to be so Grinchy as to initiate the first increase just before the winter holidays, so unless things diverge materially from what we see today, we think it unlikely that there will be a rate increase in 2015. That means that while rates may get a bit jumpy here and there as the Greek crisis evolves, overall we don't expect any huge moves in U.S. rates, barring any exogenous shock.

US Economy

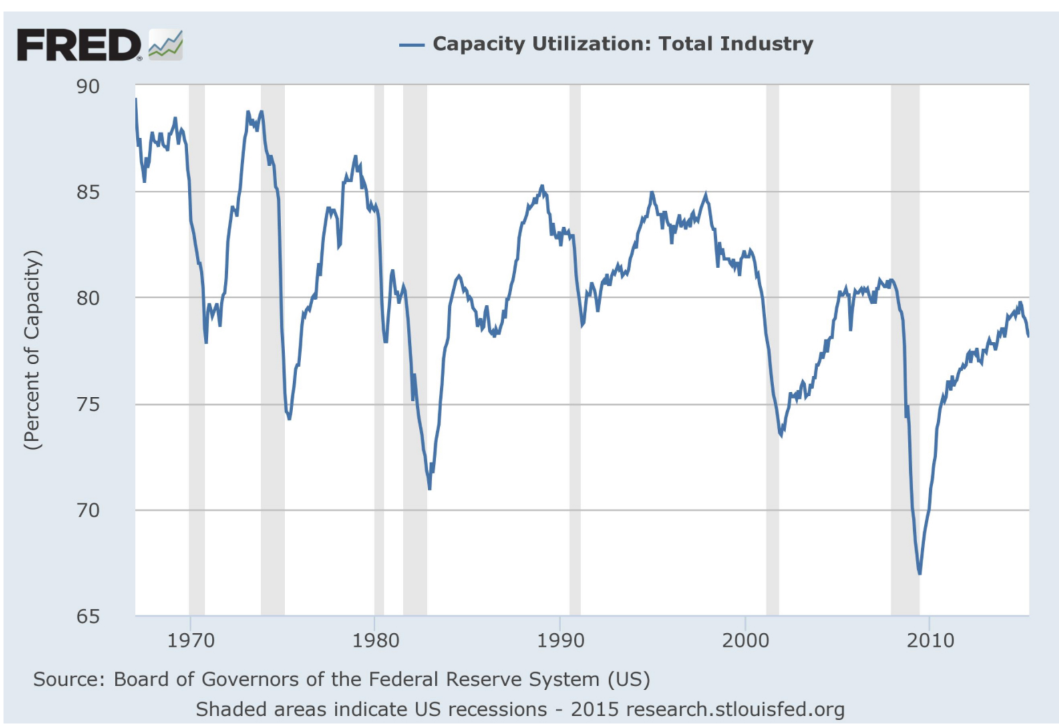


The annoying truth that very few economists want to admit is that the field is more art than science - much like investing. If investing were as easy as simply looking at the past and extrapolating it forward, you'd not need us. When it comes to economics, the best we can do is to develop an idea of general future probabilities based on how events unfolded in the past.

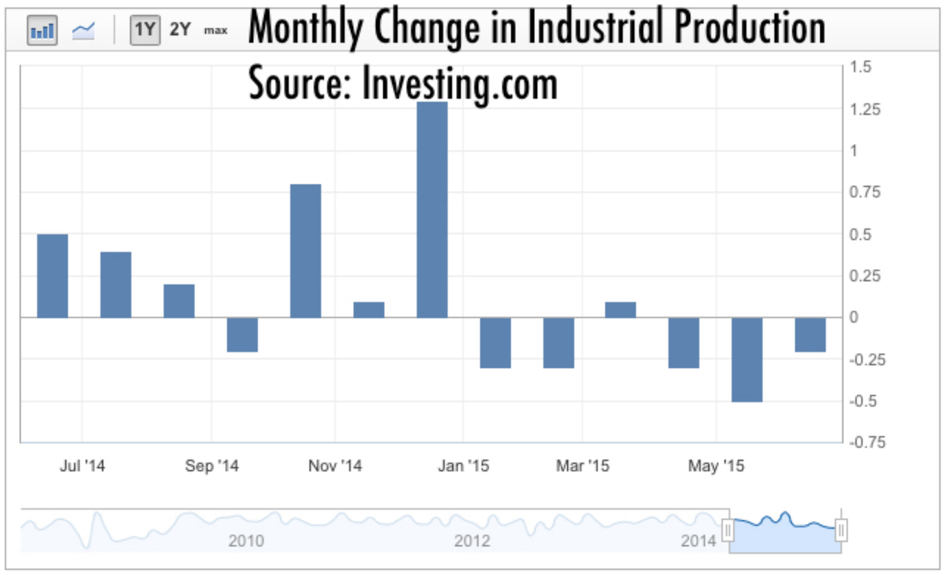
The headlines have been heralding all kinds of economic triumphs lately, which has been giving yours truly much brow furrowing consternation; talk about heads in the sand! Let me walk you through what no one seems else seems to be talking about.

One: Last month we talked about how Q1 GDP had been revised into a contraction, falling 0.7%. It is important to note that this is *the first time in recorded US economic data that the economy has contracted three times during a recovery*. That seems like a noteworthy lack of strength, particularly given all the support the Federal Reserve has been supplying coupled with the mindboggling level of federal spending; recall that during the last seven years US debt has doubled, meaning the government overspent as much in the past 7 years as it did in the entire 230 years prior combined!

Two: June 15th we learned that Capacity Utilization for total industry in the United States fell for the sixth month in a row. This is measured by the Federal Reserve and represents, "the percentage of resources used by corporations and factories to produce goods in manufacturing, mining, and electric and gas utilities for all facilities located in the United States (excluding those in U.S. territories). This measure has fallen six months in a row ten times previously since 1967, the earliest recorded data. *Every single time it has fallen in the past six times in a row, the economy has been in a recession.* In fact, the economy has never been in a recession when the metric did not fall for at least six consecutive months. Think of it this way, the US economy has thrown a big old production party, but hardly anyone's on the dance floor and everyone's wondering when the crowd is finally going to arrive.

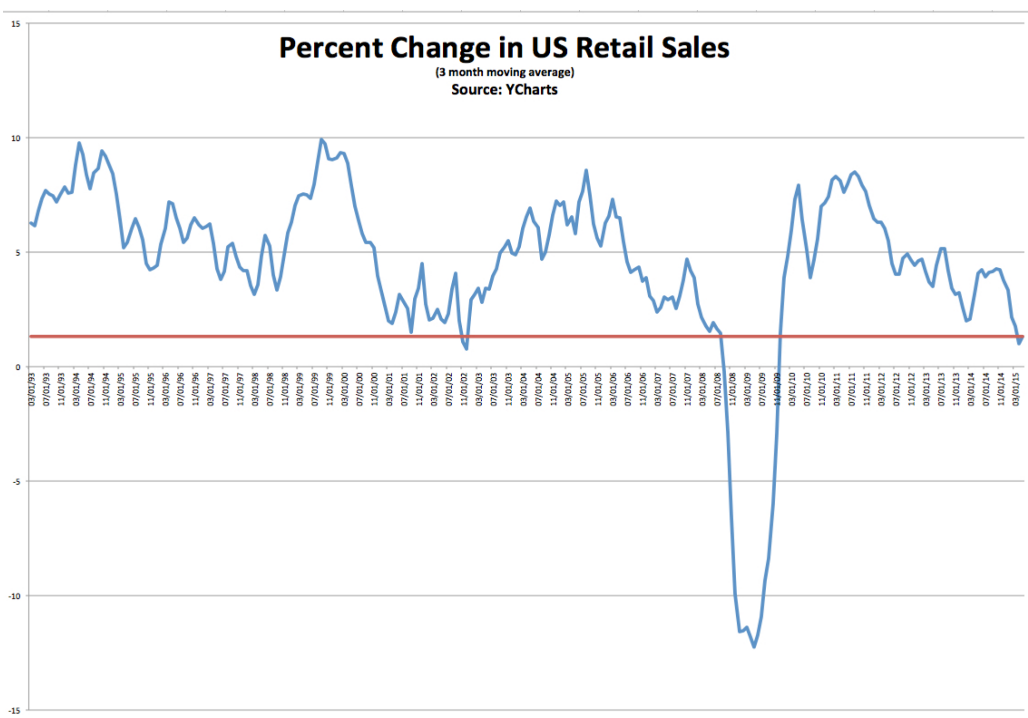


Three: Industrial Production has now come in below expectations six months in a row, and has shown a rather concerning downward trend since January. Keep in mind that a contraction in GDP for two quarters in a row, i.e. six months, is the definition of a recession. Industrial Production used to be the metric for the economy before GDP started being measured after WWII. May's number is also a bit of a blow to the hopes for a turnaround to GDP in Q2, as the level of production so far in Q2 is down 2.4% at an annual rate relative to the average for Q1, which was itself down 0.3% from Q4 2014. This means we are likely to see the first back-to-back quarterly contraction in production since Q1 and Q2 of 2009. Were this pre-WWII, this data mean an official declaration of a recession.



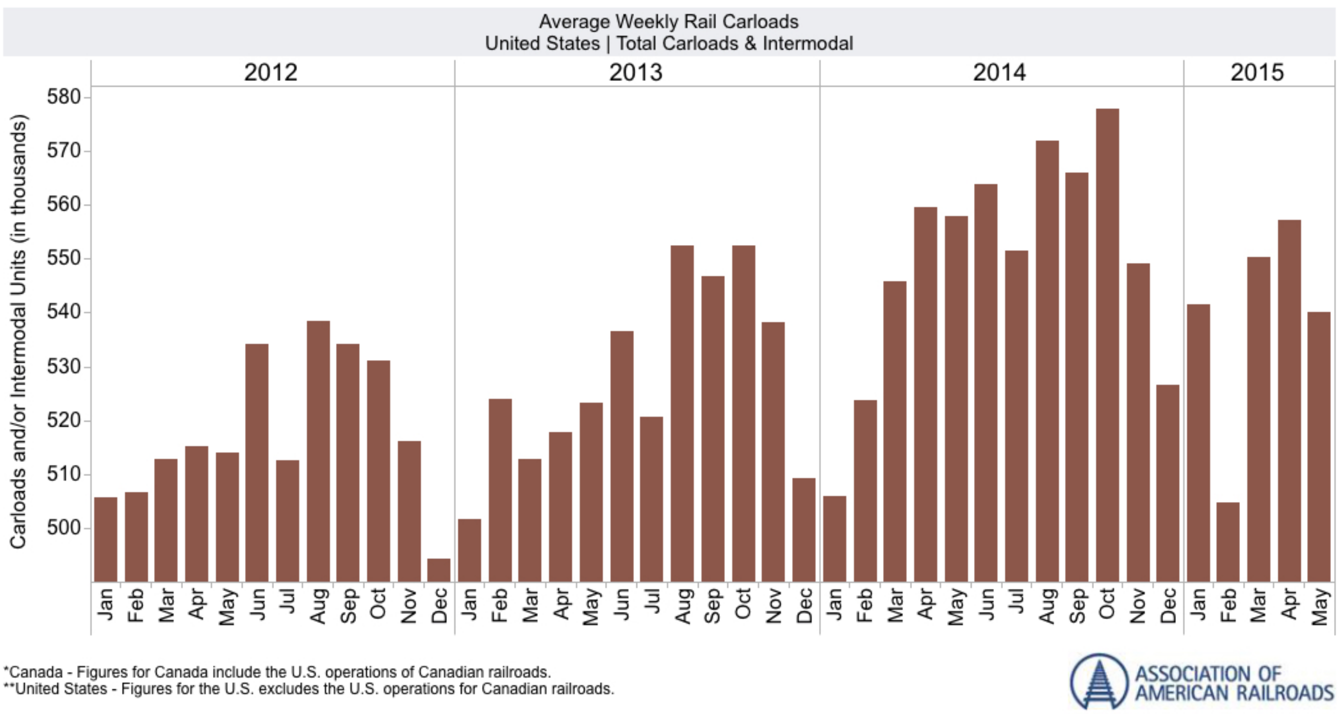
Release Date	Time	Actual	Forecast	Previous
Jun. 15, 2015 (May)	09:15	-0.2%	0.3%	-0.5%
May 15, 2015 (Apr)	09:15	-0.3%	0.1%	-0.3%
Apr. 15, 2015 (Mar)	09:15	-0.6%	-0.3%	0.1%
Mar. 16, 2015 (Feb)	09:15	0.1%	0.2%	-0.3%
Feb. 18, 2015 (Jan)	10:15	0.2%	0.3%	-0.3%
Jan. 16, 2015 (Dec)	10:15	-0.1%	0.1%	1.3%
Dec. 15, 2014 (Nov)	10:15	1.3%	0.7%	0.1%

Four: The three month moving average for US retail sales is at a level that is never seen outside of a recession, hat tip to Raoul Pal of Real Vision Television, (which I highly recommend for on-demand interviews with the best and brightest in the markets) for pointing out this one to me. While May retail sales were up from April, they were still 25% below March with an overall trend downward trend that is clear in the chart; so much for the return of the American consumer… not just yet.

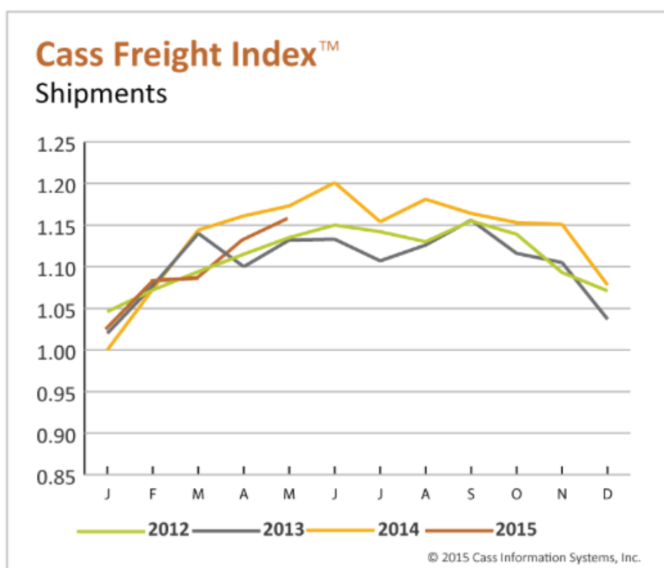


Five: The talking heads on TV claimed that the contraction in Q1 was due to extreme weather conditions and the port closures/slowdowns due to the labor union kerfuffle on the west coast. First quarter earnings releases and analyst calls where abuzz with retail executive bemoaning the lost sales thanks to goods getting stuck at the west coast ports. Alrighty then… we were willing to give them some wiggle room here. However, the port situation was resolved some months ago, which should have led to a big jump up in transportation needs within the US to get goods to and from those congested ports. Errrh….. May… not looking so good. That phrase is starting to sound like Wall Street speak for, “The dog ate my homework.”

MONTHLY RAIL TRAFFIC DATA



Not exactly inspirational; not only has rail traffic in 2015 been materially lower overall than in 2014, but May saw a sizable decline both relative to April and to May 2014. This data is reinforced by the Cass Freight Shipping data, which was released on June 15th, showing that while shipments and expenditures rose in May from April, they are still below 2014 levels, which was the strongest year so far since the Great Recession. Both car-loadings and intermodal-loadings were declining by month’s end as well, indicating that June is likely to also be weak.



	May 2015	Year-over-year change	Month-to-month change
Shipments	1.158	-1.3%	+2.3%
Expenditures	2.537	-4.2%	+1.5%

T o

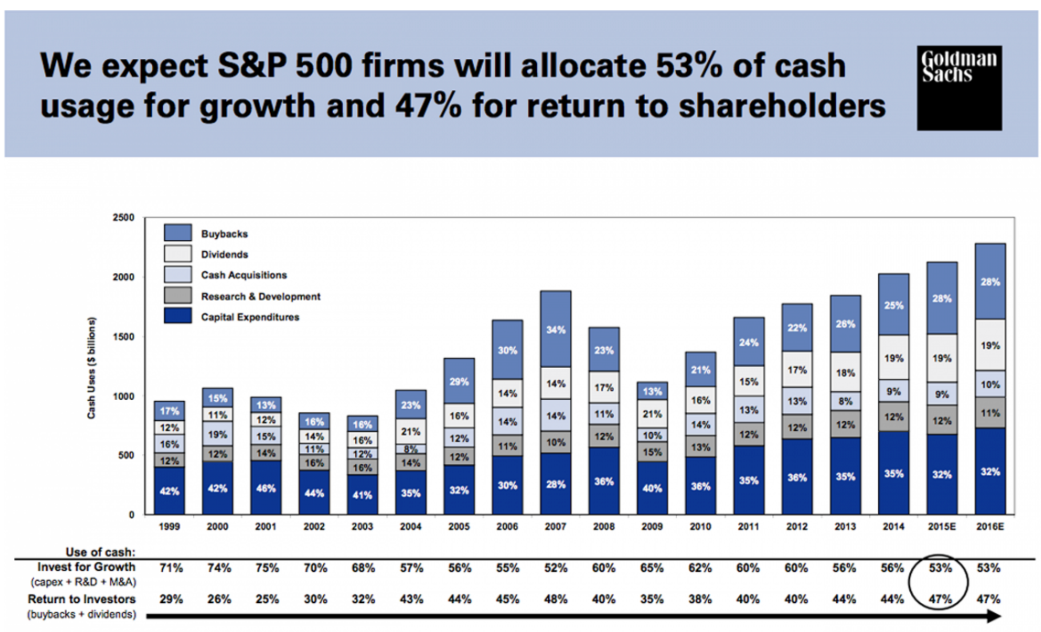
emphasize the point with transports, earlier this week Federal Express delivered quarterly earnings and revenue that fell short of expectations, citing pension costs, the impact of the strong dollar and lower fuel surcharges. All reasonable claims except they are nothing new, thus the company's guidance should have already taken those factors into account. To us this just gives further reason for concern.

Six: For all the talk about how the labor markets are heating up, getting tighter… whatever lovely catch phrase you like, June 18th the Labor of Bureau Statistics announced that real average hourly earnings decreased by 0.1% in May, seasonally adjusted. Real average weekly earnings also decreased by 0.1%. So much for all the talk about tightening labor markets inducing inflation, I keep scratching my head wondering what the heck the talking heads are looking at! On top of that, a recent report from Glassdoor Inc. revealed that job seekers had to wait about 22.9 days for an offer or rejection in 2014, up from 12.6 days in 2010 – again not an indicator of a tight job market.

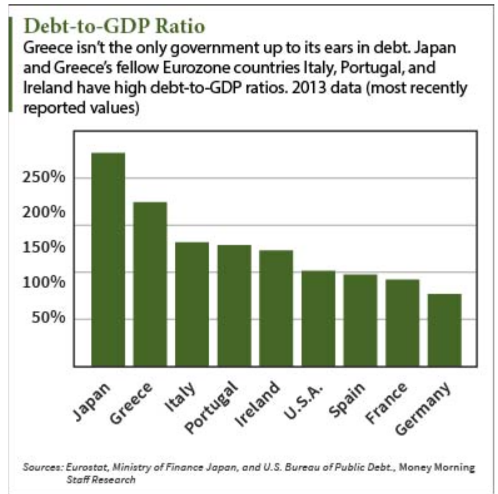
Source: HSBC. Note: the index includes a broad range of economic & survey data. Each release is compared with its survey median and the forecast error or "surprise" is measured in terms of standard deviations away from a "no surprise" scenario. A positive drift in an index implies the economic data have been coming in stronger than the market has been forecasting. Latest data point 12/05/2015.

To drive the point home, the chart at right shows just how much of the incoming data has surprised to the downside. Does this mean that expectations are entirely out of whack with reality or does it mean that the economy is weakening? Well, putting it all together…

Bottom Line: *As we said earlier, economics and investing involve looking at the new data coming in, comparing it to earlier data and looking for correlations in an attempt to identify trends or causation. In other words, we seek to understand what's going on now, what's causing it and where are we going? The current recovery has stumbled an unprecedented three times into contraction, which gives concrete data on how week this recovery actually has been. Capacity utilization, Industrial Production and Retail Sales data all point to a recession. Transportation of goods is well below last year and not showing signs of improvement and if one looks under the covers of the labor market – it is much weaker than the headlines indicate. One of our primary jobs is to manage risk and when we put all that data together, it gives us cause for concern as to the direction of the economy. The chart at right indicates that we aren't the only ones noticing just how weak the economy has become, as executives increasingly decide to return money to shareholders directly rather than invest it in elusive future growth.*



Grexit… again!



The headlines are once again dominated by the living Greek economic tragedy. Conventional wisdom has been to lambast the Greeks with the usual damning triumvirate of a nation whose citizens are either lazy, stupid or evil… or all three. The nation is currently in a technical default, having failed to make payments already due on loans to the International Monetary Fund (IMF), but has claimed that it will make a single lump sum payment later in the month for all monies due in June. The size of the Greek debt relative to GDP is second only to Japan, which given its ability to control its own currency is a very different animal.

To put the level of Greek debt in context, at a total of $352.7 billion, it is about half of the $700 billion that was approved by Congress for the Troubled Asset Relief Program in 2008. So in the context of global debt, it isn't that big of a deal, what is a big deal however is the precedent the situation will set for the Eurozone, the second largest economy in the world. I can't imagine just how much coffee and antacids have been consumed this week in Luxembourg, as all sides find themselves stuck between a rock and a hard place, with no clear common ground.

Yes, Greece is a disaster, but having been to the country, (I'm in love with Santorini and Mykonos) and having seen just how hard many of the Greeks work, my ire gets up when I hear that the problem is with those darned Greek people. Let's look at the data on just how lazy those Greeks really are.

Data compiled by the Organization for Economic Co-Operation and Development (OECD) shows that in 2013, (the most current data available) Greece had the second highest number of average annual hours actually worked per worker at 2,037 hours- only Mexico worked more!

How many hours for those diligent Germans who we are told are fed up with their lazy cousins to the south? A whopping 1,388, just two-thirds of the hours that those lazy Greeks put in every year. The Germans sit in 34th place on a global level for hours worked, behind Russia, Ireland, United States, Italy, Portugal, Canada, Spain, Sweden, Belgium, France, Denmark and Norway. Yes, the average annual hours worked in Germany in 2013 was *less* than Greece, Italy, Spain and Portugal!

So what gives? Why is Greece struggling, and for that matter why are Italy, Spain and France also battling weak economies? There is no easy answer for that, but lets take a quick look at the data.

According to data compiled by the World Bank benchmarked to June 2014, out of 189 countries ranked for ease of doing business, Greece was number 61 while Germany was number 14, the lower the number the easier it is. Italy sits at number 56, Spain at 33 and Portugal at 25. For comparison, the United States is number 7.

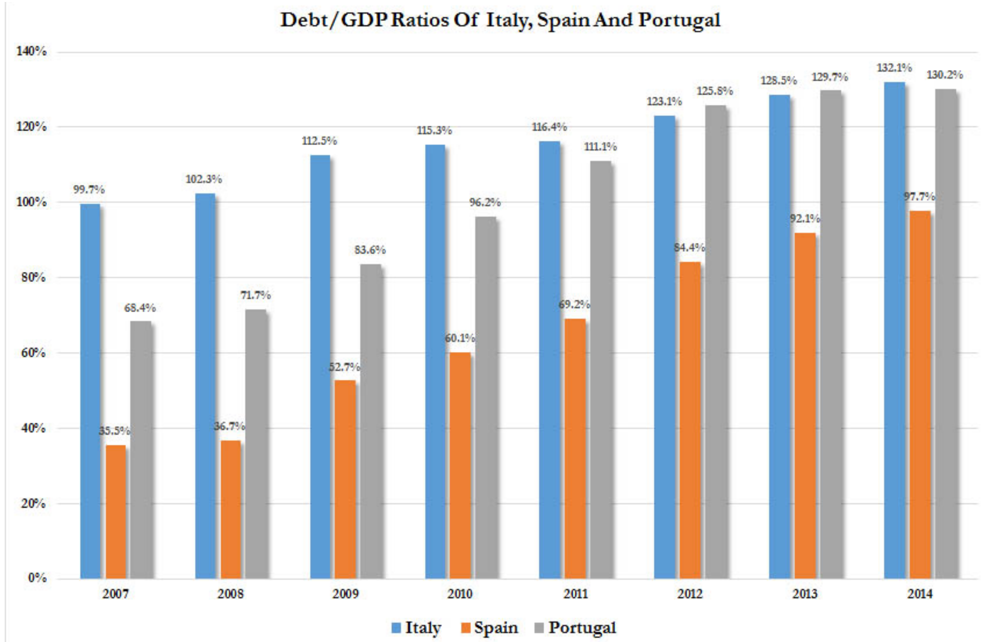
For getting credit, Greece ranks number 71 while Germany was 23.

For getting electricity Greece ranks 80 while Germany ranks 3.

For enforcing contracts, Greece ranks 155 while Germany ranks 13.

As for that excruciating austerity we keep hearing about, meaning the cuts governments were wailing about having been forced to endure. Errrr, hmmmmm, not so sure where that is coming from when we look at data from the IMF on the next chart….

Spending cuts? Where? All three countries have increased their debt to GDP ratios since the crisis began. So here's the real scoop.



Greece has a massive government full of rules and regulations on darn near everything that makes it very difficult to start or run a business and a tax code that makes War and Peace look like a summer beach read. Now all these rules, regulations and taxes were put in place for ostensibly good reasons, like most bureaucratic shenanigans, "We need to protect hotel employees, cab drivers, restaurants, nurses, fishing boats, gardeners etc. etc. etc." The problem is that when you add up all this "protection" for existing businesses, employees, consumers, tradespeople… it becomes increasingly tough to run a business.

To make up for just how tough it is, the government has made it a practice to promise people lots of safety in the form of pension systems, welfare aid, etc. The math here isn't too tough to figure out. If on the one hand you make it really hard on people to get things done and on the other hand you provide ample support for a decent living for those who aren't working for whatever reason, well you'll have less people working their tails off, which means less money available to tax and spread around to those who aren't working. But that's ok, because hey, we are part of the Eurozone and can get debt cheap, so we'll just borrow whatever we can't get through taxation and spend that. No worries.

That worked for a while… until the market started looking at the math a bit more in depth and realized that Greece had reached the point where it really cannot sustain its debt any longer. Greece is like the family with a single income earner holding down two jobs that pay slightly over minimum wage who needs to support a spouse, some kids, manage a $525,000 adjustable rate mortgage whose rate keeps rising, has two cars in the driveway in desperate need of rather costly repairs, a cousin who just moved in and has some serious health problems and found out today that the roof has a major leak. Now the bank keeps calling and telling you that you need to work harder and cut back on the spouse's spending habit as your mortgage rate continues to rise and you are already late on a few months' worth of payments and your credit cards are maxed out. Your boss is telling you that your skills are seriously lacking and your cousin says she can't possibly live in that room you gave her unless she gets to redecorate it on your dime. At some point, you throw your hands up in the air and tell everyone to shove it!

Earlier this week, according to a report by the Financial Times, Greek prime minister Alexis Tsipras argued that, *"The pensions of the elderly are often the last refuge for entire families that have only one or no member working in a country with 25 per cent unemployment in the general population, and 50 per cent among young people."* That's Greek for shove it.

How does a politician manage this type of pressure from back home? Ms. Merkel and Mario Draghi just aren't that scary or persuasive!

So that's where we are. The majority of Greeks have decided to go the "shove it" route and sent Yanis Varoufakis to deliver the message, in a rather debonair manner we might add, (that's Yanis on the left.) This has left Germany's Angela Merkel, the European Central Bank's Mario Draghi and France's François Hollande in a tizzy as they try to figure out how to work with a Greek envoy that appears to be quite confident their game theory skills will eventually get them whatever they want. Italy's Renzi, by the way, is mostly back home dealing with his nation's struggling economy and the seemingly eternal roll of sitting between the U.S. and Russia – poor man has enough on his plate!

So here we stand with Greece still wanting to be part of the Eurozone club, having never, even upon admission to the club, been able to satisfy the requirements for membership. To be fair, many nations who were let into the Eurozone club never have been able to meet them either.

Bottom Line: *What does a Grexit mean for the rest of the world? First, it likely means a stronger dollar relative to the euro, at least in the near-term, as there will be a flurry of uncertainty given that (1) the Maastricht Treaty didn't provide any way for a nation to exit the Eurozone and (2) there will be fears that other member nations may try to find wiggle room around their heavy sovereign debt loads, which will give some cause for concern about the future of the Eurozone. Eventually, all that flurry will likely pass as frankly a Eurozone without Greece is stronger than one with it. However, the Eurozone economy is still struggling, thus the ECB will continue on with its euro-style quantitative easing, which means that over the longer run, the U.S. dollar is likely to continue it bull run.*

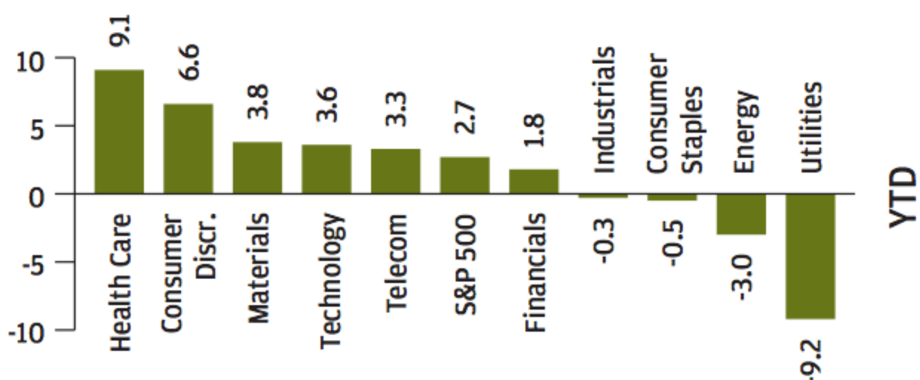
Market Recap

(as of June 13th, 2015)

		Index Returns (%)				
Equities	**Level**	**1 week**	**QTD**	**YTD**	**1 year**	**3-yr. Cum.**
S&P 500	2094	0.12	1.72	2.68	10.73	68.62
Dow Jones 30	17899	0.32	1.15	1.51	9.49	53.06
Russell 2000	3144	0.36	1.22	5.58	10.54	73.04
Russell 1000 Growth	664.06	-0.09	1.35	5.24	13.92	69.88
Russell 1000 Value	635.01	0.33	1.83	1.10	7.72	70.44
MSCI EAFE	1891	1.39	3.40	8.56	-1.27	53.31
MSCI EM	979.46	-0.22	1.05	3.35	-4.66	16.26
NASDAQ	5051	-0.31	3.32	7.23	18.90	84.64

Fixed Income	**Yield**	**1 week**	**QTD**	**YTD**	**1 year**	**3-yr. Cum.**
U.S. Aggregate	2.44	0.05	-1.90	-0.32	2.12	5.66
U.S. Corporates	3.36	-0.01	-3.10	-0.85	1.37	11.07
Municipals (10yr)	2.35	0.21	-1.50	-0.26	3.15	9.60
High Yield	6.63	-0.18	0.57	3.11	0.53	24.95

	Levels (%)					
Key Rates	**6/12/15**	**6/5/15**	**3/31/15**	**12/31/14**	**6/12/14**	**6/12/12**
2-yr U.S. Treasuries	0.74	0.73	0.56	0.67	0.42	0.30
10-yr U.S. Treasuries	2.39	2.41	1.94	2.17	2.58	1.67
30-yr U.S. Treasuries	3.10	3.11	2.54	2.75	3.41	2.77
10-yr German Bund	0.83	0.85	0.15	0.53	1.39	1.43
3-mo. LIBOR	0.29	0.28	0.27	0.26	0.23	0.47
3-mo. EURIBOR	N/A	-0.01	0.02	0.08	N/A	0.67
6-mo. CD rate	N/A	N/A	N/A	0.27	0.27	0.47
30-yr fixed mortgage	4.17	4.17	3.89	4.04	4.34	3.88
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25



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