November 10th, 2015

MERITAS ADVISORS

Comprehensive Wealth Management

MONTHLY INVESTMENT OUTLOOK

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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 early 2016 and is currently available for pre-order from Amazon. In addition to her frequent television appearances, Lenore also gives a weekly radio update on Monday and Friday 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

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Dear Clients and Friends: While August and September left most investors looking for the Mylanta, October was a veritable rocket ship… despite further news of economic weakness both here and around the world. We are currently knee deep in earnings season and so far the trend of weak revenue growth, coupled with earnings growth that are driven in large part by financial engineering, is continuing while the growth of the US economy in the third quarter came in below expectations. As usual, we have a lot to cover so let's get rolling! *Lenore Elle Hawkins, your Meritas Advisors chief economist, writer and excessive lover of pumpkin pie, along with Mike and Greg, wishing you and yours a very Happy Thanksgiving full of laughter, love and an overabundance of tasty treats!*

Market Update

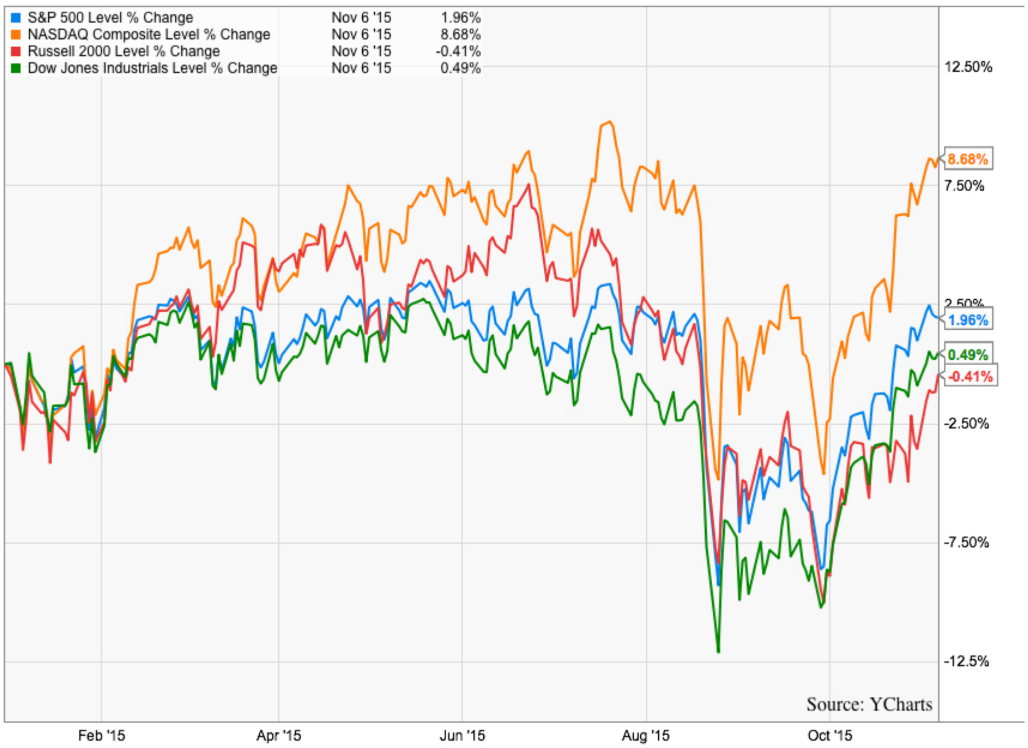
The S&P 500 rose 8.3% during the month of October, contrary to the doom and gloom implied by September and August, marking **not only the strongest month for the index in 2015, but also the strongest since October 2011**. Two of the four major equity indices, namely the S&P 500 and the Dow Jones Industrial Average, printed monthly returns in the top 3% of all months since 1979!

Index	1m Ret.	%ile	Best Since	3m Ret.	12m Ret.
S&P 500	8.57	0.970	10/11	-0.92	3.29
Russell 2000	5.52	0.809	2/15	-6.23	-1.03
Dow	8.77	0.975	10/11	0.13	1.85
Nasdaq	9.47	0.938	10/11	-1.38	9.22

The Good News:

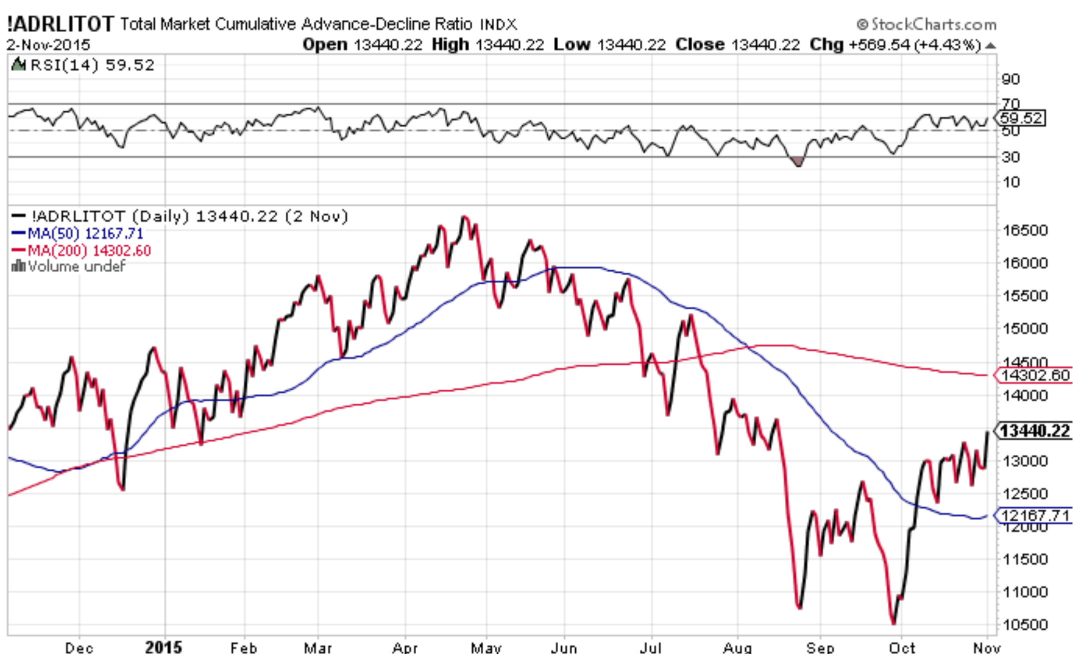
Such a fast run up in stock indices is usually driven by a small group of high-flying stocks which is often then a prelude to a rapid decline, but this time we are seeing something we haven't seen in quite some time. This time we've seen a rising percentage of companies see their stock prices also moving up. This is referred to as "breadth" in the market and it is often considered a sign of a more robust upward move in equity markets than if the market indices are moving up based on a small number of high-flyers. We are also seeing nice volume on these moves. That's important because if a stock, or a bunch of stocks in an index move up on low volume, that means a small portion of investors are involved in the move. That usually means that those watching the moves can't have a whole lot of conviction in the direction of the move. When we see a more normal volume of trading, and even better, rising volumes, along with an upward moving market, we have more confidence in the direction.

This next chart shows the dramatic run up in recent weeks for all the major U.S. indices. Note that despite this run up, only the Nasdaq is in solid positive territory, up over 8%, with the S&P 500 up just under 2% while the Dow Jones Industrial Average and the Russell 2000 (small market capitalization companies) are both essentially flat year-to-date.



As of Friday' close, 82% of stocks in the S&P 500 are now trading above their 50-day moving averages. Prior to this week we haven't seen this figure go above 80% all year and since 1990, there have only been ten prior streaks of six months or longer where the reading remained below 80%.

This chart at right shows how the number of advancing stocks has risen substantially since the October lows.



The not-so-good-news

Let's take a step back and look at what typically happens when breadth has been weak for six months or longer. While we generally like to see an index moving upwards with increasing breadth, it turns out that when this occurs after a prolonged period of weak breadth, it doesn't always lead to strong market performance in the immediate future, as the chart below shows. However, over a longer period, stocks have tended to perform well, with the exception of 2001 and 2009.

Days Streaks Without a Breadth Reading Above 80%*

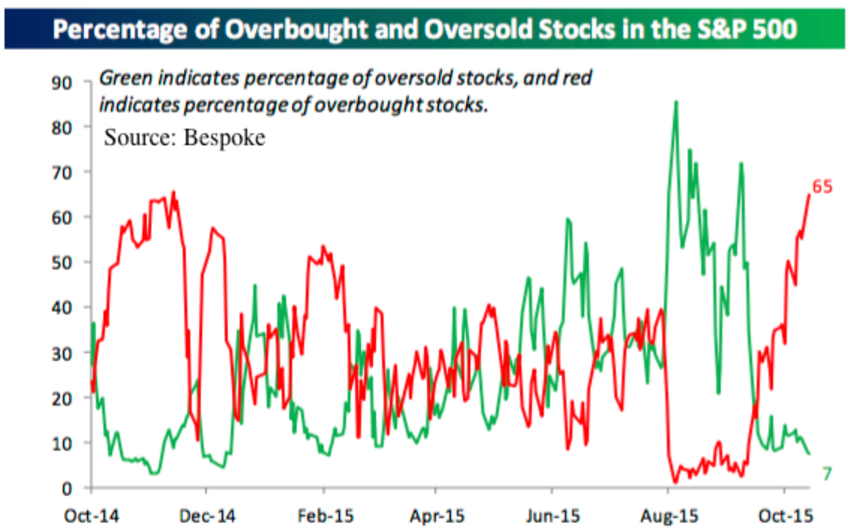
Date	Trading Days Below 80%	Next Month (%)	Next 3 Months (%)	Next 6 Months (%)
12/30/1991	192	-0.85	-2.76	-0.54
11/30/1992	212	1.01	4.15	4.90
8/26/1994	382	-1.89	-4.15	2.50
2/7/1996	144	-1.52	-0.69	1.87
10/30/1998	144	6.61	15.78	21.24
5/16/2001	506	-5.96	-8.04	-11.51
11/22/2002	179	-4.39	-10.02	3.55
9/17/2004	149	-2.24	5.82	3.82
9/20/2006	173	3.28	7.42	7.80
1/6/2009	311	-7.07	-11.72	-5.95
11/2/2015	211	?	?	?
	Average	**-1.30**	**-0.42**	**2.77**
	Median	**-1.71**	**-1.72**	**3.03**

Source: Bespoke

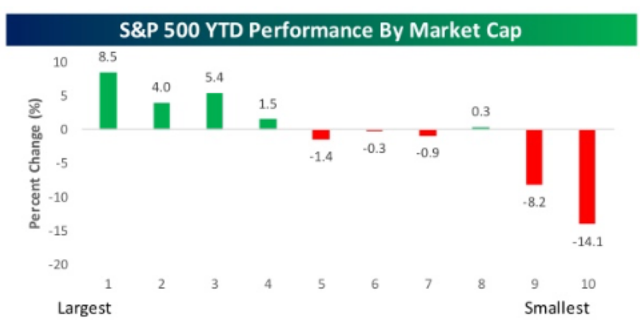
We also like to look at just how fast the market has moved upwards. As of Tuesday's close the S&P 500 is up over 11% from the August lows, and from a technical perspective is in highly overbought territory, having moved more than two standard deviations above its 50-day moving average, as shown in the following chart.

For those of you who might be unfamiliar with this way of looking at the markets, this type of analysis is referred to as "Bollinger Bands." Many technical analysis tools will allow you to select a specific moving average and the number of standard deviations away from that moving average. For example, a Bollinger band (50,2) would show three lines moving with the price of the security. The middle line is the 50-day moving average. The top line represents two standard deviations above that 50-day and the bottom line represents two standard deviations below. A Bollinger band (20,3) is a 20-day moving average with three standard deviations above and below. This is a useful tool to get an idea of the magnitude of price movements. The movement we have recently seen indicates a heavily overbought market and often indicates a near-term pullback of some degree is likely. If we look at individual stocks within the S&P, we see that the percentage of overbought stocks has risen dramatically and to a level we have not seen in quite some time.

We are also seeing in the markets that it pays to be big. If we look at the 25 largest stocks in the S&P 500, by



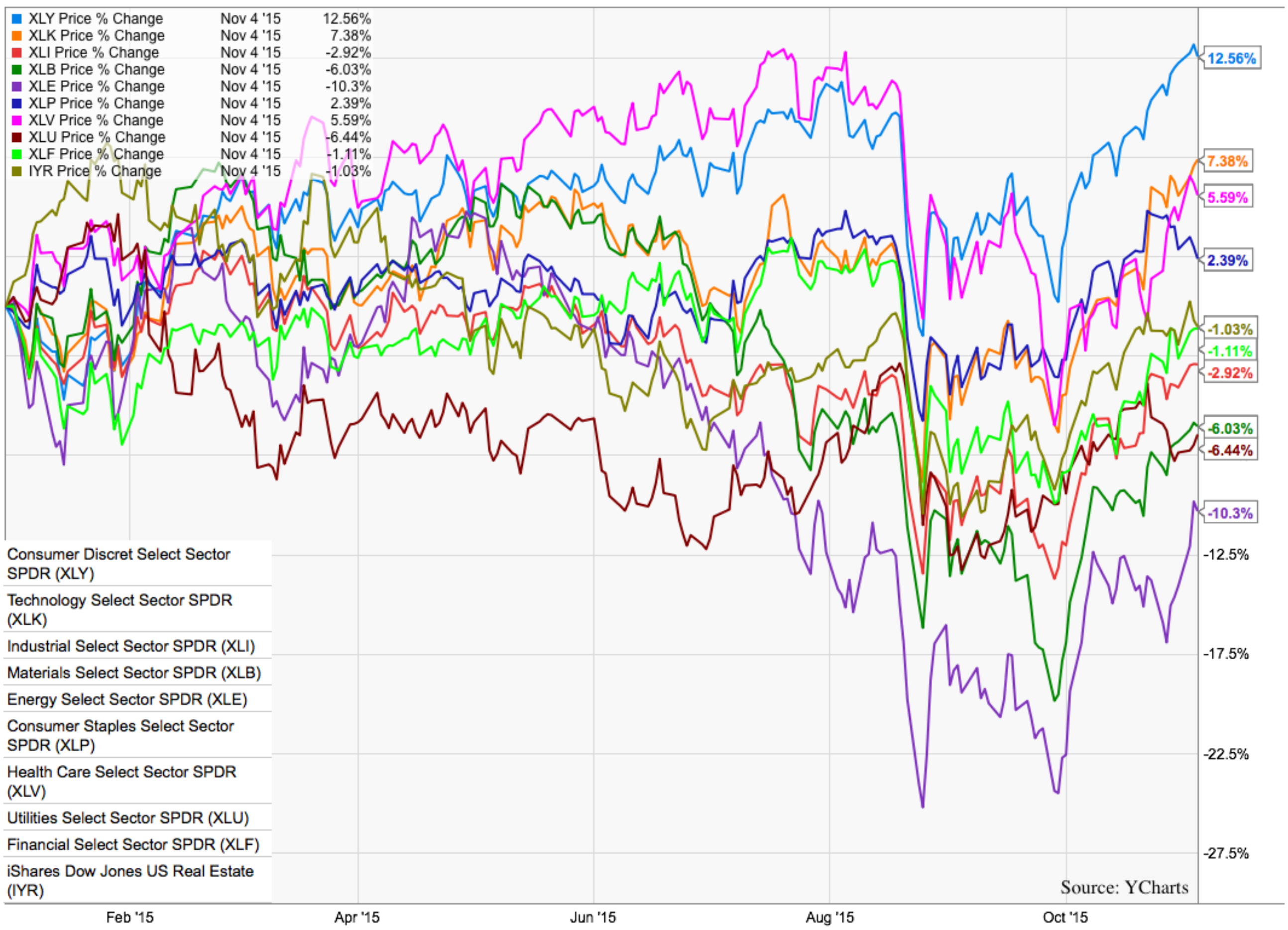
market cap, the majority of them are in overbought territory, up an average of 8.4% year-to-date. On the other end of the spectrum, the 25 smallest stocks are down an average of 27.4% year-to-date – a veritable bear market! This trend is fairly consistent across the entire S&P 500 when broken out into percentiles by market cap.



Source: Bespoke

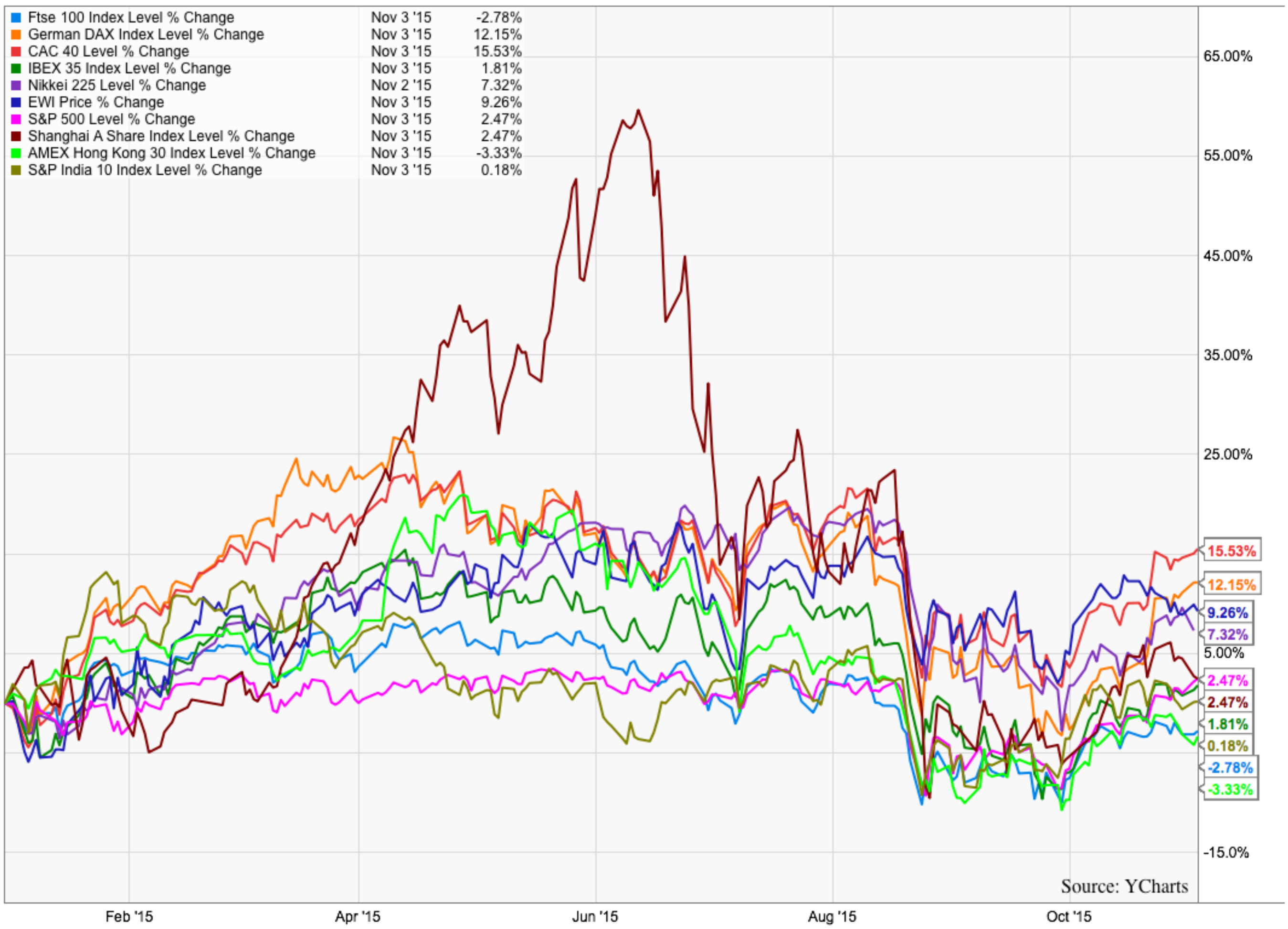
Bottom Line: *A pullback here is likely, but there is nothing to suggest a pullback of particularly large consequence is in the works in the near-term.*

Looking at sectors, we see that the Consumer Discretionary sector continues to be the strongest performer, having been in the top sectors for most of the year. *We will point out that shares of Amazon account for over 11% of the total market cap in the Consumer Discretionary sector, and its shares are up over 110% year-to-date, which is rather distorting for the sector*. The healthcare sector has recently recovered some of the loses it suffered in August and September while technology has recently come on exceptionally strong. Energy, materials and utilities are currently the worst performers. We don't see any reason to expect energy nor materials to make appreciable gains in the near-term.



Internationally, over the past month many of the international indices have enjoyed exceptionally strong performance as well, with Germany's DAX up nearly 14%, China's Shanghai A Share Index up over 12% and France's CAC 40 up over 11.5%. Even Spain's beleaguered IBEX 35 rose over 8.5%. In contrast, the previously strong Italian EWI fell 1%.

Year-to-date France's CAC 40 is the strongest performer by far, up nearly 16% with Germany's DAX trailing just slightly, up a little over 12%. The U.S.'s S&P 500 is up a paltry 2.5% in comparison.



We suspect that with the European Central Bank's recent hints that it may engage in further rounds of quantitative easing, equity prices in Europe are likely to enjoy a tailwind, despite the struggling economies. The divergence between the European Central Bank's and China's leanings towards easing versus the U.S. with Fed Chairman Janet Yellen sounding increasingly hawkish is likely to put continued upward pressure on the U.S. dollar relative to foreign currencies, providing a headwind to U.S. exports and those companies that generate a material portion of their revenues from overseas.

Yes, Janet Yellen and her colleagues at the Federal Reserve are sounding more hawkish and last Wednesday Ms. Yellen gave another non-announcement announcement that the Fed could hike rates in December. We knew that, we've always known that. One has to wonder what the Fed is doing us repeatedly telling us things we already know. It is as if they are trying to get the markets to react to just a hint of an action rather than taking any real action. So there's that… but how's the U.S. economy actually doing?

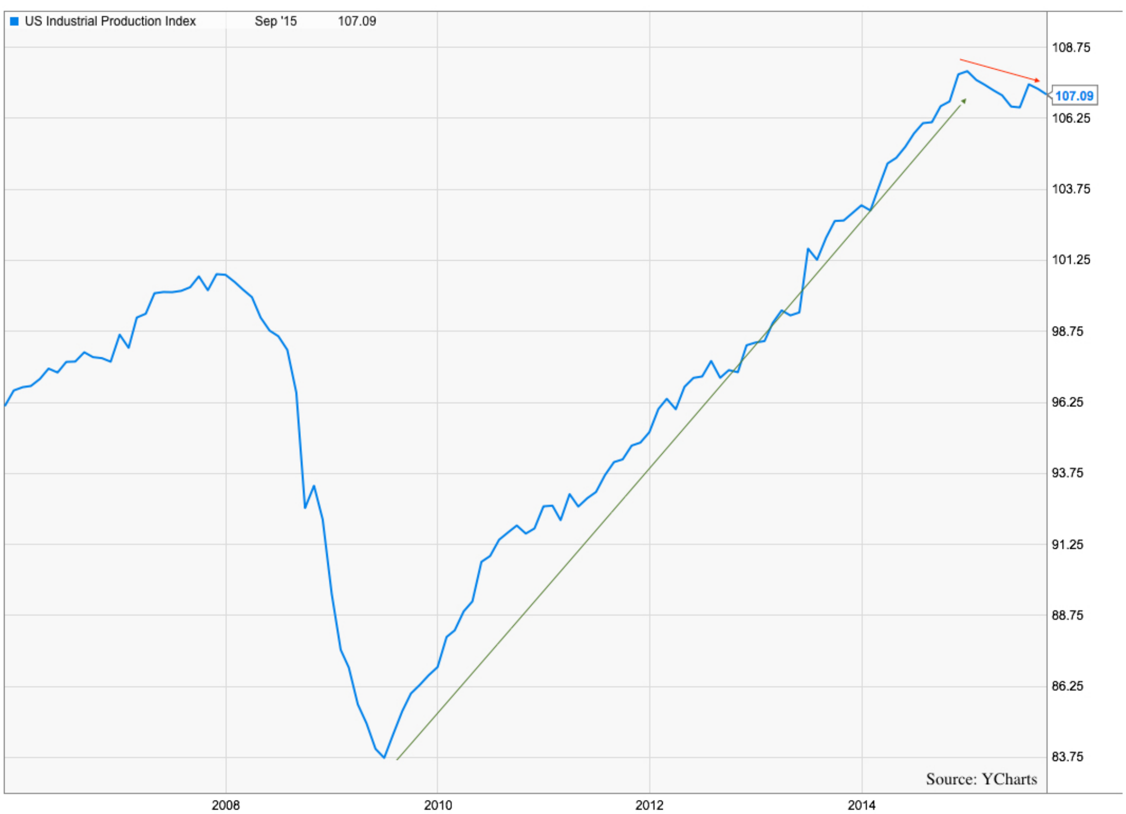
US Economy

Last week started with the weakest headline ISM (Institute of Supply Management) Manufacturing report since December 2012 at 50.1, however many economists were expected a reading below 50, (which is a contraction) so this was actually better than expected. A painful portion of the grim report came from **ISM Manufacturing employment, which is now at its lowest reading since August 2009**. While manufacturing is a relatively small share of the total US economy, we'd prefer to see more upbeat data. Overall manufacturing looks weak, with everything but customer inventories lower year-over-year as this next chart illustrates.

ISM Manufacturing Current Levels: October 2015

				Change	
Index	**Current**	**One Month Ago**	**One Year Ago**	**One Month**	**One Year**
Overall	50.1	50.2	57.9	↓	↓
Production	52.9	51.8	62.8	↑	↓
New Orders	52.9	50.1	63.0	↑	↓
Backlog Orders	42.5	41.5	53.0	↑	↓
Supplier Deliveries	50.4	50.2	56.1	↑	↓
Business Inventories	46.5	48.5	52.5	↓	↓
Customer Inventories	51.0	54.5	48.0	↓	↑
Employment	47.6	50.5	55.2	↓	↓
Prices Paid	39.0	38.0	53.5	↑	↓
Export Orders	47.5	46.5	51.5	↑	↓
Imports	47.0	50.5	54.5	↓	↓

If that didn't drive it home, this chart on US Industrial Production ought. The Industrial Production index shown below is an indicator that measures real output for all facilities located in the United States manufacturing, mining, and electric, and gas utilities. This index is generated using 312 individual data series. The chart below shows how its longer-term, steep upward trend from the depths of the financial crisis stalled towards the end of last year and is now trending downwards.



In fact, on a **global level, manufacturing has been under pressure** with the Global manufacturing purchasing manager's index, (an indicator of the economic health of the manufacturing sector based on new orders, inventory levels, production, supplier deliveries and the employment environment) down to 51.4 from 52.2 a year ago. Remember that anything below 50 is a contraction. On the bright side, the current 51.4 is a seven-month high! In the US, the manufacturing purchasing manager's index is down to 54.1 from 55.9 a year ago, but up from 53.1 last month.

On a more upbeat note, the **ISM non-manufacturing beat expectations mightily**, coming in at 59.1 versus expectations for 56.5, down from last month's 56.9. So the manufacturing sector is continuing to weaken while the services sector strengthens. The good news is the service sector counts for a larger portion of the economy, however the fly in the ointment is that these two tend to move along much closer together and are now diverging to a point not seen since late 2000/early 2001. This is cause for concern as we have every reason to believe the two will return to their historical relationship. *Given the global picture, at the moment it looks more like services will move towards manufacturing than the reverse*.

If we look at construction, it is also struggling. Residential construction spending rose 61 basis points in September, driven primarily by gains in private residential spending, without which the spending number would have actually declined month-over-month.

Monday afternoon the Federal Reserve released its Senior Loan Officer Survey and reported that for the first time since early 2012, a net **7.3% of bankers reported tightening standards for large and mid-size firms based on a less certain economic outlook**. Most banks also reported weakening demand for most categories of mortgages since the second quarter while seeing credit card credit demand increase. In response, banks reported having eased lending standards on loans eligible for purchase by Fannie Mae and Freddie Mac. Tightening credit conditions are a headwind to economic growth, of which Chairperson Yellen and her team are highly aware. We're sure they are watching this data very closely.

Friday we saw **very strong payroll report for October**, but this number can be quite volatile, so if we look at a three month rolling average, the current gain is still 26,000 less than the average during the first six months of the year. We did like to see a 0.4% rise in average hourly earnings last month, bringing the annual rate up to 2.5%, which is the strongest in the past six years. That bodes well for holiday spending, which ought to have companies like Amazon pleased as punch. If we look at the labor-force participation rate however, that remained unchanged at 62.4%, which is 0.5 lower than in January. This data point is one that causes yours truly much angst. Think of this as a measure of what percentage of the population is rowing the economic boat. The more that row, the faster we can go. Today we have roughly the same portion we had in the late 1970s, not exactly a robust time!

The news of the strong jobs report sent the markets into a tizzy as the probability of the Fed kicking off the first interest rate hike in more than nine years at their next meeting in December soared to 68%, which is almost double the odds of such a hike just one month ago. One of the arguments for such an increase is that it would provide some assistance to savers who have been struggling to earn much of anything on their savings. Hmmmm, if the Fed raises rates, and your truly still considers that unlikely given the bigger picture of the US economy and slowing global growth, it will likely only raise rates initially by 0.25%. Over perhaps the following year it could theoretically get to 1%, which would in reality still do very little to help savers. The bigger beneficiaries initially would be those providers of money market funds that have been forced to eat the cost of overhead in order to give investors in such funds even the tiniest of yields. This led to soaring share prices of companies like Charles Schwab, E*Trade Financial and TD Ameritrade Holdings on the jobs news Friday.

Bottom Line: *We are seeing diverging data coming out on the domestic economy and continue to be concerned with the weakness we see in global commodities, transports and particularly in global exports as they typically lead global GDP trends.*

Earnings Season

So far 73% of the companies in the S&P 500 have exceeded bottom line EPS (earnings-per-share) estimates but just 44% have beaten topline revenue estimates. This is a trend that we do not like seeing as companies cannot eternally manage earnings up while revenues struggle. Looking at smaller companies, for the Russell 2000, (the small cap company index) 46% of companies have beaten revenue estimates with 59% beating earnings.

Looking forward, **the downward revisions have continued their trend, but with a bit of a less dour tone**. Over the past four weeks, analysts have raised estimates on 475 companies in the S&P 1500 and lowered for 815, for a net of -22.7% of the index which is an improvement over the -30% revisions just two weeks ago.

What concerns us is that revenue growth is a function of economic growth; in a strong and growing economy businesses are able to sell more. We are not seeing overall strength in revenue growth, but instead we are seeing revenue expectations continue to weaken, which gets us nervous. Next, earnings growth is determined primarily by… wait for it… revenue growth, (just a bundle of insight here!). So when we see revenue weakening we get nervous. When we see earnings doing far better than revenue over an extended period of time we get more concerned. Think of this as getting fit and trim for swimsuit season. Getting rid of any excess is often beneficial, but it cannot go on forever as at some point you are starting to cut into long-term health. With weak revenue, companies can only continue to strengthen earnings by cutting into investments necessary for longer-term growth, which may make them look good today, but not so good for the future. In fact, we've seen quite a few companies get hit hard this earnings season, like Under Armour, when they chose to reinvest in future growth rather than the now popular financial engineering of share buybacks to artificially improve per share figures. We don't like seeing the investment community focusing so much on short-term performance over longer-term growth, but that is typically a sign that investors aren't confident in the potential for long-term growth; given the data we see, we understand the bias.

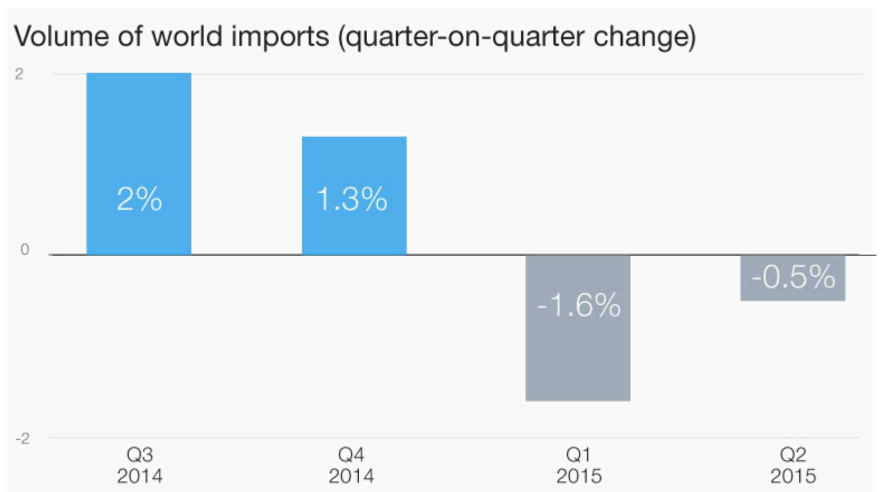
We are now in a corporate profit recession, meaning overall, corporate profits have now contracted for two consecutive quarters and are expected to contract again in the last quarter of 2015, primarily due to the strong dollar and lower oil prices. **Revenues for the S&P 500 have now declined for three consecutive quarters**, something that hasn't happened since the financial crisis in 2009. Looking back over more than 60 years of national accounts, quarterly changes in real GDP account for around 30% of the variance in quarterly earnings growth. Absent a major drop in global GDP, oil is unlikely to face another major drop. The dollar however, could continue to strengthen if the Fed does in fact embark upon a series of rate hikes while the other major economies around the world act to weaken their currencies.

Global Economy

Monday morning the OECD, (Organization for Economic Cooperation and Development) lowered its global growth forecasts for 2015 and 2016 to 2.9% and 3.3% versus 3.0% and 3.6% previously. This comes just a few weeks after the International Monetary Fund predicted that the world economy would, in 2015, grow at its slowest pace since the financial crisis. We are particularly concerned with global exports as world trade has long been a strong indicator of global growth and so far in 2015, trade has been at levels typically associated with a global recession. To further drive home our concerns on global trade, we looked at the reports coming from the largest shipping company in the world, A.P. Moeller-Maersk, which handles about 15% of all consumer goods transported by sea. The CEO of A.P. Moeller-Maersk recently stated that, "The world economy is growing at a slower pace than the International Monetary Fund and other large forecasters are predicting." Err, wait! They just reported trade levels that are typically seen during a global recession and this guy thinks it is even worse. Argh! The company reported recently a 61% drop in third quarter profit as demand for ships to transport goods across the world hardly grew from a year earlier.

China, the world's second largest economy, reported that its exports declined 6.9% year-over-year versus expectations for 3.8% and marking the fourth consecutive month of declines. In India, exports of the top five sectors including engineering and petroleum fell by about 31% in September on a year-over-year basis. Keeping a wary eye out here!

To put the chart below in perspective, world trade grew by 13% in 2010, but has been slowing considerably since then. The WTO (World Trade Organization) lowered its forecast in annual volumes to 2.8% from 3.5%, which is well below the 7% average for the 20 years leading up to 2007.



Bottom Line: *The combination of new trade barriers being introduced faster than existing ones are being removed coupled with cyclical problems that include falling commodity prices and debt overhang are acting as headwinds to global trade, which harms economies all over the world. While the US is the largest economy and is driven much by internal demand, it is not immune to the fates of the global economy.*

Your Money with Greg Tull

Markets, like Boards of Directors, do not like negative surprises. That may be another reason that the Federal Reserve is working hard to convince market participants that they may indeed raise interest rates next month (December) for the first time since 2006. According to the Fed Funds Futures market on Friday November 6, bond traders (remember, traders are short term focused, and investors are long term focused) are 70% sure that the Fed will hike rates this year. After all of the work the Federal Reserve has done since the financial crisis to try to help the economy get back on track, the last thing the Fed wants to do is to risk derailing the recovery by catching market participants off guard and triggering a stock market tailspin. If the economic data, such as the strong November 6 jobs report remain strong, and the bond market continues to factor in a high likelihood of a rate increase this year, the stars may align for the Fed to feel confident to raise interest rates at the end of their next two day meeting, December 15-16.

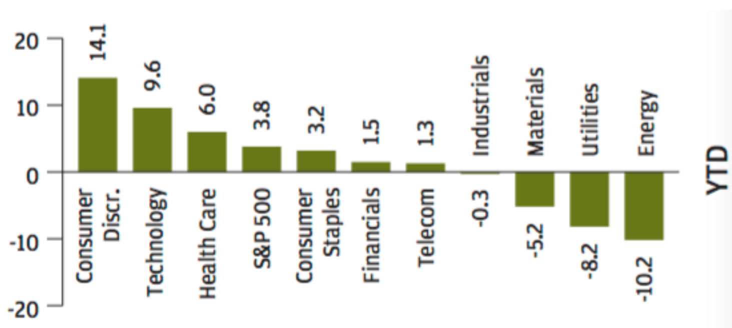
Market Recap

(as of November 7th, 2015)

Equities	Level	Index Returns (%) 1 week	QTD	YTD	1 year	3-yr. Cum.
S&P 500	2099	1.02	9.55	3.76	5.52	56.66
Dow Jones 30	17910	1.45	10.25	2.67	4.57	45.36
Russell 2000	2982	3.29	9.11	0.68	3.76	51.30
Russell 1000 Growth	676.71	0.85	9.53	7.85	9.57	63.31
Russell 1000 Value	616.50	1.22	8.86	-0.89	0.92	50.14
MSCI EAFE	1743	-1.54	6.17	0.96	-0.44	25.26
MSCI EM	852.47	0.56	7.74	-8.66	-11.60	-7.91
NASDAQ	5147	1.92	11.53	9.74	12.24	77.53

Fixed Income	Yield	1 week	QTD	YTD	1 year	3-yr. Cum.
U.S. Aggregate	2.54	-0.80	-0.78	0.34	1.33	4.45
U.S. Corporates	3.56	-0.94	-0.52	-0.62	0.44	5.53
Municipals (10yr)	2.23	N/A	N/A	N/A	N/A	N/A
High Yield	7.78	-0.33	2.41	-0.10	-2.12	12.14

Key Rates	Levels (%) 11/6/15	10/30/15	9/30/15	12/31/14	11/6/14	11/6/12
2-yr U.S. Treasuries	0.90	0.75	0.64	0.67	0.54	0.30
10-yr U.S. Treasuries	2.34	2.16	2.06	2.17	2.39	1.78
30-yr U.S. Treasuries	3.09	2.93	2.87	2.75	3.09	2.92
10-yr German Bund	0.70	0.52	0.59	0.53	0.78	1.45
3-mo. LIBOR	0.34	0.33	0.33	0.26	0.23	0.31
3-mo. EURIBOR	N/A	-0.07	-0.04	0.08	0.08	0.20
6-mo. CD rate	N/A	N/A	N/A	0.27	0.27	0.35
30-yr fixed mortgage	4.01	4.01	4.08	4.04	4.17	3.61
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25



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