The first quarter of 2016 was a roller coaster ride. From the onset, the S&P 500 fell nearly 5% in the first week of trading and by the second week of February was down approximately 10%. A sharp rebound then took hold as the flu-like temperature of the global economy seemed to subside; oil prices stabilized, China concerns dissipated, and the U.S. Fed backed down on the number of proposed rate hikes for the year.

S&P 500

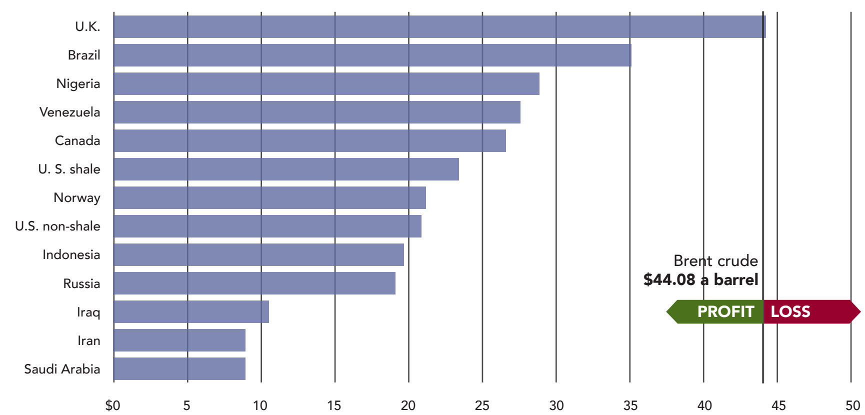
The quarter rebounded with some unlikely champions leading the way: emerging markets and energy. This was largely due to a change in investor sentiment that the sky was not falling, driven by a prevailing view regarding stabilization of oil prices, China, etc. Emerging markets funds saw unprecedented investor flows which boosted returns in the back-half of the quarter. The iShares MSCI ACWI ex U.S. ETF (consisting of international equities excluding U.S. and small-caps) exemplified this by rising by more than 12% from its February lows, to finish flat for the quarter. The S&P 500 Energy sector rebounded as well after a disastrous 2015, down 21%, to finish the quarter up 4%.

As we look forward, looming questions exist around China and Energy and whether the recent momentum can continue. China recently rolled out its "13th" strategic five year plan to achieve the government's requisite GDP Growth level of 6.5% a year. The focus of lucky number thirteen will be on growing China's industries in cloud computing, semiconductors and clean-energy while moving away from steel, cement, and glass industries. Time will tell how successful the Chinese government will be, but history would lead us to believe that the new areas of focus could see some overcapacity coming from "the big red machine." For example, China accounted for 57% of the world's cement production last year. In 2011 and 2012 combined, China produced the equivalent of all United States cement production for the entire 20th century.

The oil & gas industry has seen a seismic shift over the last decade as the United States has become the world's largest producer of oil and natural gas, taking the title from Russia. The United States emergence on the global oil & gas scene has the historical leading energy producing countries (i.e. Saudi Arabia, Russia and remaining members of OPEC) all shaking their collective heads in disbelief. The U.S. technological innovations in extraction, i.e. fracking, have surged inventories to their highest levels since 1930, while pressuring gasoline prices to their lowest levels in more than a decade. Over an eight year period the U.S. has seen its oil imports decline by 60% and is now achieving that elusive independence which has dominated past U.S. domestic and foreign policies. While domestically this surge in energy production has had positive effects for consumers, it has had the opposite effect for the global oil & gas industry. It was just two years ago that oil topped $100 a barrel and companies and oil producing countries reaped soaring profits.

Cost of producing a barrel of oil and gas

Average cash cost to produce a barrel of oil or gas equivalent in 2016, based on data from March 2016.



Source: WSJ

Now the dynamics of energy supply and demand have been flipped on their head to the point that oil prices barely cover the average cost of getting oil out of the ground for most countries (see chart). Furthermore, we have exploration & production companies filing for bankruptcy, banks writing-down energy loans and firms like Royal Dutch Shell and Chevron reining in costs and laying off workers.

In this ever-changing investment landscape we remain steadfast in our approach: Investing in companies that generate cash to sustain and expand operations, maintain low debt levels, have sound management teams, and reward shareholders through dividends and share buybacks. This leads us to maintain our positive outlook on large-cap U.S. companies, and believe that the U.S. remains resilient enough to lead a global recovery.