Peregrine asset advisers

3rd Quarter 2016 Market Overview

Mr. Market Climbs a Slippery Slope

"...too many goods chasing too few customers"

Our stock market faces a headwind. Even though the S&P 500 managed a 3.3% in the third quarter and is up 7.4% for 2016, this gain is only marginally higher than the levels during the fall of 2014. The S&P 500 is up only 3% over that time.

Broad measures of the market like the New York Stock Exchange and the Russel 2000 are actually down over the past two years. The market is clearly missing an element that can drive a steady uptrend.

The market wants our economy to accelerate. Growth is the missing ingredient. We are barely growing at 1%. Our economy has been struggling to find traction and has even slowed further over the past year. It would take very little to lapse into negative growth.

Similar conditions exist throughout the rest of the developed world. Sluggish growth abounds. Global trade has hit the skids. Worldwide demand for goods and services is actually falling according to international trade measures. (International Bank of Settlements)

Earnings for S&P 500 companies are expected to fall 2.1% in this third quarter. This marks the **sixth** consecutive quarter of receding earnings, according to Factset Research. Most companies are forced to manage declining sales so they are shrinking rather than growing. This is not optimum for investors.

Concurrently, **production capacity from industry is expanding** and is prolific relative to demand. This means we have too much of everything. There is a glut of oil, energy, agricultural products, and raw materials. Manufacturers churn out more cars, sneakers, packaged foods, TVs, heavy equipment, IPhones, and Coca Cola than ever before. But we are left with a reticent buyer. There is not enough demand for existing capacity.

Our Federal Reserve has been doing its best to change this. While Fed policy has supported the stock market at current levels, it has not been able to ignite our moribund economy. Near zero interest rates and the enormous amount of printed money by the Fed is not flowing to fuel the real economy. In fact, the expansion following the recession of 2008-09 is the slowest economic expansion in history.

What can reverse this predicament? A full-fledged recession would eliminate the over supply problem and maybe set the stage for a recovery but this would be a harsh consequence that no one would want to endure.

A more desirable remedy for "too many goods chasing too few customers" is a fiscal stimulus in the form of a tax cut. A tax cut for individuals and businesses would juice the economy. However, we will have to wait until next year for this lifeline to materialize. Hopefully, a new president and congress will enact this legislation. For now, we wait and play defense.

Connecting the Dots

Since sales and earnings are declining and stock prices are rising, the market is becoming more expensive. If earnings fall and share prices rise, you can see this is not a healthy environment for investing because stock prices become more overvalued.

Investors are becoming uneasy with our weak economy. Volatility in the markets has picked up since September. Investors realize the earnings picture is not constructive. In addition, uncertainty surrounding the election and the next move by the Fed are factors that contribute to a less favorable outlook for the market in the fourth quarter.

So, how do we protect the high water mark for client portfolios in times of market stress? One way to achieve this important endeavor is to invest in a narrow list of companies with an exclusive improving earnings outlook.

Another defensive strategy is the ABS (Always Be Selling) principal. This means stocks ripe for a decline are managed and eliminated from portfolios.

The final defensive tactic for a portfolio is to invest in assets that would be a haven during market turbulence. Examples of these assets are fixed income investments, gold, and defensive, low volatility stocks.

Peregrine Portfolios

The Peregrine Equity Composite is up 10.14% for 2016 and rose 4.57% for the third quarter. Our Balanced Composite is up 8.30% for 2016 and tacked on 3.17% in Q3. These are good advances and it would be a reasonable goal to maintain these returns through year end.

Interest rates are threatening to rise. We have sold some of our bond holdings. Bond values fall with higher interest rates so this precaution was necessary. Many of these holdings have been excellent performers on a total return basis with interest and capital gains combined.

In the third quarter, our best investments for realized gains were **Union Pacific, Facebook, Acuity Brands, Mercado Libre, and Netease.** We ended up selling **John Deere, Reliance Steel, and Deutsche Bank** for disappointing losses.

Three aspirational companies worth highlighting are **Acacia**, **Nutanix**, and **Twilio**. These companies provide B to B solutions for companies requiring cloud based infrastructure. They reduce cost and add security and efficiencies for businesses.

We have already been investing in these companies for clients. The initial month of trading in these companies is reminiscent of many technology stocks that developed into widely recognized stock market leaders. All three are also similar in that they are recent IPOs and they have extraordinary growth prospects.

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Past performance is no guarantee of future results. Investment management involves the possibility of losses. Significant general stock market moves up and down can influence the performance of client portfolios. Composite returns are based on client portfolios of over $100,000. Not all clients are included in the composites. All returns include the reinvestment of dividends. All returns are net of fees. Composite returns are derived from aggregated, time-weighted returns for clients of Peregrine Asset Advisers. Individual client returns can deviate from the composite returns. While Peregrine uses the S&P 500 as a benchmark, Peregrine does not attempt to mimic the structure of this index. Individual client portfolios vary. The number of securities held also varies per client.