Abner Herrman & Brock
asset management

Investment Review and Outlook **July 2016**

"A New Chapter"

The Federal Reserve has moved aggressively to stabilize the U.S. economy and restore economic growth since the 2008-09 recession, which has been followed by several years of anemic economic growth. Fed actions included lowering interest rates and increasing the money supply through purchases of securities, mostly U.S. Government debt, to reduce interest rates. Today, it appears that the Federal Reserve has achieved its objective of stabilizing the U.S. economy. U.S. unemployment has declined to 4.7% of the labor force from the peak unemployment of 10% in 2009. Consumer confidence, housing starts and automobile sales have rebounded. Wages have begun to increase as the economy approaches full employment. Full employment levels imply that the number of new jobs required to be added each month to remain at full employment will be lower. Today, the U.S. economy needs to add approximately 100,000 new jobs a month to maintain full employment from the need to add approximately 200,000 jobs a month when the unemployment rate was at a higher level. Although the improvement in economic indicators has provided the Fed with more confidence to increase interest rates, the exit of England from the European Union creates new uncertainties for economic growth internationally and may impact the pace of future actions by the Fed. Recent comments by the Federal Reserve Chairman, Ms. Yellen, have also indicated a slight shift in approach from that of helping to stimulate the economy to one of restoring a more normalized relationship between short term interest rates and longer term interest rates. A first step toward normalization occurred in December 2015 when the Fed raised the Fed Funds rate by .0.25%. At approximately the same time, the Fed reduced its purchases of securities, decreasing the total supply of money also with the intention to help increase interest rates.

Modestly higher interest rates would be an important positive change for our economy for several reasons. Investors who invest in fixed income securities will benefit from higher interest rates because they would receive greater income on their interest bearing investments. In particular, seniors and retirees, who comprise approximately 15 % of the US population, typically have a large percentage of their savings in fixed income securities. Therefore, the increased income that fixed income investors will receive as a result of higher interest rates may increase their spending. Consumer spending represents 70% of the U.S. economy, thus an increase in consumer spending will have a positive impact on economic activity. Another benefit of higher interest rates is for the Fed to position itself to be able to reduce interest rates to rejuvenate the economy should the economy falter in the future. Finally, higher interest rates would assist pension plans in meeting their investment return objectives so that corporations as well as municipalities will not be faced with having to make large contributions to their retirement plans in order to meet obligations in future years. Conversely, higher interest rates would have a negative impact on business and individuals that borrow to invest. The higher cost of borrowing would negatively impact those that borrow to make investments because the higher cost of debt would lower their return on investments. In sum, the move to higher interest rates would have a positive benefit to those who rely primarily on savings, potentially increase consumer spending and provide pensions with greater cash flows to meet their obligations, while negatively impacting those that rely on borrowing to invest.

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As the focus of the Fed shifts to the timing and execution of increasing short term interest rates, investors with assets in separately managed bond portfolios will be in a significantly stronger positon than investors who are invested in bond funds. AHB client Bond portfolios, as well as the bond portion of AHB client Balanced portfolios are invested in individual investment-grade bonds with actively laddered maturity dates which will experience lower volatility and protection compared to a bond fund which does not have a maturity date but rather a net asset value. AHB client portfolios own individual bonds which can be held to maturity should interest rates rise and interim bond prices decline. Investors who invest in bond funds are unable to protect against a decline in value from their original investment because they do not own the underlying bond in the bond fund. Typically, bond funds are structured without a final maturity and as such their value is highly correlated to the change in interest rates. During recent years when interest rates were declining, bond prices typically would rise as did the value of bond funds. As the outlook has now changed where it is likely that interest rates will eventually rise it is also likely that bond prices will decline. Thus, the asset value of bond funds will most likely decline as will the value of the assets in the bond fund.

In addition to investors moving out of bond funds to separately managed portfolios, many investors have also been divesting their holdings of hedge funds. In most cases investors were attracted to hedge funds with the expectation of achieving above average rates of return while assuming only a minimum amount of risk. In a rising equity market many hedge funds were able to meet their assumed investment objective. However, as the equity markets have become more challenging in the past few years, many hedge funds were unable to provide the promised above average returns after their high management fees and in fact some incurred significant losses. Hedge fund investors are now revisiting the decision of an appropriate investment objective for their assets.

At AHB we manage only "separately managed portfolios" to meet each client's unique investment objective. AHB clients have significant investable assets that require the need to have their assets positioned properly. Separately managed portfolios place each client's interest first, as opposed to being placed in a fund with many other investors who have varying investment objectives and risk tolerances. We do recognize that pooled investment portfolios such as funds provide a valuable service for those investors who do not have sufficient wealth to gain the attention of a firm such as ours that will structure an investment portfolio to meet each client's specific investment objective. Once again, we appreciate and thank you for the opportunity to be of service in providing you with our investment management services. It is said, "Good Clients Make Good Firms", thank you for helping us to be the "Good Firm" we are today and strive to be going forward.

Investment Policy Committee

Abner, Herrman & Brock Asset Management

Founded in 1981, Abner, Herrman & Brock Asset Management manages portfolios individually structured to assist each client in achieving their investment objectives. Stock portfolios are managed utilizing a Core Equity philosophy, investing in both large capitalization value and growth disciplines with an objective of long-term, after-tax appreciation and below market volatility. Portfolios are diversified across economic sectors, industries and companies. Bond portfolios are managed to provide a high rate of current income and total return. Portfolios are invested in staggered maturities of U.S. Treasury, government agency and investment-grade corporate bonds and where appropriate, investment-grade municipal bonds. Portfolio managers are available to meet with clients upon request.

Please visit our website at www.ahbi.com for a more detailed description of our investment **Philosophy, Process and People.**