A&I FINANCIAL SERVICES LLC
Optimizing Assets and Income

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First-quarter Update

Our client portfolios benefited from diversification as a wide range of asset classes had positive returns for the quarter. International stocks led the way, despite currency movements eating into U.S. dollar-based investors' returns. The bond market was also positive, as Treasury yields declined over the quarter. Our tactical positions in floating-rate loans and flexible bond funds collectively outpaced core bonds over the quarter.

Economic Round-up

The **U.S. economy** appears to be in pretty good shape overall, and the Federal Reserve has hinted that it could possibly begin rate hikes later this year. In the "plus" column: employment and economic growth. Core Inflation is still very low, partly due to declining oil prices. Not as upbeat: the strong dollar, which has hurt export growth. U.S. consumer spending hasn't improved amidst sluggish wage growth.

Abroad, the European Central Bank launched quantitative easing (bond buying), trying to boost **Europe's** slow-moving economy. As the **Bank of Japan** and the **People's Bank of China** also use stimulus, we see lots of central bank support for global financial markets.

Portfolio Commentary

Durability and *resilience* are our guiding lights for portfolio construction. We build diversified portfolios that have multiple paths to positive returns and protection against multiple risks.

- Right now, we are mindful of risk factors, primarily that **U.S. stocks** are expensive. Also, Fed support, which has been critical to the post-financial-crisis stock market rally, is slowly being scaled back. We think the most likely scenario from here is fairly low U.S. equity returns over the next five years. Still, stocks remain attractive relative to other assets and so could continue to perform well for some time. We continue to own U.S. stocks, but hold a lower weight than we would if return potential were higher.

- **European stocks** have lagged U.S. stocks in recent years, so are more attractively priced today with stronger return potential, in our view. That European stocks have dawdled hasn't necessarily been surprising given the poor economic health of the region. In this instance, we think European stocks

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are priced to generate attractive returns if we look out five years and as a result, our portfolios own a nearly full strategic weighting in developed international stocks.

- **Emerging markets** have been buffeted by investor worries—China's growth rate, in particular. We require a healthy margin of safety here, so we hold only slightly more than our long-term strategic allocation. We also expect that the stock pickers we have chosen should add value by selectively allocating across a wider and more varied opportunity set in emerging markets than in others.

- In structuring our clients' **bond allocation,** we know that interest rates will be the predominant factor in determining future bond returns. Since we do not have the ability to predict when or if rates will rise, we consider a range of assumptions. Today, all of our scenarios yield the same conclusion about core bonds—returns over the next five years are likely to be very low. So, we own less in core bond funds and have instead invested in flexible fixed-income strategies with broad mandates that should perform in various interest-rate climates. Core bonds remain a protective tool against stock market losses.

We know that not all risks we manage against will play out, and in many cases there will be a small price to pay (a premium) for that insurance. We also know it can take time for our investment thesis to be rewarded (which is why our decisions are not based on a short-term view). We are confident that— over time—our integration of these considerations should result in sound, well-performing portfolios that help our clients meet their financial goals.

As always, we appreciate your confidence and welcome questions about your individual situation. For more detail on the topics discussed above, we encourage you to read the quarterly investment commentary posted on our website and included in our upcoming Investment Letter mailing.

Best regards,

Karl Frank, CFP®