Bradley, Foster & Sargent, Inc.
Quarterly Market Commentary

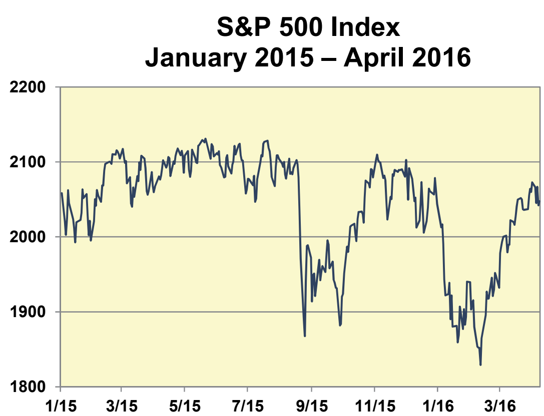
April 2016

Stay the Course

> There is no such thing as a final answer to security values… Market values are fixed only in part by balance sheets and income statements; much more by the hopes and fears of humanity; by greed, ambition, acts of God, invention, financial stress and strain, weather, discovery, fashion and numberless other causes impossible to be listed without omission.
>
> Gerald Loeb, *The Battle for Investment Survival*

> If you can keep your head when all about you
> Are losing theirs and blaming it on you;
> If you can trust yourself when all men doubt you,
> But make allowance for their doubting too;
> If you can wait and not be tired by waiting, …
>
> Rudyard Kipling, *If*

Investors have been through a rough patch so far this year. Historically, January has been a good month for the market, but this year we experienced the worst January performance in the history of the U.S. stock market. Then during the first two weeks of February, things got even worse. At the intraday low on February 11, 2016, the S&P 500 Index was down over 11% since the start of the year. At this point, the stock market rebounded quickly, as investors concluded that they were too pessimistic about the U.S. economy and corporate earnings and that equities were oversold. As this commentary goes to press, the total return of the Dow Jones Industrial Average and S&P 500 Index are modestly positive for the year to date. The U.S. stock market, however, has not advanced over the past fifteen months as the chart below demonstrates:



Source: Bloomberg

Forecasting Short-Term Movements in the Stock Market

When asked by our clients about the direction of the stock market, we at Bradley, Foster & Sargent respond that while we always seek to make thoughtful predictions, we are not ashamed to admit that it is impossible to make accurate forecasts about the short-term movements of the stock market on a consistent basis. In addition to factors mentioned by Gerald Loeb, who was quoted at the outset of this commentary, there are also a plethora of economic and political influences: corporate earnings, inflation and interest rates, liquidity, investor psychology, political climate, geopolitical events, funds flow, and last but not least, Federal Reserve policy. Warren Buffett's statement during the middle of the terrifying 2008 bear market addresses the futility of trying to fathom short-term market movements: "Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea whether stocks will be higher or lower a month — or a year — from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over." The chart below, showing the S&P 500, validates Warren Buffett's comments, which were made during some of the worst days of the Panic of 2008:

S&P 500 Index
October 2007 – December 2015

Source: Bloomberg

We understand that some seasoned investors, having lived through the two crushing bear markets of 2000-2002 and 2007-2009, when the S&P 500 dropped 50% and 57% respectively, were tempted to sell stocks broadly this January and February near the bottom, as they had no desire to experience a third harrowing bear market. At Bradley, Foster & Sargent, we cautioned against indiscriminate selling of equities earlier this year. Instead we sought to emphasize to our clients the investment performance of quality equities over the long haul. We pointed to the following performance data of quality stocks since 1926 (when Standard & Poor's commenced compiling its index):

Average Annual Returns for U.S Large Companies 1926-2015
(Nominal Returns – Not Inflation Adjusted)

Capital Appreciation (Price Return)	Dividend Return	Total Returns
5.80%	4.25%	10.05%

Source: Ibbotson

The Power of Compounding

While these returns may seem modest, the compounding effect is remarkable. The table on the following page demonstrates what an investment of $10,000 today in a Roth IRA at a compound annual growth rate of 10.05% (the S&P 500's average annual growth rate since 1926) would produce if held for different time periods:

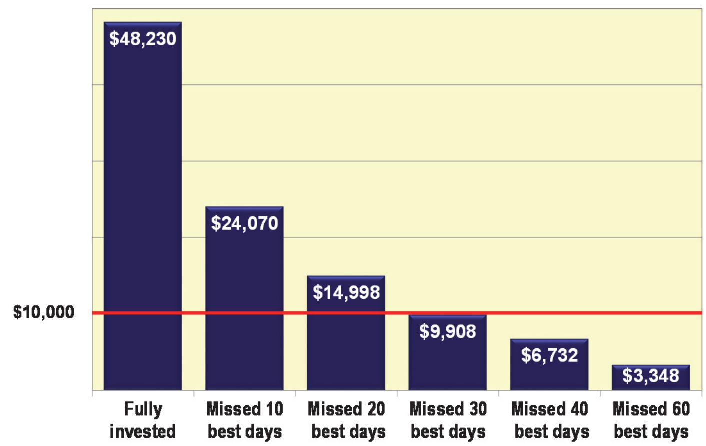
Investment	Holding Period	Market Value
$10,000	10 years	$ 26,056
$10,000	20 years	$ 67,889
$10,000	30 years	$ 176,889
$10,000	40 years	$ 460,895
$10,000	50 years	$1,200,888

Thus, a 21-year-old who invested $10,000 in the S&P 500 Index using a Roth IRA at the same compound annual growth rate of the S&P 500 since 1926 would have a portfolio worth $1.2 million at the age of 71. This assumes that quality stocks continue to perform as well in the future as in the past 89 years — an assumption which may seem questionable with the current economic problems we face in the U.S. Yet over the past century, the market performed well in spite of wars, an impeachment trial, the financial Panic of 2008, rampant inflation, many recessions and the Great Depression. It is also vital to note that there were two decades when the S&P 500 Index produced average annual returns which were negative. From 1930 through 1939, the average annual return of the S&P 500 was –0.1%, and for 2000-2009, it was –0.9%. Thus, investing in equities takes patience, but thus far in America, it has paid off over the long haul.

Timing the Market Often Backfires

For a variety of reasons — investment approach, liquidity needs, or temperament, among others — many investors try to time the market, selling stocks at apparent peaks and seeking to buy stocks at lower prices. This is exceedingly difficult to accomplish on a consistent basis. Market lows often lead to emotional decision-making. Being out of the market for just a few of the best days can exert an extremely negative effect on the market value of an investor's portfolio. As the chart below shows, missing the best 30, 40 or 60 days in the stock market during a 20-year period can result in a portfolio showing negative returns:

Impact of Being Out of the Market
(Performance of a $10,000 Investment in S&P 500 Index)
1/2/1996 – 12/31/2015



Source: JPMorgan

Over the Long Term, the Stock Market Tracks Earnings

The trajectory of the U.S. stock market over longer periods tends to track very closely with earnings. The table on the following page demonstrates this fact. It also shows that the market tends to revert to the mean, as the valuation of the market during the "Internet bubble" at the turn of the last century was not sustainable:

S&P 500 Earnings and Stock Market Valuation

Year-end	S&P 500 Operating Earnings	S&P 500 Index	P/E Ratio
1987	$ 16.04	247.08	15.4
1999	$ 51.68	1469.25	28.4
2007	$ 82.54	1468.36	17.8
2014	$113.01	2058.90	18.2
2016 Estimate	$118.12	2060.00	17.4

Source: Standard & Poor's

Over the past forty years, the average P/E ratio of the S&P 500 has been 16.5. However, with inflation below 2%, the P/E ratio has averaged 17.9, according to Strategas Research Partners.

Stocks for the Long Haul

At the moment, investors have many justifiable concerns. U.S. corporate earnings have stagnated due to an anemic global economy and tepid U.S. economic growth, as well as foreign exchange headwinds and poor profitability in the energy sector. There are fears of global deflation, the impact of the slowing Chinese economy, serious geopolitical issues in many parts of the world, and one of the most dysfunctional U.S. Presidential election campaigns in history. It is at times such as this when it is useful to point out how much wealth can be created by owning quality growth stocks. The table below shows a selection of stocks in a variety of industries which are currently broadly owned by investors:

Company	Price 12/30/1994*	Price 3/31/2016	Total Return**	Compound Annual Return**
Apple	$ 1	$109	8,500%	23.3%
Starbucks	$ 1	$ 60	7,484%	22.6%
Nike	$ 2	$ 61	3,326%	18.1%
Danaher	$ 3	$ 95	2,935%	17.4%
Microsoft	$ 3	$ 55	1,983%	15.4%
United Technologies	$ 8	$100	1,813%	14.9%
Wells Fargo	$ 6	$ 48	1,344%	13.4%
Johnson & Johnson	$14	$108	1,177%	12.7%
Pepsi	$17	$102	852%	11.2%
Exxon	$15	$ 84	849%	11.2%

* Split adjusted
**Includes dividends

Source: Bloomberg

In uncertain times like this, it is vital for investors to stay the course. If an investor needs funds over the shorter term, it is not prudent to hold those funds in stocks but rather in lower risk, liquid assets. But if the investor's investment objective is capital appreciation over the longer term, then it is critical to continue to maintain significant positions in high-quality equities with great brands, wide moats, strong balance sheets, fine management and robust cash flow. As we at Bradley, Foster & Sargent have written before, what matters is not timing the market but rather time in the market.

Bradley, Foster & Sargent, Inc.
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