MEMO

To: Clients and Friends of Scott Strategic Investments

From: Bob Scott

Date: July 2016

Re: 2nd Quarter Investment Memo
"A very quick update – Brexit What Brexit"

I apologize for the delay in the 2nd Quarter Investment Memo. Little Britches Rodeo Finals in Oklahoma delayed my progress.

Summary

- The US economy shows resiliency in the face of uncertainty.
- While market volatility increased globally, equity markets recovered.
- Fixed income continues to improve, especially with the Federal Reserve's dovish sentiment.
- Two of the three domestic stock indices were in the green.
- Value continues to perform better than growth.

	6/30/16 Close	3/31/16 Close	Change	Gain/Loss
DJIA	17,929.99	17,685.09	+244.90	+1.39%
NASDAQ	4,842.67	4869.85	-27.18	-0.56%
S&P 500	2,098.86	2,059.74	+39.12	+1.90%
MSCI EAFE	1,593.67	1,652.04	-58.37	-3.53%

Performance reflects price returns as of market close on June 30, 2016.

Economy: In good (ok) shape

- The direct impact of Brexit on the U.S. economy may be small. The U.K. accounts for a very small portion of U.S. exports and imports, explained Raymond James Chief Economist Scott Brown.
- The U.S. economy still appears to be in good shape, led by a rebound in consumer spending growth in the second quarter.
- The housing sector continues to improve.
- Business fixed investment remains relatively soft.

- The dollar has strengthened (a restraint for U.S. exporters) but remains below its former high.

Federal Reserve: Less likely to raise rates

- Fed policy remains very accommodative. The central bank will provide additional liquidity if needed.
- The Fed is less likely to raise short-term interest rates in the near term. Future policy moves will be data-dependent.

Bottom line: Take it a day at a time

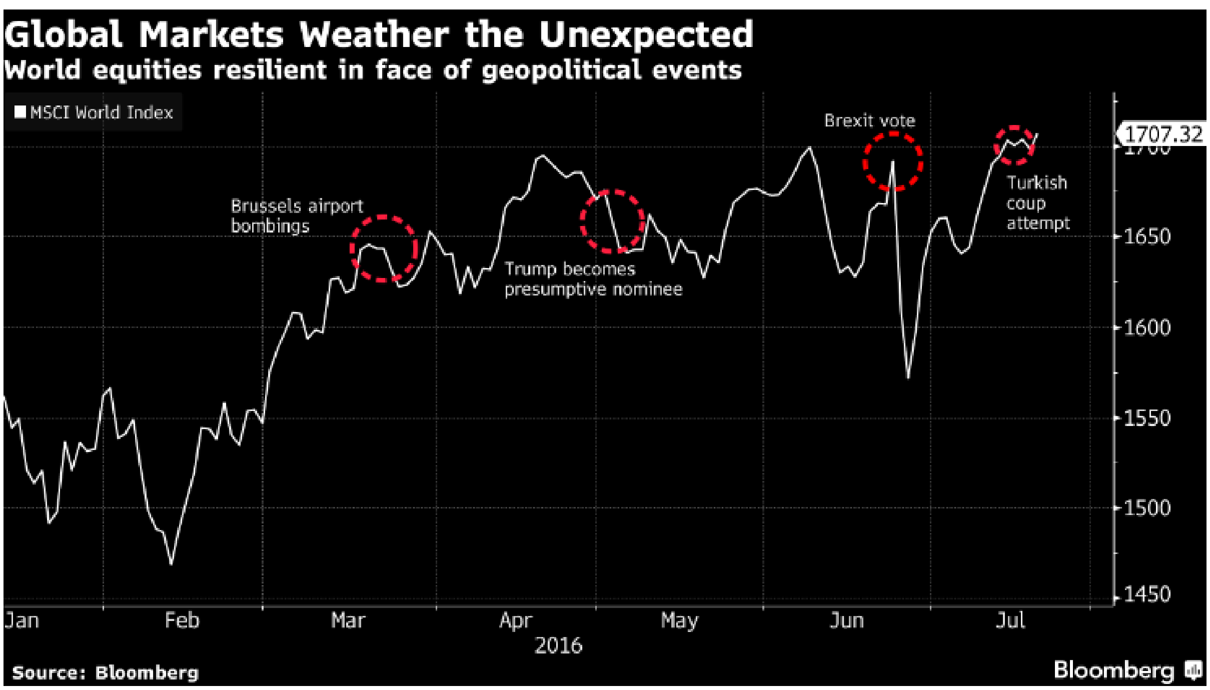
- Short-term influences rarely change the secular trend of the market, and it's important to take some time to see how everything settles, advises Raymond James Chief Investment Strategist Jeff Saut.
- Take a moment to assess and determine if you can potentially take advantage of the volatility to add to positions in your portfolio or build new ones.
- It's still very important to know what you own, pay attention to fundamentals and allocate assets appropriately.

<u>Commentary</u>

Three Things I want to talk about, Brexit, earnings and what I am reading this summer.

Brexit – What Brexit?

So, even if you knew the Brits were going to vote yes for the Brexit, how would you have played it? Stay in the market, or sell everything? Same could be said for Trump's nomination and sadly the Brussels airport bombing.



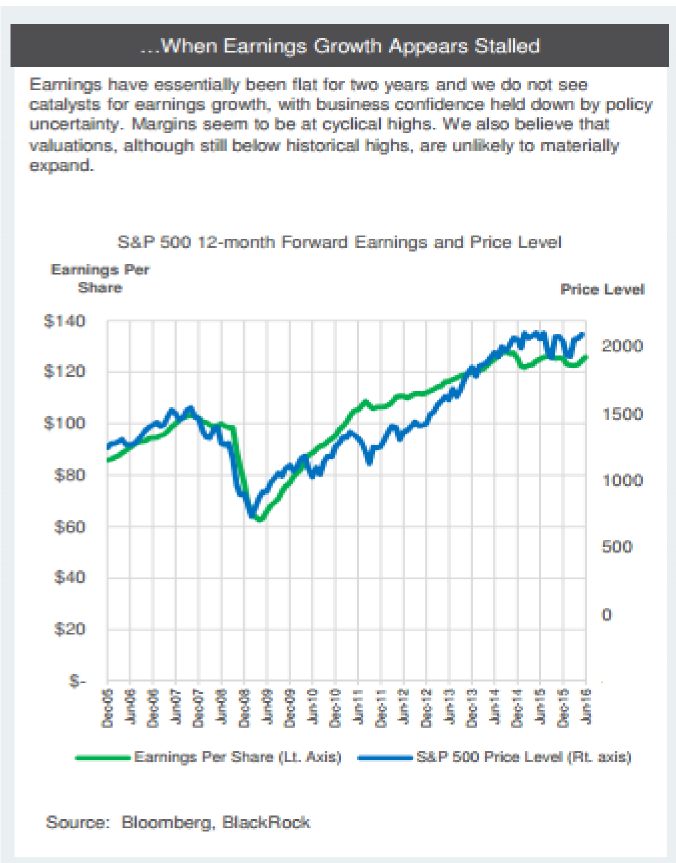
Hard to time the market even if you know the future. Doesn't mean you shouldn't pay attention to value or valuations but remember human behavior is really hard to predict. And the "experts"? Oh you mean the experts talking about rising interest rates for the last 5 or 6 years? Think SSI Tenets.

Earnings

Earnings – Larry Kudlow likes to say "earnings are the mothers milk of stocks". That is to say that stocks follow earnings. So what happens when earnings growth stops or decelerates, in the short run it depends on human behavior. In the long run, it may be a problem.

In a paper I have mentioned obliquely in the past, *"OccamsRazor Redux: Establishing Reasonable Expectations for Financial Market Returns*" by John Bogle and Michael Nolan, Bogle lays out his methodology which is simple and consistent with the title.[1]

Returns = dividend yield + earnings growth +/- (change in P/E) ratio

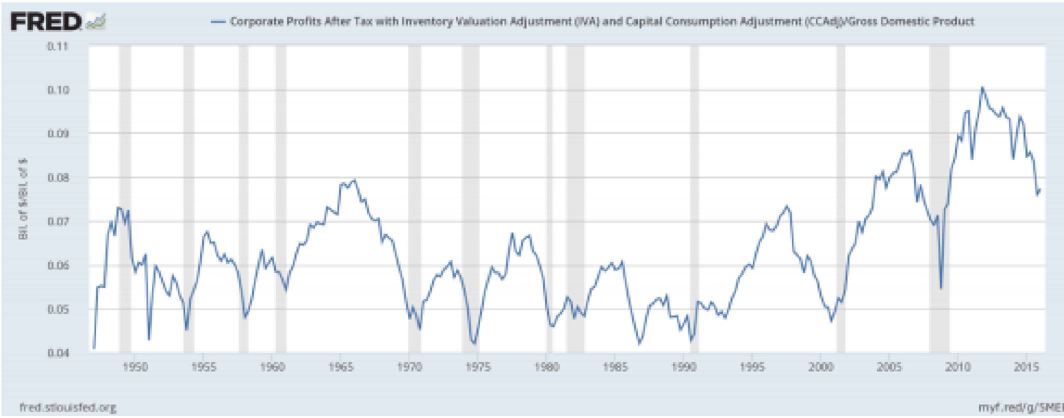


We know the S&P 500 dividend yield is approximately 2% and if we guess the direction of earnings growth it is safe to assume that things will continue to be challenging, and for prices to continue their climb, in most cases, multiples will need to expand, and they are significantly above average already. The exhibit from BlackRock indicates earnings growth is and has been slowing.

In the exhibit below from the St. Louis Fed, we can see that profit margins (earnings) have been at record highs as a percent of GDP for some time. Jeremy Grantham likes to say that profit margins "are probably the most mean reverting series in finance and if profit margins do not mean revert, then something has gone badly wrong with capitalism." They could be on their way toward mean reversion.

---

[1] **Occam's razor** (or Ockham's **razor**) is a principle from philosophy. Suppose there exist two explanations for an occurrence. In this case the simpler one is usually better. Another way of saying it is that the more assumptions you have to make, the more unlikely an explanation is.



Source: fred.stlouisfed.org

Books

Two good reads to put on the list.

The Obstacle is the Way by Ryan Holiday – The book draws it's inspiration from Stocism, the ancient Greek philosophy of enduring pain or adversity with perserverenace and resilience.

The Boys in the Boat – Nine Americans and Their Epic Quest for Gold at the 1936 Berlin Olympics.

Personal

Busy month for the Scott's and I apologize for the memo delay. Below is a picture of Diana and Truman at the Little Britches National Finals, Guthrie, Oklahoma (very hot). They did great.

As I have shared with many of you, we have a well-defined process for evaluating investments and strategies. Although we have no idea what is going to happen in the short run we know our SSI Tenets of investing have historically proved successful over the long term and we like to think we know what we are doing.

SCOTT STRATEGIC INVESTMENTS TENETS OF INVESTING

1. I believe a value driven investment philosophy is the most effective way to build long term wealth.
2. Investor behavior can be more important than investment performance.
3. Price matters, risk and return are a function of price.
4. “This time is different are the four most dangerous words in investing.”[i]
5. Managing risks is more important than higher returns.
6. Market timing and macroeconomic forecasting are not critical to investing nor do I believe they are possible.
7. Investing is not speculating or gambling there is a difference.
8. Managers should focus on absolute returns, not relative performance.
9. I believe in “eating your own cooking” and working with managers who also believe in this aligning concept.

10. Be diversified, but not too diversified.

For those of you interested in specific economic news I would highly recommend you visit my website www.scottstrategicinv.com and visit the Market View Tab where you can see various Raymond James commentary and video Point of View Updates.

Please do not hesitate to share our quarterly Investment Memo with friends and family. We greatly appreciate your confidence and trust and will continue to dedicate ourselves to earning it. If you have any questions, or thoughts regarding the above ideas or your specific portfolio, please don't hesitate to contact me.

Best regards,

Bob Scott, CFP®, AAMS
Financial Advisor

Scott Strategic
Investments
An Independent Firm
189 Talisman Dr., Ste. D
Pagosa Springs, CO
81147
(970) 731-3070 Phone
(800) 731-6345 Toll Free
(970) 731-3079 Fax
www.scottstrategicinv.com

Securities offered through Raymond James Financial Services,Inc.

Member FINRA/SIPC

Disclosures

Links are being provided for information purposes only. Raymond James is not affiliated with and does not endorse, authorize or sponsor any of the listed websites or their respective sponsors. Raymond James is not responsible for the content of any website or the collection or use of information regarding any website's users and/or members.

Investing involves risk, and investors may incur a profit or a loss. Past performance is not an indication of future results. Investors cannot invest directly in an index. The Dow Jones Industrial Average is an unmanaged index of 30 widely held stocks. The NASDAQ Composite Index is an unmanaged index of all common stocks listed on the NASDAQ National Stock Market. The S&P 500 is an unmanaged index of 500 widely held stocks. There is an inverse relationship between interest rate movements and fixed income prices. Dividends are not guaranteed and must be authorized by the company's board of directors. Please note that international investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility.

- *The information contained in this report does not purport to be a complete description of the securities, markets, or development referred to in this material. Any opinions are those of Robert D. Scott and not necessarily those of RJFS or Raymond James. Expressions of opinion are as of this date and are subject to change without notice.*
- *Keep in mind that there is no assurance that this or any strategy will ultimately be successful or profitable.*
- *Diversification and asset allocation do not ensure a profit or protect against a loss.*

Market Indexes Defined

MSCI EAFE U.S. Dollar: An unmanaged capitalization-weighted index of companies representing the stock markets of Europe, Australasia and the Far East.

MSCI EAFE Small-Cap Index: An unmanaged, market-weighted index of small companies in developed markets, excluding the U.S. and Canada.

MSCI Emerging Markets: Designed to measure equity market performance in 25 emerging market indexes. The three largest industries are materials, energy and banks.

BC High Yield: Covers the universe of fixed-rate, non-investment grade debt. Pay-in-kind (PIK) bonds, Eurobonds, and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC-registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures and 144-As are also included.

Russell 2000: Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

Barclays Capital Aggregate Index: Measures changes in the fixed-rate debt issues rated investment grade or higher by Moody's Investors Service, Standard & Poor's, or Fitch Investor's Service, in that order. The Aggregate Index is comprised of the Government/Corporate, the Mortgage-Backed Securities and the Asset-Backed Securities indices.

Standard & Poor's 500 (S&P 500): Measures changes in stock market conditions based on the average performance of 500 widely held common stocks. Represents approximately 68% of the investable U.S. equity market.

BC Global Aggregate ex-U.S. Dollar Bond Index: Tracks an international basket of bonds that currently contains 65% government, 14% corporate, 13% agency and 8% mortgage-related bonds.

The Dow Jones-UBS Commodity Indexes : Composed of exchange-traded commodity futures contracts rather than physical commodities.

The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation. Investments mentioned may not be suitable for all investors.

[i] Sir John Templeton quote.