# U.S. & Global Balanced

**COMMENTARY Q3 2016**

FRANK MERSCH | RICK BROWN

FRONT STREET CAPITAL
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**FRONT STREET GLOBAL BALANCED INCOME CLASS**

## MARKET OVERVIEW

### EQUITIES

Equities climbed during the third quarter of 2016, despite the U.K's vote to exit the European Union, weak global economic data and uncertainty from the Federal Reserve.

We have maintained all along that the Fed has missed the opportunity to normalize the rate structure. And now, at the end of another quarter, the Fed has once again postponed an interest rate hike. While initial monetary policy was effective, we are of the opinion that these abnormally low rates are no longer benefiting the economy. Have negative interest rates helped Japan or Europe? It's unlikely, and rather than helping, these unorthodox monetary policies are becoming counterproductive and dangerous.

Nevertheless, we are no longer looking to central bank policy for investment direction. Rather, our focus has shifted towards stock picking, liquidity, trading and sector rotation. We no longer want to play with the central banks.

As we enter the fourth quarter of 2016, the biggest event ahead is the U.S. presidential election. Though we have just come through the least volatile quarter in quite some time, the question is, will this low-volatility persist? We have two U.S. presidential candidates that are widely disliked, and Americans will likely have a president that was not so much "voted in" as "won by default". At this point, we are contemplating the impact for each of the three most likely outcomes:

I. A Clinton win with a Congressional house divided

II. A Trump win

III. A Democratic sweep

Of these outcomes, the first would be the most welcomed by the market. Both the second and third outcomes would likely cause an uptick in volatility and some downside in the market, initially. To us, the most devastating result would be a Trump win, as we have strong concerns around the impact of Trump's trade policy (interesting point: trade policy is one thing a president can direct without any congressional meddling). We believe that if he follows through on his seven-point trade policy, the result will be a global trade war. He would be undermining decades of growth and cooperation. This would not be good for global markets, and emerging markets in particular. Perhaps Trump will switch roles and be more pragmatic when elected? We do not believe he will, and thus, we will be vigilant going into this election.

### FIXED INCOME

Most fixed income asset classes performed reasonably well during the quarter, but high-yield and investment-grade corporates led the way as credit spreads tightened.

Treasuries lagged as investors sold these assets to take on more risk. The improved market sentiment helped to drive performance and money flows, which helped to deliver a decent quarter for the market.

Later in the quarter, the focus shifted to the timing of interest rate increases by the Fed and the rate of future interest rate moves. U.S. 10-year yields started the quarter at + 1.47%, and ended at +1.595%, but fluctuated significantly, with a low of +1.359% on July 8 to a high of +1.728% on September 13.

## FRONT STREET GLOBAL BALANCED INCOME CLASS

FUND MANAGERS:
FRANK MERSCH & RICK BROWN

After a pretty rough start to the year, the Global Balanced Class outperformed its benchmark during the third quarter of 2016. Holdings within the financials sector were the best performing group, and there was a strong rebound in the high-yield segment. In addition, our conservative stock selection contributed to the Fund's performance.

As you may recall, we made a tough call at the beginning of the year, thinking that we could take the U.S. Federal Reserve at its word when it called for four interest rate increases for 2016. We had anticipated that, with the Fed taking such steps, we would see a steepening of the yield curve and thus, financials would outperform. Unfortunately, the Fed failed to follow through with rate increases as stated, despite an improving economy, falling employment and slightly higher inflation. Markets have continued to monitor and anticipate Fed policy, and financials performed well in the most recent quarter.

We expect the coming period to bring heightened volatility, and the Fund's outlook will depend much on the outcome of the U.S. presidential election and on the timing of expected interest rate increases from the Fed.

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