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BEACON INVESTMENT ADVISORY SERVICES

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A Look Ahead at the Year Ahead: Ten Investment Forecasts and Four Strategic Wealth Management Themes to Capitalize on Them

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As we acknowledge each December in presenting our outlook for the coming year, no one can know the unknowable or predict the unpredictable. But, as wealth managers, it is a core part of our job to analyze the world around us and invest in the context of the short- and intermediate-term economic landscapes. We have never believed in a "one size fits all" portfolio and have always provided custom tailored advice to our valued clients based on their personal goals and risk tolerance. With this in mind, we would like to share with you our perspective on, and predictions about, some significant events that we believe will unfold in the year ahead.

Beacon's Ten Investment Forecasts for 2016

1. U.S. stock returns to be positive, but below long-term returns of 10% per year.
2. The stock market will experience another 10%+ correction, its second in two years.
3. In the fixed income area, investment grade credit risk will be preferred to interest rate risk.
4. The real estate recovery will continue, with prices rising at single digit rates at the national level.
5. The U.S. Dollar will continue to strengthen vs. the Euro and Yen.
6. Oil prices will rise from their current price of roughly $35–$40 per barrel, but not come close to the $80+ barrel price levels experienced in the latter half of 2014.
7. Companies with strong organic revenue growth will outperform the market as a whole.
8. China will devalue its currency further vs. the U.S. Dollar in order to support economic growth.
9. Inflation will be a non-factor, with the CPI increasing below its roughly 3% long-term average rate.
10. Despite volatility, emerging markets will surprise to the upside, outperforming developed markets.

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BEACON'S FOUR INVESTMENT THEMES FOR 2016

Beacon's 2016 Investment Themes reflect our forecasts for the coming year, and beyond, and reflect our best thinking to protect capital and improve returns:

1. Maintain a diversified portfolio with downside protection at its core as volatility increases.
2. Intelligent search for yield.
3. Emphasize high quality investments.
4. Returns will be subdued for most asset classes.

A GLANCE BACK ON THE YEAR THAT WAS

In a familiar refrain in the seven years since the Credit Crisis ended, U.S. stocks and bonds experienced another positive year at the time of this writing. Returns were muted for most asset classes in 2015, which is not surprising given the impressive run in recent years. The somewhat tepid returns mask the sharp 12% stock market correction that occurred this summer, the first since 2011. As of this writing, the S&P 500 is up approximately 2.2% in 2015, while bonds, as represented by the Barclay's Aggregate, are up a more mundane 0.6%.

Before we look ahead to 2016, it seems only fair to look back on our 10 forecasts for 2015. What did we get correct and where did we go wrong? In our view, eight of our ten predictions were correct and two were incorrect. Problems in China led to negative returns for most emerging markets, the first of our incorrect forecasts. We thought investors would be attracted to the lower valuations in emerging markets. Instead the cheap got cheaper as China's devaluation of its currency had investors moving into traditional safe haven investments. Although the Republicans maintained control of Congress, no major legislation was announced in the healthcare, tax and immigration areas, resulting in our second incorrect forecast.

We did get the majority of our calls correct. U.S. equities and real estate prices increased yet again. The Federal Reserve (Fed) finally raised short-term interest rates. In the fixed income market, high quality corporate and municipal bonds outperformed U.S. Treasuries and high yield bonds. Volatility increased resulting in the first U.S. stock market correction since 2011. Across the pond, the European Central Bank (ECB) took a page out of the Fed's playbook, enacting its own quantitative easing (QE) program. Growth slowed in China, with GDP falling from roughly 10% to 7%, but the Chinese economy averted an economic collapse. The unemployment rate fell from 5.6% to 5.0%

in 2015, but has leveled off as the economy approaches its "full employment" status. **Table 1** provides a summary scorecard for our 2015 forecasts.

Table 1: Review of Beacon's 2015 Financial Forecasts

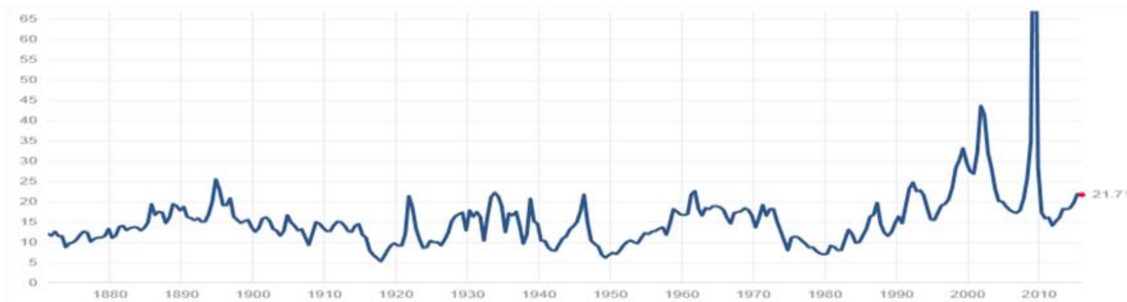
Forecast	Assessment	Rationale for Assessment
Stocks will deliver positive returns	Correct	The S&P 500 increased 2.2% as of late-December
The ECB will enact some form of QE	Correct	The ECB enacted a 1.1 trillion Euro QE program
The Fed will raise interest rates in 2015	Correct	The Fed raised interest rates in December
Investment grade credit preferred	Correct	Investment grade credit beat Treasuries and junk
First 10% correction in 3+ years	Correct	The S&P 500 experienced a 12% correction in August
Real estate recovery will continue	Correct	Real estate prices increased roughly 5% in 2015
China's growth will slow	Correct	China's GDP fell from roughly 10% to 7%
Emerging markets will rise	Incorrect	Emerging markets, in aggregate, fell in 2015
Unemployment rate will drop	Correct	Unemployment fell from 5.6% to 5.0%
GOP legislative reform	Incorrect	Legislation was passed, but nothing transformative

A CLOSER LOOK AT BEACON'S TEN INVESTMENT FORECASTS FOR 2016

There is an element of risk in offering predictions, since the future is uncertain. We can state with confidence that some forecasts we offer for 2016 are likely to be correct, some incorrect, and some partially correct. We can also predict with great confidence that what will ultimately prove to be some of the major events of 2016 are neither on our list, nor on anyone else's. For example, few strategists forecasted that China would devalue its currency in 2015, providing the impetus for the first stock market correction since 2011. It is often the events that few investment strategists are talking about that result in the most extreme market movements. As noted in our Executive Summary section, Beacon portfolios are custom tailored to each client's unique risk tolerance. Hence, our investment ideas may be appropriate for some clients, while not consistent with the goals and objectives of others. With these important caveats in mind, we humbly offer you some color around our top ten investment forecasts for 2016.

1. **U.S. stock returns to be positive, but below long-term returns of 10% per year.**
   We continue to believe that the market is unlikely to achieve any material P/E multiple expansion. In fact, with the S&P 500 trading at more than 21x trailing twelve month earnings (**Figure 1**), versus its long-term average of roughly 15, the risk skews towards a multiple contraction. In our view, gains will likely be limited to earnings growth, dividend yield, and net stock buybacks, resulting in single-digit returns for most domestic stock market indexes.

Figure 1: Trailing P/E Ratio for the S&P 500



Source: Multpl.com

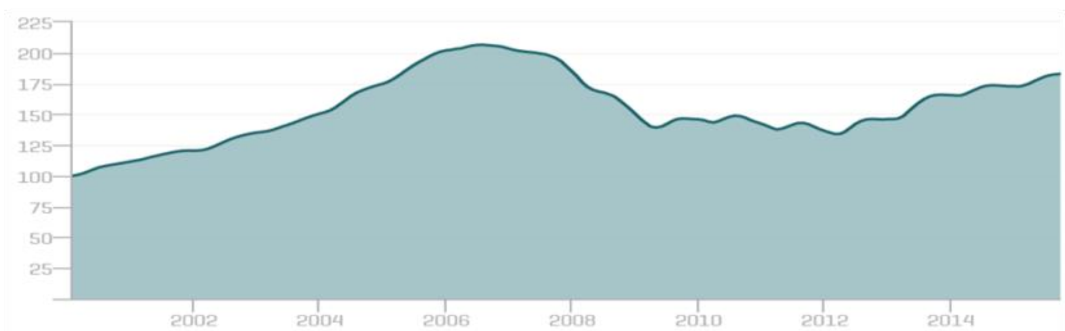
2. **The stock market will experience another 10%+ correction, its second in two years.**
   The stock market is currently priced under the assumption that economic growth and earnings will accelerate. Any disappointment in the GDP or earnings numbers may result in a multiple contraction for the market as a whole. Of course, predicting the exact catalyst of a correction in advance is challenging—if not an impossible task—but other sources of a correction may include problems in China, Europe or the Middle East, an unexpected rise in interest rates, the fallout from a strong dollar, collapse in commodity prices and the ever present "black swan" risk.

3. **In the fixed income area, investment grade credit risk will be preferred to interest rate risk.**
   Rates gradually rose in 2015 and the trend is expected to continue in 2016. However, due to the sluggish global economy and the Fed's oft repeated "measured pace" approach, we believe interest rates will rise modestly. GDP continues to expand so we do not expect a surge in defaults, outside of the commodity space, with many of these firms now downgraded to junk status. Hence, we favor investment grade credit risk over the interest rate risk of long dated U.S. Treasuries.

4. **The real estate recovery will continue, with prices rising at single digit rates at the national level.**
   The ingredients for an attractive real estate market remain in place. Namely, relatively low interest rates and low levels of unemployment. Money spent on home remodeling and improvements continues to be solid, as evidenced by recent earnings reports from home retailers Home Depot and Lowes. Real estate prices

have increased sharply since the end of the Credit Crisis and Great Recession (**Figure 2**) and we expect the recovery to continue, albeit at a more measured pace with the national Case-Shiller Home Price Index rising single digits in 2016.

Figure 2: Case-Shiller 20 City Composite Index



Source: Standard and Poors

5. **The U.S. Dollar will continue to strengthen vs. the Euro and Yen.**
   The U.S. Dollar has experienced a very strong run over the past year versus most major currencies (**Figure 3**). The U.S. economy has continued to strengthen, albeit at a moderate pace, while Europe and Japan remains on the edge of a recession. As the Fed exits from its quantitative easing (QE) policy and raises rates, the European Central Bank (ECB), Bank of Japan (BOJ), and Peoples Bank of China (PBOC) are moving in the opposite direction. We believe this dynamic creates an environment for a continued strong dollar.

Figure 3: U.S. Dollar Index (DXY) vs. a Basket of Major Foreign

Source: TradingView.com

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6. **Oil prices will rise from their current price of roughly $35-$40 per barrel, but not come close to the $80+ barrel price levels experienced in the latter half of 2014.**

   It was not that long ago when oil prices were more than $100 a barrel (**Figure 4**) and gasoline prices were more than $4 a gallon at the pump. What a difference a little more than a year makes. Oil has struggled to stay above the $40 a barrel range as the year comes to a close, Saudi Arabia defends its market share and Iran integrates itself further into the world economy. Major oil firms have slashed billions of dollars in capital expenditures and many marginal players have been forced out of business. We believe the supply vs. demand equation is gradually moving in a more favorable way for oil prices and hence expect prices to rise over the course of 2016.

Figure 4: Crude Oil Prices, 2013-2015

Source: InfoMine.com

7. **Companies with strong organic revenue growth will outperform the market as a whole.**

   The current bull market and economic recovery are getting long in the tooth by historical standards. With earnings growth remaining challenging, we believe that companies with strong organic growth will be rewarded by the market. For example, we believe exchange traded funds (ETFs) weighted by revenue, such as RWL, may outperform the traditional market capitalization weighted S&P 500.

8. **China will devalue its currency further vs. the U.S. Dollar in order to support economic growth.**

   China devalued its currency, the Renminbi (RMB), roughly four percent in August, relative to a basket of major world currencies (**Figure 5**). This devaluation led to corrections in most markets around the world. The devaluation was driven in part by China's slowing GDP growth rate, down from its recent average of 10% to a less sizzling 7%. There are no signs of a material reacceleration of Chinese GDP. We believe further devaluation may be in the cards in order to meaningfully spur exports.

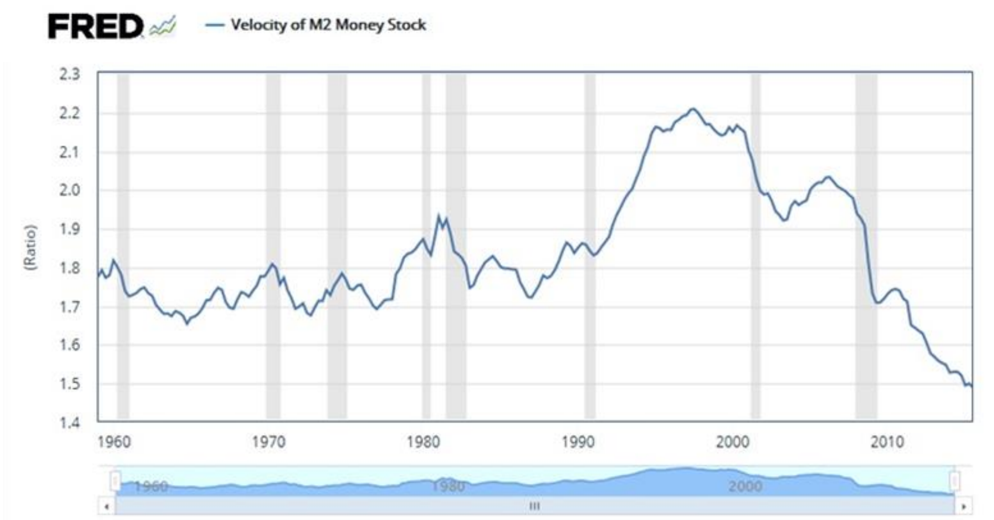
Figure 5: Chinese Renminbi vs. U.S. Dollar

Source: Xe.com

9. **Inflation will be a non-factor, with the CPI increasing below its roughly 3% long-term average rate.**

   When the Fed expanded its balance sheet from roughly $700 billion before the Credit Crisis to roughly $4.5 trillion today, many investors assumed that inflation would surge. Of course, nothing of the sort has emerged and deflation maintains a real risk. The missing link in the inflation equation is that the velocity of money has collapsed (**Figure 6**). In other words, banks are holding onto excess reserves resulting in the extra "printed" money not making its way into the economy. We believe this dynamic continues, keeping inflation under control for the remainder of 2016.

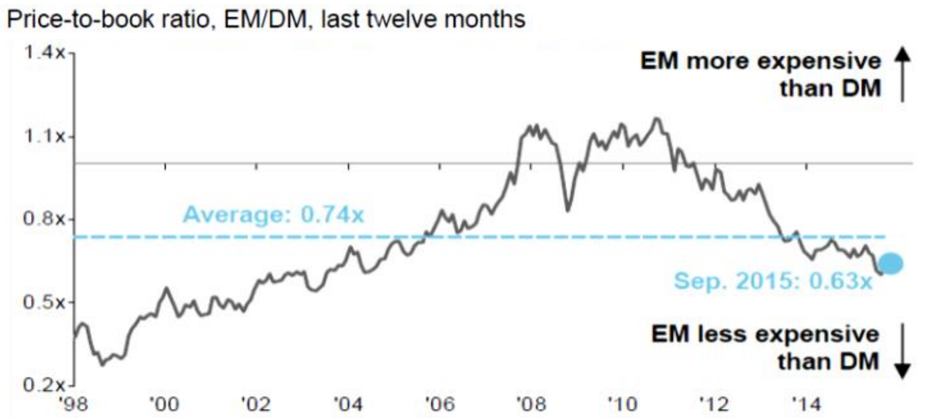
Figure 6: The Velocity of Money



Source: Federal Reserve Bank of St. Louis
research.stlouisfed.org

10. **Despite the likelihood of high volatility, emerging markets will surprise to the upside, outperforming developed markets.**
    Emerging markets have been a disappointing asset class in 2015, with the MSCI Emerging Market Index down roughly 13.8% as the year comes to a close. However, in our view valuations remain attractive (**Figure 7**) and much of the bad news may be built into current equity prices. We expect the U.S. Dollar to remain strong, acting as a headwind for returns in emerging markets. However, a normalization of valuation levels for most emerging market nations may overcome the currency headwind, resulting in overall attractive returns for the year.

Figure 7: Emerging Market (EM) vs. Developed Market (DM) Valuations



Source: JP Morgan Guide to the Markets, September, 2015

BEACON'S FOUR STRATEGIC WEALTH MANAGEMENT THEMES FOR 2016

Investment forecasts in and of themselves are interesting, but of little direct value. They must be actionable if they are to be valuable for our clients. Therefore, coupled with our Ten Investment Forecasts we offer Four Strategic Wealth Management Themes for 2016, along with specific investments to implement them. Some of our recommended investments will apply to all clients, but since our financial plans are custom tailored, not all investments may apply to your particular situation.

One commonality among our themes is that volatility is likely to increase as the Fed normalizes it's monetary policy and the returns for most asset classes are likely to be somewhat muted. We believe performance in 2016 will be somewhat similar to what occurred in 2015, with possibly more upside if the economy accelerates from its current growth rate of roughly 2% per year. In this type of environment, we believe a focus on diversification and high quality investments is the best course of action. These viewpoints help shape the thinking that underlies our four strategic themes for 2016 and the specific investments that will capitalize on them.

1. **Maintain a diversified portfolio with downside protection at its core as volatility increases.**

   Beacon has long believed in intelligent diversification among different asset classes—Equity, Hybrid, Alternative, Fixed Income and Cash. This approach to diversification helped cushion client portfolios during the stock market correction in August. Some of

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our recommended investments with downside protection include the Acertus Planned Return Strategy, AQR Managed Futures Fund and Blackstone Alternative Multi-Strategy Fund.

2. **Intelligent search for yield. Despite the Fed raising interest rates on December 16th for the first time since the 2006, interest rates remain at exceptionally low levels.** The temptation for investors is to get extra yield by taking on high levels of credit risk. This approach clearly did not work in 2015 as junk bonds were among the market's biggest losers. In our view, it is best to get yield from a variety of high quality sources. Some of Beacon's recommended investments that fit the bill include Versus Capital Multi-Manager Real Estate Income Fund, Breckinridge Municipal Bond SMA and Fidelity's Limited Term Municipal Income Fund.

3. **Emphasize high quality investments.** With valuations elevated and the world economy growing at sluggish rates, we believe it is prudent to overweigh high quality investments in client portfolios. A number of Beacon's investments would fall into this category including the Vanguard Dividend Growth Fund, Oakmark International Fund, FPA Crescent Fund, as well as our proprietary Acertus Accelerated Return, Core, and Factor Information Return Model (FIRM) strategies.

4. **Returns will be subdued for most asset classes.** As we noted in our forecast for equity returns in 2016, given the high starting point of stock market valuations, returns will most likely consist of earnings growth, dividends, and net stock buybacks. We estimate these three categories will aggregate to single digits. Returns on bonds will likely be limited to the coupons, plus or minus a small capital gains or loss factor. There is not much room for the level of interest rates to fall with the 10-Year Treasury hovering around 2.2%. However, we think a sharp spike in interest rates is unlikely given the even lower yields emanating from Europe and Japan. We continue to expect positive returns from real estate assets in 2016, but given the strong recovery from the 2008-2009 lows, a double digit return may be too much to ask. In short, 2016 is likely to be a year of singles and doubles.

We at Beacon look forward to the opportunity to discuss our Ten Investment Forecasts with you, as well as the ways in which our Four Strategic Wealth Management Themes can be custom tailored to your personal situation. As always, we close by thanking you for your loyalty and support. We consider our relationship with our clients a true *partnership and our sole mission as a firm is to add value to our clients in any way we can. It is with the fulfillment of this mission in mind that each of us at Beacon is focused on individual and collective improvements each day.*

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