MarketView

First Quarter 2016

Back to Where We Started

The year started out with the Standard and Poor's 500 Index (S&P 500) grinding slowly higher for the first half of 2015, followed by a late summer swoon and then a dramatic October recovery. When all was said and done the S&P ended the year slightly lower, down .73% for the year. Outside of a handful of high-priced stocks like Amazon (up 117.8%) and the gun manufacturers (up about 100% as a group), the average S&P stock was down 4.11%. With the majority of S&P 500 stocks down, most investors (70%) lost money in 2015 according to Openfolio.

GS Investments, Inc.

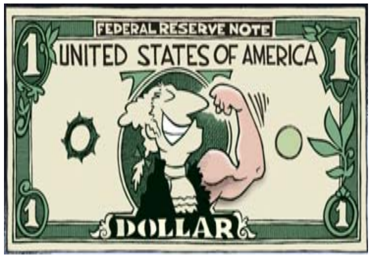
Largest Stock Holdings

12/31/2015

Securities	Pct.
Wells Fargo and Company	2.14%
Microsoft Corporation	2.12%
Walt Disney Company	2.05%
PepsiCo Incorporated	2.01%
VISA Incorporated	1.94%
Home Depot Incorporated	1.93%
Apple Incorporated	1.85%
Boeing Company	1.83%
Honeywell International	1.82%
Berkshire Hathaway Class B	1.81%

The major drivers of the market in 2015 were the plummeting price of oil, the increase in value of the U.S. dollar, a faltering Chinese economy and the Federal Reserve's move to raise interest rates. Each of these situations has both positive and negative implications for the U.S. economy as we move forward. We will cover each of these in turn below:

1. Oil continued its precipitous slide with West Texas Intermediate Crude prices ending 2015 at $37.04, down from $98.42 at the end of 2013, and $53.27 at the end of 2014. This had serious, negative consequences for profitability within the energy sector. Earnings of Energy companies in the S&P 500 dropped nearly 60% from 2014 levels. Profits, based on current energy price assumptions, are expected to continue to drop in 2016. However, with gasoline prices at their lowest average levels since 1999 and natural gas prices down 41% from last year, Energy Voice estimates an average annualized household savings of $1,400. This, in effect, is a tax cut that families can use for other purchases. We expect that eventually we will see a benefit to retailers and firms that sell consumer goods.



2.The U.S. dollar has appreciated significantly against international currencies since fall 2014. This has made it more expensive for U.S.-based firms to sell their products internationally. It has also made the price of foreign-produced goods cheaper. While a strong dollar will continue to hurt U.S. manufacturers, we believe most of the year-over-year headwinds have already been reflected in these companies earnings and stock prices. Compar-

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isons in 2016 should become a bit easier than they were in 2015. Regardless, a strong dollar will continue to provide resistance to any profit recovery for U.S. manufacturers in 2016.

3. The Chinese stock market has dropped over 40% since its June 2015 highs. This has put tremendous fear in the global markets as China is the world's second largest economy. However, it is important to put this dramatic correction into perspective. In November, 2014, the Chinese government took steps to open up its market to both foreign and domestic investors. In a little less than 7 months, the market more than doubled. Since then, the Chinese market, as measured by the Shanghai index has given back nearly all of the gains from this quick bubble. We think this is somewhat comparable to the "dot.com bust "in the U.S. where fortunes were made and lost in such a short time-frame that it had little impact on the actual economy. More worrisome is the amount of debt that China has taken on since 2008. We will be watching this dynamic closely.

4. The Federal Reserve (the Fed) raised a key interest rate (the federal funds rate) by a quarter percent in December. This is the first time the Fed has raised this rate in nearly 10 years, moving it from 0% to .25%. However, it is always advisable to pause and put this increase into perspective. Instead of keeping rates at or near their lowest levels in 75 years, expectations are for multiple (2 to 4) 1/4% increases. We believe that relatively low rates will last for quite some time as cheaper oil and the strong dollar will keep a lid on inflation. Also, rates continue to decline in the rest of the world making it difficult for the U.S. to go the other way as it would propel the U.S. dollar even higher. Finally, the continuation of market turmoil in China will cause the Fed to be more conservative, just as they were holding off rate increases this fall when the Chinese market began to correct. The main benefactors of higher rates will be banks and financials.

Over the long-term, the most important factor affecting stock prices is earnings. The current forecast for final 2015 S&P earnings is expected to be flat to slightly down from 2014 levels. This is mainly due to a 60% decline in the energy sector earnings and weakness in materials and industrials. For 2016, S&P Capital IQ projects consensus operating earnings for the energy sector to come under increasing pressure. On the other hand, strong earnings growth is expected in the consumer discretionary, financial, health care, and technology sectors, with a strong rebound in materials.

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“Expert” Predictions for 2016 are in. Do they matter?

Since 1926 the median annual stock market return, as measured by the S&P 500, has been just over 10%. According to a Birinyi Associates survey of the 9 largest investment banks, S&P 500 predictions for 2016 are bunched relatively close together with an average predicted return of just above 10%. So do we think they will be right? Probably not, if one considers that over the last 90 years there have only been 6 occasions where the market has provided a return in the range of 8-12% (the 10% median return +/- 2%). As an investor, how should one react to predictions, like these, that are so consistently unreliable? We believe that the answer is to focus on the long-term, where annual returns have averaged 10%.

Investors ditching Money Managers

Of interest to us was a recent article in the WSJ highlighting the move away from “money managers” in 2015. Although the numbers are undeniable, the majority of the $207 billion taken from money managers was placed with advisors using mutual funds. As we have mentioned many times before, mutual funds (and to a certain extent, ETFs) add an extra “layer” of cost. In other words, there is the advisor fee plus the expense ratio fees built into the ongoing costs of the funds. A core part of the GS Investment philosophy is to use individual securities, thereby eliminating this layering of costs to the client.

It follows then, that the higher cost structure of an advisor using funds/ETFs makes it harder to produce superior returns. This is why so many consistently underperform their respective benchmarks.

We encourage investors to focus on their “net return” rather than focusing on the charges imposed by the advisors or the funds/ETFs that they use. After all, it is the return that the investor receives after all fees and expenses are deducted that counts.

When all is said and done, we like to think that our clients receive a strong value proposition with good service, reasonable fees/costs and above average returns.

Notable

“No passion so effectually robs the mind of all its powers of acting and reasoning as fear.”
Edmund Burke

“If you follow the crowd, you might get lost in it.”
Anonymous

“Avoid the precepts of those thinkers whose reasoning is not confirmed by experience.”
Leonardo Da Vinci

“There is no living thing that is not afraid when it faces danger. The true courage is in facing danger when you are afraid.”
L. Frank Baum

“It has been my experience that folks who have no vices have very few virtues.”
Abraham Lincoln

"The stock market is a device for transferring money from the impatient to the patient."
Warren Buffet

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Quick Take

The recently negotiated Trans Pacific Partnership trade agreement between the U.S. and 11 of the largest economic countries bordering the Pacific Ocean, allows for 70+ years of protection for copyright material, but as little as 5 years on pharmaceutical drugs. That means that Hollywood films like "Dumb and Dumber" will have decades of proprietary rights protection, but life-saving drugs from major U.S. Pharmacy companies can be copied in as few as five years.

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GSI Tenets

GS Investments, Inc. is an investment management company specializing in individual and institutional asset management. Privately owned and operated, GS Investments, Inc. is run by its owners, Glenn H. Steinke, C.F.A., John G. Steinke, M.B.A. and Greg Cunningham.

Glenn Steinke, CFA brings over 45 years of investment management experience to the business. Previous capacities include Vice President and Senior Investment Officer with a major pension fund ($1.8 billion under management) and Senior Vice President with a major Minneapolis-based financial institution ($3 billion under management). Glenn is a graduate of the University of Minnesota.

John Steinke MBA offers a broad financial services background with 20 years of portfolio management experience and 7 years of banking experience including capacities as a Vice President of a $50 million bank and as a private banking office for a large, Minneapolis-based financial institution. John received his BA from Concordia College (Moorhead) and his MBA from the University of Minnesota.

Greg Cunningham Prior to joining GS Investments, Greg spent 15 years at Minneapolis-based Ameriprise Financial, a national leader in financial planning with over 2 million retail clients and $300 billion in assets. Here he worked with the Chief Investment Officer in support of the international and domestic hedge funds and with the President and General Manager of RiverSource mutual funds. Greg is a graduate of Gustavus Adolphus College in St. Peter, MN.

Sheri Ritchie brings over 20 years of financial services experience to the business. Previous capacities include client service and support positions with Dean Witter and Kemper brokerage firms and a Minneapolis-based investment management firm. Sheri is a graduate of the University of St. Thomas.

GSI Investment Philosophy

GS Investments, Inc. utilizes a balanced approach for the majority of its accounts although each account is tailored to the individual needs of each client. Taxable or tax-exempt bonds are used along with a common stock component. The division between bonds and stocks is determined by the personal objectives of each client. A need for income and a willingness to assume risk are also determinants of an account's bond/stock mix.

GS Investments, Inc. emphasizes the purchase of quality securities and employs a long-term investment style, as market timing, frequent shifts in asset allocation and interest rate forecasting are not consistent with the firm's philosophy. In-depth market analysis and many years of experience support this approach.

GSI Fixed Income Strategy

GS Investments, Inc. emphasizes a staggered maturity approach when purchasing bonds. Individual security investment grades and call protection are considered when making these investments. Quality grades of "A" or higher are favored with tax-exempt issues. Government bonds are dominant among taxable securities.

GSI Equity Strategy

GS Investments, Inc. favors stocks emphasizing quality and growth. Appropriate cyclical growth stocks and small capitalization growth stocks are used periodically as well. Additionally, GS Investments, Inc. believes that a growth oriented philosophy tends to result in less frequent trading and lower tax payments (for taxable accounts) on realized capital gains. This provides a lower cost approach for the client.

Client Communication

GS Investments, Inc. emphasizes client communication. Written investment objectives as well as periodic oral and written reports are used to heighten the understanding between the client and investment manager. In addition, easy to read, detailed reporting is provided by state-of-the-art investment software in order to inform the client of portfolio progress.