Pinnacle Capital Management, LLC

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COMMENTARY

The first quarter of 2016 was a modestly positive period for the markets. The S&P 500 gained 0.8% (1.3% inclusive of dividends) while the Barclay's Aggregate Bond Index returned 3.0%. This latter gain was primarily a result of bond prices rising as interest rates fell. This was the reverse of the prior quarter. Attractive yields for investors still remain illusory.

ECONOMIC STATISTICS					
	1st Qtr (3/31/16)	4th Qtr (12/31/15)	*% Change*	1 Yr Ago (3/31/15)	*% Change*
S&P 500 Index	2,059.74	2,043.94	*0.8%*	2,067.89	*-0.4%*
10 Year Treasury Yield	1.77%	2.27%		1.92%	
Gold Spot ($ / oz)	$1,232.71	$1,061.42	*16.1%*	1,183.68%	*4.1%*
WTI Crude Oil (next future)	$38.34	$37.04	*3.5%*	47.60%	*-19.5%*
GDP Qtr / Qtr	N/A	1.4%		0.6%	
CPI Y / Y	1.0% (Feb)	0.7%		-0.1%	
Unemployment Rate	5.0%	5.0%%		5.5%	

Perhaps the most interesting news for the quarter was that oil prices ceased their downward trajectory. Oil prices advanced 3.5% during the quarter as measured by the nearest future contract for West Texas Intermediate crude. Likewise, we're sure you've noticed lately that gasoline prices have bottomed out as well. All of this is not to say that oil prices are about to shoot upwards. While we may see significant *short-term* moves, upwards or downwards, we don't foresee a *sustained* upward movement in the near future. While rig counts are coming down and wells are being shut in, there is far too much excess inventory that needs to come out of the system. This may take years, as a decline in a surplus is a far cry from a shortage. All this bodes well for consumers, but not so well for energy producers. In no way do we subscribe to the view that low energy prices are a sign of economic weakness - at least at this point in time.

Some of our readers may dispute our prior claim that this was the "most interesting news for the quarter". After all, we're in the midst of a Presidential primary season featuring the most colorful pool of candidates in our collective memory. Nonetheless, we believe the most significant investment implication of the election at this point in time is the level of uncertainty which has been injected into the investment decision making process. Markets generally dislike uncertainty; but unless a strong incumbent is running, this uncertainty usually exists at this point in the election cycle. So while there is certainly much fodder for the newspaper headline (and Saturday Night Live skit) writers, we think it is premature to devote significant time to the subject of the upcoming election.

Now that we have gotten the election out of the way - for now - let's turn back to the economy. It seems the two brightest spots in the current domestic economy are automobile sales and the travel & entertainment industry. This is a good news / bad news story. First, the strong automobile sales represent a high level of consumer confidence, notwithstanding any surveys to the contrary. The high level of sales is driven by rapidly improving technology (especially with respect to collision avoidance), low gasoline prices, increased average miles driven, low financing costs, and improving consumer income and balance sheets. Still, it's hard to see U.S. sales advancing vigorously from these levels, so other factors will have to contribute to economic growth going forward.

Entertainment presents an interesting case. It seems that one emerging societal trend is that people increasingly want new experiences as opposed to owning more things. By this we mean that people are tending to prefer to spend on travel, eating out, watching new movies, etc. as opposed to spending to obtain more possessions. We're describing a *relative shift* in preference. People still want more "stuff". But more than wanting "stuff", people are preferring to "do more stuff". Perhaps this is a reflection on the lack of the introduction of radically new items (such as the introduction of the smart phone) or a side effect of the bursting of the housing bubble - i.e., we're not buying homes, furniture, and large screen TVs like we used to. Even high auto sales may be a function of this trend, as people travel further to destinations away from home. But in any case, we expect to see a higher rate of economic growth over time from the travel and entertainment industries than by the consumer goods industries. While theoretically, this is neither good nor bad for the overall economy - it just represents a shift in preference - we would point out that the relevant industries such as media, transportation, and dining are more strongly positioned vis-à-vis foreign competition than many other industries. This is obviously a positive for the U.S. economy.

We think it prudent to comment on U.S. corporate profitability. This has been an increasing concern for some investors. It is likely that earnings for the S&P 500 declined in the first quarter. This will be the 4th consecutive quarter of earnings decline, a circumstance we have not witnessed since 2009. While some of this is due to slow growth and weak overseas markets, especially with respect to commodity producing nations, we see two significant factors. First, the strength of the dollar over the past year or so, which was driven by the prospects of rising U.S. interest rates, has resulted in overseas revenues and earnings being translated into fewer U.S. dollars. For the most part, U.S. companies' underlying earnings are better than they appear after the currency adjustment. We don't see this as a significant headwind going forward, and we think the comparisons will get easier in the future.

Second, a portion of the decline can be attributed to falling earnings in the oil and commodity sector. For example, whereas quarterly net profit margins of S&P 500 excluding the energy sector remained roughly flat between the 4th quarter of 2014 and 2015 (ranging between 10.6% and 10.9%), the net profit margin of the energy sector of the S&P 500 fell from 6.7% to 2.8% over the same period. When viewing this in combination with tepid GDP growth, it appears that what is happening is that the benefit of falling energy prices has not yet been fully offset by higher spending elsewhere. This is not all bad. As consumers and businesses utilize the savings to improve their balance sheets, it becomes easier to weather a downturn at some point in the future. It is still possible that spending will accelerate, but for the near term, general uncertainty and memories of the past two recessions are probably tamping spending growth.

When balancing the positives and negatives, economic growth has been less than robust. This does not surprise us; and we expect it to remain that way for at least several quarters. But still, we're discussing rates of growth - not of decline. We are just completing the seventh year of economic expansion. Sometimes, we forget that the glass is more than half full.

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