Colorado Capital MANAGEMENT

Enriching Lives

Quarterly Market Update

Volume 15, Issue 4 September 2015

Key Data Points:

- **Q2 GDP was up 3.9%**
- **Unemployment falls to 5.1% in September**
- **U.S. stocks fall 6.4% in Q2**
- **Emerging markets down almost 18% for the quarter**
- **10 Year Treasury Yield falls to 2.1%**
- **Federal Reserve keeps rates close to 0**

Inside this issue:

Economic Growth Picks Up

Economic growth picked up in the second quarter in the U.S., with a report of 3.9% GDP far exceeding the anemic growth that occurred in the first quarter. Higher levels of consumer expenditures, exports, and state and local spending contributed to growth for the quarter.

The U.S. economy has held up relatively well amidst reports of slower growth in China and other emerging economies and a continued downturn in the energy sector. In fact, U.S. economic expansion is in its sixth year, longer than the typical U.S. expansion which has averaged five years since 1945, according to Moody's Analytics. (see chart on Page 2) Whether the expansion continues hinges not just on conditions at home, but also on the effects of the slowing global economy.

EFFECTS OF CHINA

Anxiety about China and its impact on the world economy intensified in the third quarter, dominating headlines and at times overshadowing news about U.S. growth. China's economy is on track to grow at its slowest rate in almost six years, with growth forecasts falling under 7% this year. While China still represents a major source of global growth, its GDP is far lower than its peak of 10% five years ago.

Slower growth in China is tied to lower demand for commodities and other products exported by the U.S. and other countries. Although American exports to China accounted for less than 1% of U.S. GDP last year, falling Chinese demand has been blamed for some of the

*(Continued on page 2, **Economy...**)*

Market Undergoes First Correction in 4 Years

After a relatively strong start to the quarter in July, stocks underwent a sharp correction in August and continued to fall in September, resulting in negative returns for market indexes around the world for the quarter and the year. On a positive note, bonds held their ground through the market retreat, providing ballast for diversified portfolios.

The downturn this quarter stemmed from uncertainty about the declining strength of the global economy, particularly China and other emerging countries, and its impact on the markets. A surprise currency devaluation in China, falling commodity prices, and a potential change in monetary policy added to the uncertainty.

Markets do not respond well to uncertainty, and often decline until positive sentiment returns. The irony is that as soon as positive sentiment returns in one area, unexpected issues arise elsewhere. How to handle this ever-present uncertainty is one of the key challenges of investing.

STOCK MARKET CORRECTION

Stocks slid world-wide during the third quarter as investors retreated from riskier assets. Large company U.S. stocks (as represented by the S&P 500 Index) fell 6.4% for the quarter and were down over 5% for the year as of September 30.

The stock market sectors contributing most to third quarter losses included energy and materials, hurt by plunging commodity prices, and health care, which experienced a sharp pullback late in the quarter due to controversy about drug pricing and its political implications. Smaller cap and international stocks also fell

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ECONOMY...

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recent distress in U.S. markets.

Also to blame was the surprise devaluation of China's currency in early August. The roughly 2% devaluation of the yuan versus the dollar was aimed at boosting Chinese exports, but the move also roiled currency markets and global stock markets, showing the broad reach of China's evolving capital markets.

Even with the recent downturn, China's explosive growth over the last decade and a half has had a positive impact on global economic growth and stock market returns in China. It should be no surprise that an inevitable slowing of that growth should be felt on the downside as well.

While the rate of growth in China is subsiding, its overall contributions as the world's second largest economy should continue to benefit the U.S. and world economy.

ENERGY CONTINUES TO SLIDE

Oil prices resumed the downward path that began early in the year, as slowing global demand—particularly from China—brought crude oil prices to new lows, under $40/barrel. Excess supply remains an issue. Even with evidence of a decline in U.S. output, supply has remained high around the world, with steady production by OPEC and potentially more supply coming from Iran. All of this has increased concerns that prices will stay low for several years.

The silver lining of lower energy prices and cheaper fuel is a potential increase in discretionary income. We have seen some evidence of that in recent reports of higher consumer spending. According to Moody's Economics, lower energy prices have contributed 0.5% to GDP so far this year, and that rate may grow in the second half of the year.*

AREAS OF STRENGTH

News reports about a slowing Chinese economy and falling energy prices raise doubts about whether U.S. growth can withstand global economic turmoil. While this turmoil may get resolved in the short term, it will always exist in some form. In spite of this, there are many positive signs suggesting the U.S. expansion can persist.

The overall domestic economy appears relatively balanced, marked by a strong housing market, the lowest levels of unemployment since 2008, and steady increases in consumer spending, thanks in part to low inflation. Low interest rates have provided cheap financing for many consumers, as shown by increased real estate and auto purchases so far this year.

Business sentiment is still generally positive: U.S. companies are typically upbeat as they report strong sales, pricing, and solid investment. We are also seeing steady profit growth in many industries (with the exception of energy).

These factors would not suggest a recession is anywhere on the near horizon; according to Moody's Analytics, the likelihood of a recession is extremely low, and they expect the economic expansion to continue over the next 2-3 years.*

AREAS TO WATCH

There are some potential risks to this forecast. September's reports of slowing manufacturing and lower employment growth, as well as the continued appreciation of the dollar, could counteract some areas of economic strength. The Fed's potential interest rate hike "later this year" and the impact on the markets also makes forecasting the path of the U.S. economy difficult.

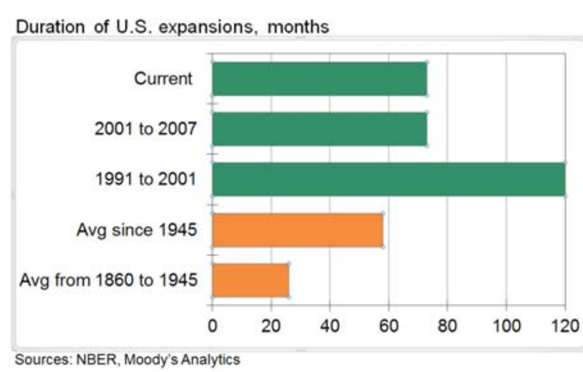
The longer this Fed-induced uncertainty is drawn out, the harder it is for investors to gauge the economic and market impact. We still believe, however, that small, gradual rate hikes by the Fed should not derail the economic growth we have seen over the last few years.

OUTLOOK

The economic implications of the current world financial markets, including an appreciating dollar, low energy prices, low interest rates in the U.S., and heightened concerns about China's economy, are still playing out.

While many had underestimated the downside effects of an increasingly global economy, there are still reasons to be positive. As already noted, consumers should continue to reap the benefits of low energy prices and mortgage rates, and U.S. companies continue to create jobs, reducing unemployment and boosting business growth.

While we acknowledge that we are in midst of an unusually sluggish recovery and expansion, we are still optimistic that we will see annual economic growth of 2-3% over the next two years, and hope to be surprised on the upside.



Moody's Analytics, Economic and Consumer Briefing, Sept. 2015

INVESTING...

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more than 10% for the quarter, reflecting the difficult environment across the stock market spectrum in terms of company size, sector, and country exposure.

EMERGING MARKETS VERY WEAK

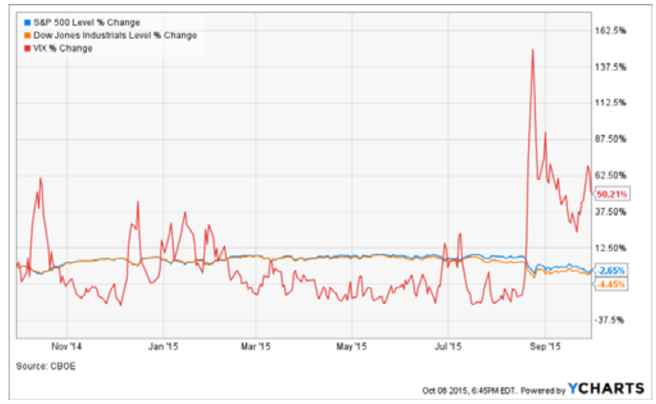
The quarter's sharpest declines came from stocks of emerging markets countries, which tend to have greater exposure to weaker sectors such as energy and materials and are also more dependent on demand from China. With both of these sources of growth at risk, emerging market stocks fell sharply, with the MSCI Emerging Market Index falling almost 18% for the quarter.

Looking at a broad basket of emerging markets stocks over the last ten years, there have been periods of outperformance that have compensated for the weaker performance of late, as noted by the chart below showing U.S. and emerging market returns. We would hope to again see upside from the beaten-down emerging markets category.

Over longer periods, emerging markets stocks offer attractive diversification benefits and growth potential. Because they tend to experience more extreme swings in performance, they represent a small part of our overall allocation to stocks; the size of the allocation also depends on clients' risk tolerance and time horizon.

SHORT-TERM VOLATILITY AND LONGER PERSPECTIVE

Most of the quarter's downturn in stocks occurred over a very short period of time. The Dow Jones Industrial Average was down over 1,000 points when it opened on August 24, and the S&P 500 fell 11% over 7 trading days in August. With this sharp pullback, stocks entered correction territory (defined as a loss of 10% from peak to trough) for the first time in nearly four years. The correction and accompanying volatility (as measured by the red VIX index) is evident in the following chart.



While disconcerting, it is understandable that stocks would come back to earth after tripling from their lows in 2009, especially given signs of an economic slowdown overseas and interest rate concerns at home. The speed and magnitude of the correction makes you wonder whether the outlook for stocks changed so drastically in such a short period of time.

The short answer is no; stocks can be extremely volatile, but the companies they represent do not typically change in value so quickly. It is unlikely that the country's largest 500 companies (represented by the S&P 500) had an 11% downturn in their fundamentals in less than two weeks in August.

We should also recognize that corrections are completely normal. Since 1980, the average intra-year market decline has been 14% according to J.P. Morgan; August's correction of 12% from its peak in May is relatively mild by comparison. Also noteworthy: In 27 of these 35 years since 1980, stocks generated positive returns for the year.*

BONDS AND THE BENEFIT OF DIVERSIFICATION

Bonds were flat to slightly positive for the quarter, boosted by a flight to safety during the stock market correction. The Fed's decision to hold steady on interest rates at their September meeting also generally helped bond performance. Higher quality government and municipal bonds fared the best, while riskier high yield bonds suffered, reflecting weakness in lower-rated issues and fear of defaults among struggling energy names.

Our bond holdings overall provided a measure of stability, income, and much needed downside protection in the midst of a very difficult quarter for stocks. Also providing some relief were real estate funds, one of the few positive performers this quarter.

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**Source: JPMorgan, Guide to the Markets, Oct. 2015.*

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These holdings helped to mitigate some of the losses seen in the stock portion of client accounts, illustrating the benefits of a well-diversified portfolio containing both equity and fixed income securities.

PARTING THOUGHTS

We recognize that the negative returns you may see in your statements may be disconcerting, and we understand you may be concerned about the state of the market.

Our approach has not changed, nor has the recent correction lessened our conviction in our investment philosophy. Long term market returns can be achieved by maintaining disciplined exposure through periods of extreme performance on the upside or downside, such as we have recently experienced.

In addition to discipline, we also stress the importance of broad diversification, which helps to limit downside risk, and consistent asset class exposure, which positions our clients to capture the inevitable rebound from the lows reached this quarter. Markets typically reward discipline, consistency and long-term focus, values we embrace on your behalf.

CCM UPDATE: NEW LOGO AND NEW FACES

After 15 years, we refreshed the logo for CCM, and are excited to introduce it in our materials this quarter. Our new tagline, “Enriching Lives,” reflects our commitment to assist in the enrichment of your lives through our values-based investment and planning process.

We are also excited to introduce Ryan Patterson, the newest member of the team at CCM. Ryan will support our operations and client service efforts and will also assist in the continued expansion of our impact investment offering. He brings three years of experience from the nonprofit sector which includes grant-making and program management at El Pomar Foundation and finance & accounting with Colorado Outward Bound School. He holds a bachelor’s degree in international political economy from Colorado College, where he graduated in 2012.

Ryan lives in Denver and spends much of his free time climbing, hiking, and skiing. Creating a positive impact every day through business, philanthropy, and daily activities is very important to him, and he is excited to find opportunities to integrate into the Boulder community. Welcome, Ryan!

COLORADO CAPITAL MANAGEMENT provides investment management and financial planning to high net worth individuals and their families. We develop prudent and thoughtful financial strategies designed to both limit risk and meet specific long-term goals.

While the core of our business is portfolio management, we also advise clients on a wide range of financial matters such as planning for retirement, reviewing insurance coverage, and utilizing techniques to reduce income and estate taxes.

We also offer sophisticated impact investment strategies for investors wishing to combine financial returns with positive social and environmental impact.

We provide all of these services for a flat annual fee equal to 1%, or less, of the assets under management. This “fee-only” approach enables us to avoid the serious conflicts of interest that plague other financial firms that sell products and charge commissions.

To learn more about how Colorado Capital Management can help you achieve your long-term financial goals, please visit www.ColoradoCap.com or call 303.444.9300.

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