

# Sheaff Brock

Innovative Portfolios for Intelligent Investors™

**MARKET  
UPDATE**  
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8801 River Crossing Blvd.  
Suite 100  
Indianapolis, Indiana 46240

317-705-5700 or 866-575-5700  
sheaffbrock.com

“Curiouser and curiouser!!”

Lewis Carroll  
*Alice in Wonderland*

## In This Monthly Update

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Check out sheaffbrock.com for our latest column at abcnews.com. Also listen to recorded portfolio manager calls.

(continued from page 4) Performance information of benchmark indexes is included for comparison purposes only. Two general types of benchmarks are provided with respect to the composites. The first type is a well-known and widely-recognized index, such as the S&P 500 Index (described previously), which generally is used to reflect the market for equity investments in large US companies), and the Barclays US Aggregate Bond Index (described previously), which generally is used to reflect the investment grade taxable bond market in the US). These types of indices are not selected to represent an appropriate benchmark with which to evaluate a composite's performance, but rather to allow for comparison of a composite's performance to that of a well-known and widely recognized index.

The second type of index is a more narrowly-focused index selected based on one or more characteristics, such as asset class, style or strategy, geographic area, sector, tax characteristics, or volatility, for example, similar to characteristics of a composite. Although a more narrowly-focused index will have characteristics similar to those of a composite, actual composite holdings will differ significantly from the securities that comprise an index. Consequently, use of a narrowly-focused index does not indicate that a composite will achieve returns, volatility or other results similar to those of the index. The composition of a narrowly-focused index will not reflect the manner in which a composite is constructed in relation to investment holdings, Portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility or tracking error targets, all of which are subject to change over time. Comparison of a narrowly-focused index to a composite must be limited to the similar characteristics. Clients should NOT expect performance comparable to the narrowly-focused index in an actual account.

Securities may be mentioned in a portfolio description, and if so a list of a transactions/recommendations for the trailing 12 months is available upon request. Any portfolio returns mentioned are composite returns, and are net of fees and commissions. There is the chance that market conditions or portfolio performance may deteriorate in the future, and clients may experience real capital losses in their managed accounts. Portfolios are compared to the performance of various indices although the portfolio, which contains much fewer positions, may not reflect the securities making up these indices. None of the indices may be an appropriate comparison index as our managed accounts may own companies not represented in the benchmarks. All clients of SBIA who desire to participate in option transactions receive the option disclosure document, titled Characteristics and Risks of Standardized Options, which outlines the purposes and risks of option transactions. Despite their many benefits, options are not suitable for all investors. Individuals should not enter into option transactions until they have read and understood the risk disclosure document which can be obtained from their broker, any of the options exchanges, or OCC. There were no other strategies employed to obtain the results portrayed other than those strategies disclosed in the SBIA ADV or other disclosure brochure. SBIA provides this Newsletter for general informational and educational purposes, and where appropriate, to assist in explaining the portfolios and composites. It is not investment advice for any person. Information is obtained from sources SBIA believes are reliable, however, SBIA does not audit, verify, or guarantee the accuracy or completeness of any material contained therein. The statements and opinions reflect the judgment of the firm, and along with the information from third-party sources and calculations, are made on the date hereof and are subject to change without notice. SBIA does not assume liability for any loss that may result from reliance by any person upon any material in this Newsletter. Clients or prospective clients are directed to SBIA's Form ADV Part 2A and to one or SBIA's representatives for individualized information prior to deciding to participate in any portfolio or making any investment decision. SBIA does not provide tax advice. Clients are strongly urged to consult their tax advisors regarding any potential investment. **Past performance does not guarantee future results, there is always a possibility of loss.**

## The World is Upside Down



“If I had a world of my own, everything would be nonsense. Nothing would be what it is, because everything would be what it isn't. And contrary wise, what is, it wouldn't be. And what it wouldn't be, it would. You see?”

Lewis Carroll, *Alice in Wonderland*

Just 18 months ago, if we would have predicted nearly any of the following items, you would have put us in a padded cell:

- √ The S&P 500 pays a higher dividend yield than 10-year bonds pay in interest.
- √ One-quarter of all bonds issued globally, \$12 trillion dollars worth, pay *negative* interest.
- √ Utility stocks trade at a higher P/E ratio than technology stocks.
- √ Corporate earnings drop 4 quarters in a row, and over one-third of all stocks are in bear-market territory (down 20% from their high), but the stock market is at an all-time high.
- √ The poster child of a perfect and beloved equity, Apple (AAPL), falls 20% in price.
- √ Donald Trump has a better-than-fair shot at being President.

As implausible as all of those items were 550 days ago, it's the world that we live in.

These odd times are forcing investors to lower their standards. 50% of global fixed income securities are yielding less than 1%, which is driving investors to continue buying anything they can that generates yield. A strong dividend history is usually associated with safer stocks. The search-for-yield buying spree has forced “safe” stocks, like utilities to record breaking P/E valuations. The utility sector ETF (XLU) carries a P/E ratio of 19 and the consumer staple ETF (XLP) is trading a P/E of over 22, whereas the technology ETF (XLK) is cheaper than both with a P/E of only 18. The “perceived safe” investments of long-term bonds, utility stocks, and consumer staple stocks are at very stretched valuations. Safe stuff is now expensive, and riskier stuff is now cheap.

The odd political environment is also making voters look elsewhere, as evidenced by the Libertarian candidate, for the first time ever, getting double digit polling results. A Libertarian candidate has never received more than 1% of the vote in prior elections. It is going to be a wild election, Alice in Wonderland style. Look at the picture and

imagine you are the voter in the middle. Each of the characters sort of resembles one of the candidates.

## The Curiouser Stock Market

As we mentioned in the previous column, over one-third of all stocks are in “bear market” territory (as of 7/25/16). The advance to new highs in the indices has been carried on the backs of fewer and fewer stocks. It has been a narrow advance. A narrow advance can end poorly (Dot-Com bust), or it can broaden out, meaning more and more stocks start to participate in the advance.

In the last 3 or 4 weeks the market has been broadening out as the lagging sectors have been catching up to the leaders. A broad based rally would be a harbinger of a strong second half for stocks.

In conference calls we have discussed the long period between new highs for the S&P 500 during a bull market, and historically what has happened after previous similar periods. This time we went 14 months without a new high in the S&P 500, and then the malaise was finally broken on July 11<sup>th</sup>. In the last century, this one-year-plus stretch between new highs has only happened 14 previous times. Listed below are the previous times, and then the gain (or loss) one year later for the S&P 500.

Date	1 Year Later
1/22/29	-11.4%
9/22/54	41.8%
9/24/58	14.1%
1/27/61	11.3%
9/3/63	13.3%
5/4/67	4.9%
3/6/72	5.0%
7/17/80	7.7%
11/3/82	14.5%
1/21/85	18.4%
7/26/89	5.6%
2/14/95	36.9%
5/30/07	-8.6%
3/28/13	18.4%
7/11/16	?
<b>Average</b>	<b>12.3%</b>

Source: Bespoke Investment Group

As you can see, 12 out of 14 times the market went higher in the next year. Also notice that the only periods of poor forward performance preceded the 1929 Depression or the 2008 Great Recession. Barring an economic calamity, we would bet the stock market will be a fair amount higher by this time next summer. If we match the 12% historical average, the S&P 500 should be at 2380 and the Dow Jones Industrials somewhere near 20,400.

But again, the last 20 months or so have been odd. In the dividend world, if you didn't have big weightings in expensive Utilities, Telecom, or Consumer Staple stocks, you are lagging way behind. Growth momentum stocks have done very poorly. Small-cap bad, mid-cap half bad, most large-cap mediocre, and a few stocks crazy good. Upside down. Inside out. A bit like Alice going down the rabbit hole.

## Portfolio Updates

Despite a record breaking index run for stocks, making money in equities this year has been a challenge. According to Bank of America, in the first half of 2016 less than 18% of large-cap managers beat the Russell 1000 index. This is the worst batting average for active managers since 2003. Because of this, money has been pouring into index funds and commensurately being yanked from the stock-pickers of the world. Behavioral finance will tell you that following the crowd into indexing will likely be a poor idea. Historically periods of active underperformance are followed by runs of outperformance. Below is our 1<sup>st</sup> half report card:

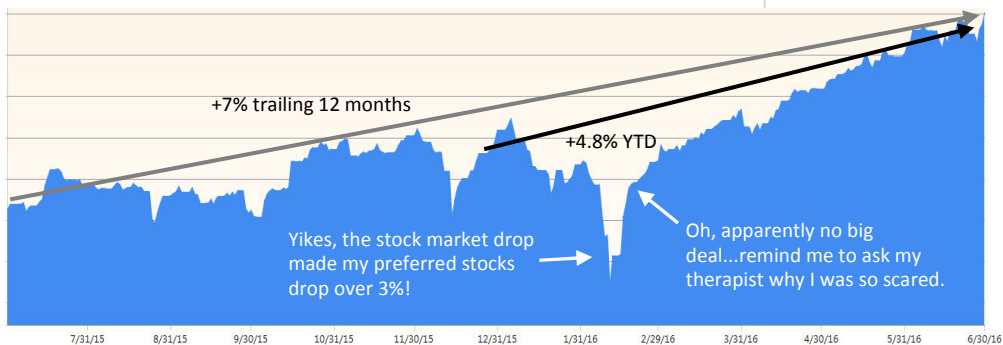
### Preferred Income

Preferred stocks have been *The Little Engine That Could* of the fixed income world, just continually pulling the train forward, delivering good yield and total return.

Period ▲	Net Return
06/30/2015 - 07/31/2015	0.99%
07/31/2015 - 08/31/2015	(0.69%)
08/31/2015 - 09/30/2015	(0.47%)
09/30/2015 - 10/31/2015	2.21%
10/31/2015 - 11/30/2015	0.51%
11/30/2015 - 12/31/2015	0.23%
12/31/2015 - 01/31/2016	(1.34%)
01/31/2016 - 02/29/2016	(0.23%)
02/29/2016 - 03/31/2016	2.58%
03/31/2016 - 04/30/2016	0.82%
04/30/2016 - 05/31/2016	1.34%
05/31/2016 - 06/30/2016	1.60%

To the right is our composite performance, month-by-month, for the last year. It has gained, with dividends reinvested, about 7% in the trailing 12 months, and just under 5% year-to-date (net-of-fees).

Below is a chart showing the gain; each line equals 1.5%. The 5 and 7% didn't come without a couple of potholes, but with the exception of early January of 2016, most moves were limited to a percent or so, either direction.



The current yield of the portfolio is still a bit under 6% and the average call protection is about 4 years. The yield-to-call is still over 4%.

Preferred stocks aren't going to get you rich, and it is hard to fathom interest rates dropping much from here to drive fixed income securities higher in price. But, the yield is still more than competitive. JR Humphreys, the portfolio manager, has been laddering the call dates so securities won't be called away all at once. He has also been adding a few positions in "fixed-to-floating" rate preferreds. In the fixed income world the preferred space is one of the few still offering a decent yield. Heck, compare the current yield of 5%+ to a like-rated, ten-year corporate paying less than half as much. Even my 4 year old granddaughter can do that math.

## High Yield Bonds

High yield bonds had a similar price scare early in the year but have come back in price after investors realized January was just a Chicken Little market move. Like the equity world, it is hard to find overwhelming value in low rated bonds. Our portfolio, sub-advised by Oppenheimer Portfolio Management, has a short duration and a yield similar to preferreds.

### Covered Call

We have systematically been increasing the option writing activity, and generally using shorter dated calls. Also, larger-cap stocks dominate the potential buy list. Options premiums are richer when volatility is higher. Richer option premiums equate to higher income from the sale of covered calls. Volatility, as shown in the chart of the VIX, has dropped to 13; a low level, and half as high as it was earlier in the year.



But, you have to play with the hand you are dealt, so we will just keep nibbling away at option premiums and accumulate them as we can for you.

### Dividend Growth & Income

This is our flagship portfolio of high quality, dividend paying companies which have had a propensity to raise their dividends. The portfolio has a definite "value" bent to it, which has hurt it this year. We mentioned in the *Alice in Wonderland* section that utilities and consumer staple stocks have had a fabulous run this year driving them to extreme levels. Remember that dude who parachuted from

the edge of space a year or two ago? When he jumped he was so high he could see the curvature of the Earth. That is how high utility stocks are right now. The low exposure we have had to these two sectors hurt our performance YTD. However, July (through 7/25) has been very good for us, but not-so-hot for our ETF competitors (DVY for example). We are up 5% and DVY is flat (net-of-fees). Perhaps the valuation swing reached the nadir and will continue favoring our style. Dividend Yield is still strong at 3.3% (and growing). We have recently started

to send emails to clients explaining reasons behind purchases and sales. With the most recent purchase this portfolio is now fully invested in 25 stocks.

### IntelliBuild Growth™

IntelliBuild is the blend of up to 33 American stocks from *Investors Business Daily* lists. It tends to play in the mid-cap and small-cap sandbox. This year, the *Investors Business Daily's* IBD 50 index has had a tough go. Through June the index was down about 3%. The fact that we got caught by stop-loss orders in January's swoon, which caused us to be somewhat underinvested during the snap-back, cost us a few percent. Like Dividend Growth & Income, July

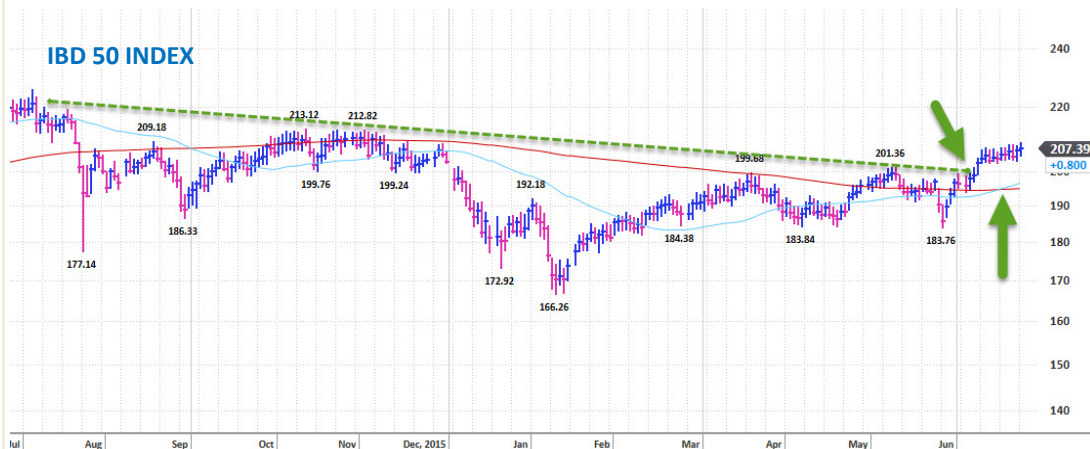


has been kind to Intellibuild. We have gained about 5% in price, as has the IBD 50 index. Not to get all wonky on you, but below is a chart of the IBD 50 index. The green dotted line shows the downtrend that has been in place for a year. Interesting that this growth index has been in a downtrend while the S&P 500 has been hitting new highs. The top green arrow shows the index broke through the downtrend line in early July. The bottom green arrow shows that the 50-day moving average broke

through the 200-day a few days ago. For technicians, these are very bullish pictures.

### Alternative

This is commodity, currency, and emerging market heavy portfolio using mutual funds and ETFs. This year has been good for those areas. If economies around the world continue their growth, demand for commodities will improve, as should this portfolio.



### Mid-Cap 10

Momentum-driven, combined with mid-cap, has been a tough space YTD. The first 6 months were difficult, but July has been great, so far +6% .

### Bulls of the Dow

Had a very good first half, and is continuing the positive returns for the 5th year. But we are out of room...which gives you a reason to read next month's letter!

If you have any questions or comments regarding this letter, including any Portfolio or composite, please contact our Chief Compliance Officer, Dave Gilreath at [daveg@sheaffbrock.com](mailto:daveg@sheaffbrock.com); you can also reach him, or any other Sheaff Brock representative, at 317-705-5700.

Style	Performance Update Portfolio	Thru June - 2016	2015	2014	2013	2012	2011	2010	2009
Fixed Income	Preferred Income - Preferred stocks	4.81	5.22	14.02	-4.57	9.10			
	High Yield Bond	2.41	-7.32	-1.93	8.78	15.38	3.99	15.93	45.69
Growth and Income	Covered Call Income - Quality stocks & covered calls	-1.60	-1.20	6.39	23.56	11.56	-10.25		
	Dividend Growth & Income - Dividend paying stocks	0.23	-7.16	5.20	36.09	12.36	5.36	17.09	24.08
Growth	IntelliBuild Growth - IBD growth stocks	-8.62	2.57	7.62	19.69*	*9/1—12/31/13, S&P 500 +12.9%			
	Bulls of the Dow - 10 strongest of the Dow 30	3.37	1.14	12.42	30.05	7.83			
	Mid-Cap 10 - Mid-cap growth momentum stocks	-15.88	-12.68	11.84	24.32	23.55	21.88	21.26	38.15
Alternative	Alternative - Metals, foreign currencies, commodities	4.81	-8.25	-4.23	-0.70	9.02	-7.74		
	<b>Index</b>		<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
	S&P 500	3.84	1.38	13.69	32.39	16.0	2.1	15.1	26.5
	CBOE S&P 500 Buy/Write	2.43	5.24	5.64	13.26	5.20	5.72		
	Barclays Aggregate Bond	5.31	0.55	5.97	-2.15	4.2	7.8	6.5	5.9
	DB Commodity Index Tracking Fund (NAV Total Rtn.)	14.64	-27.41	-28.18	-7.57	3.31	-2.71		

Composites include all (but not less than five) fully discretionary, management fee-paying and, beginning on January 1, 2011, non-management fee-paying accounts, including those accounts no longer with the firm of reasonable size that are substantially invested in accordance with the composite strategy or style. Returns are presented net of management fees and all trading expenses, and the reinvestment of all income. Net-of-fee performance was calculated using actual management fees, except in the case of non-fee-paying accounts, where model fees have been imputed. Actual advisory fees and transaction fees will vary depending on, among other things, the portfolio, account size, and activity. Fees are described in SBIA's ADV Part 2A. The securities mentioned in this report can be, and often are, owned by clients and employees SBIA. \*Denotes partial year, with note reference. October 1, 2015 Preferred Income was sub-advised by Trust Investment Advisors, Indianapolis, IN. calculated. Past performance is not indicative or a guarantee of future results.

- The S&P 500 Index is a market capitalization-weighted index comprised of the 500 stocks with the largest market capitalizations trading in the United States. This is not a managed portfolio and does not reflect the deduction of fees or expenses; returns include dividends.
- The Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market in the United States, including Treasuries, government-related and corporate securities, mortgage backed securities (agency fixed-rate and hybrid ARM pass-throughs), asset-backed securities and CMBS (agency and non-agency).
- The CBOE S&P 500 BuyWrite Index (the "BXM" or the "BXM Index") is a passive total return index based on (1) buying an S&P 500 stock index portfolio, and (2) "writing" (or selling) the near-term S&P 500 Index (SPX) "covered" call option, generally on the third Friday of each month. The SPX call written will have about one month remaining to expiration, with an exercise price just above the prevailing index level (i.e., slightly out of the money). The SPX call is held until expiration and cash settled, at which time a new one-month, near-the-money call is written. The premium collected from the sale of the call is added to the portfolio's total value. The expired option, if exercised, is settled in cash. The BXM Index does not take into account significant factors such as transaction costs and taxes and, because of factors such as these, investors should be expected to underperform passive indexes. The BXM Index is designed to represent general trends for a hypothetical buy-write strategy.
- DB Commodity Index Tracking Fund (DBC) The PowerShares DB Commodity Index Tracking Fund seeks to track changes, whether positive or negative, in the level of the DBIQ Optimum Yield Diversified Commodity Index Excess Return™ (DBIQ Opt Yield Diversified Comm Index ER) plus the interest income from the Fund's holdings of primarily US Treasury securities less the Fund's expenses. The Fund is designed for those who want a cost-effective and convenient way to invest in commodities. The Index is composed of futures contracts on 14 of the most heavily traded and important physical commodities in the world. The Fund and the Index are rebalanced and reconstituted annually in November. The Alternative portfolio is a commodity centric portfolio of ETFs and mutual funds whose constituents' profits are highly sensitive to general commodity prices. It may perform differently than DBC since the composite does not hold futures contracts.

Indexes are unmanaged and unavailable for direct investment. Benchmark returns include reinvestment of income, but do not reflect taxes, or other fees that would reduce performance. (continued pg 1)