Sheaff Brock

Innovative Portfolios for Intelligent Investors™

MARKET UPDATE
May 2016

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PLEASE NOTE NEW ADDRESS!!

In This Monthly Update

Date of publication 5/26/16

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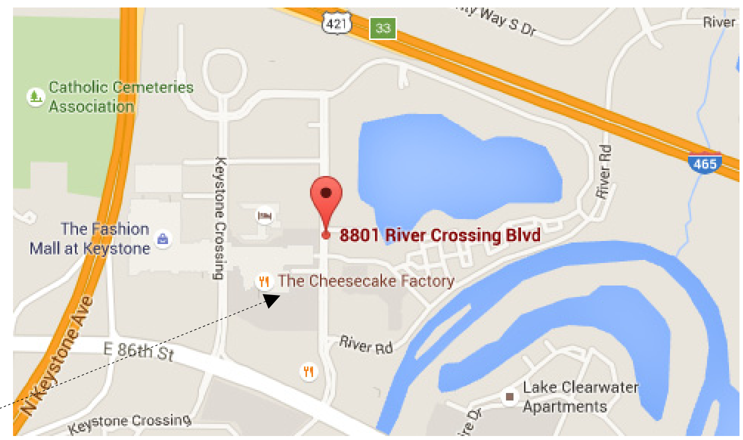
Check out sheaffbrock.com for our latest column at abcnews.com. Also listen to recorded portfolio manager calls.

Moving Day!

Eighteen months ago we told you our company would be moving to a new office in 2015. Well, construction never goes quite as planned, 2015 came and went, but we are now finally moving to the first floor of a snazzy new office building in Indianapolis.

We will be the first tenant in the building pictured. Being the first tenant has its upside (uncrowded restrooms). The downside is ongoing construction. If you happen to call in the next few months and hear hammers, saws, and "beep-beep-beep" in the background, don't let whomever you are talking to complain about it. Just remind them how uncrowded the restrooms are.



Our new address is:

8801 River Crossing Blvd., Suite 100 Indianapolis, IN 46240

The location is where I-465 and Keystone Ave. intersect, adjacent to Indy's high-end shopping mall, and within walking distance of a zillion restaurants.

A year from now half of us Sheaff Brockers will probably be pre-diabetic because of the proximity to this place.

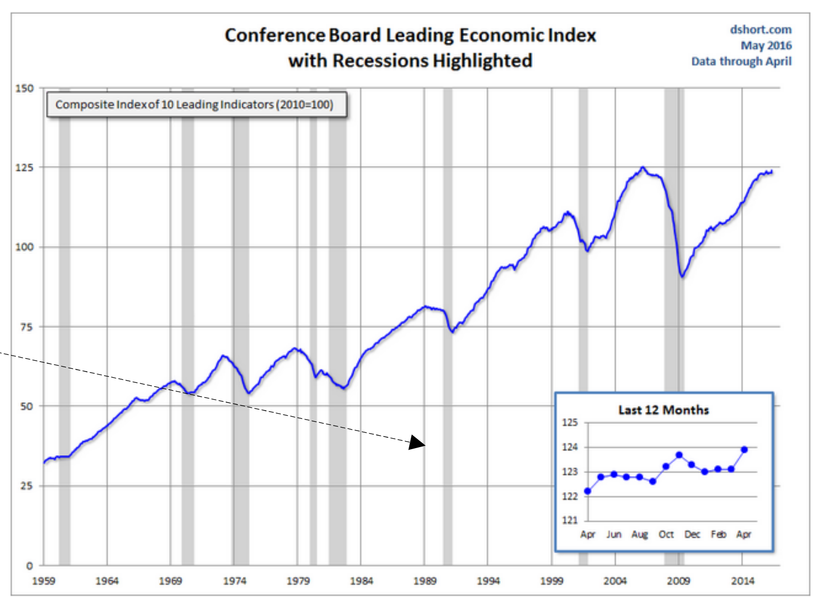
We aren't moving just to make it easier to gain weight or because we want a shiny new office. We are moving because for a long time, we have either been crammed together in too small of an office, or spread out over a couple of floors, and separated from each other. Either too close...or too far away from each other. By the time this shows up in your mailbox, we will have moved, but nonetheless, the stress might have some residual PTSD effects leaving some of us grumpy, so please be patient!

Leading Indicators

For decades the Conference Board (which is <u>not</u> a government organization) has been measuring the economic leading indicators. This is an index made up of 10 different variables. Recessions have been preceded by a rolling over, or drop in the index.

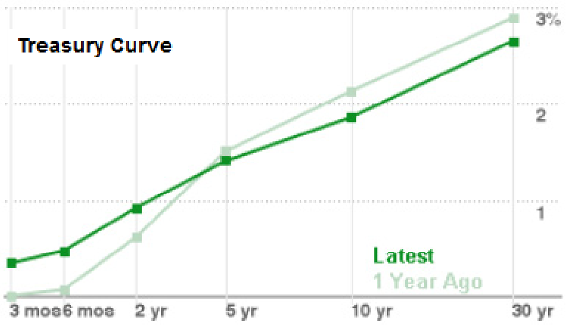
No matter what the politicians say, the economy is still hanging tough. In the last 12 months (small box right here) you can see that the index is still rising, and in fact is within a point of the all-time high.

A recession is probably not right around the corner.



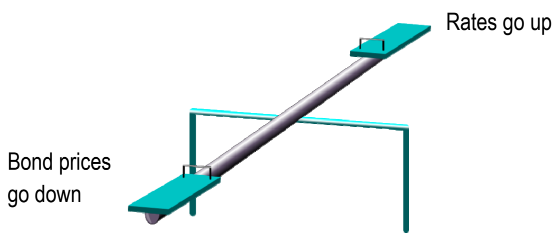
Interest Rates

Odds of an another interest rate hike by the Fed are growing. They last raised the Federal Funds rate by 0.25% in December. The Fed only has influence over short-term interest rates. Interest rates that affect you, such as on mortgages or car loans, or bank CDs and long-term bonds are much more influenced by market forces. The yield curve, nothing more than a comparison of short-term vs. longer-term rates, is still upward sloping. Today's curve, shown below, illustrates that in the last year, short-term rates have risen, while long-term rates have dropped a smidge.



The yield curve has flattened, but it is nowhere near flat or inverted. Often recessions are preceded by an inverted yield curve, short rates higher than long rates.

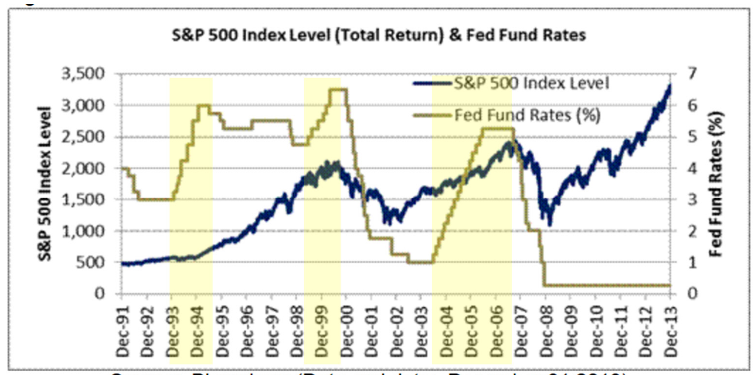
The Fed raising rates by 0.25% is sort of a shoulder-shrug. But, rising interest rates will cause all kinds of chatter about how that will affect stocks and bonds. Rising rates have a direct negative correlation with bond prices.



If you owned a 4% bond and interest rates "normalized" in the next couple of years, this chart shows how that would affect your price. It could be ugly.

4% Bond	Estimated	Price Change
Years to Maturity	Bond Price Change if Rates rise 1%	Bond Price Change if Rates rise 2%
5 years	-4.5%	-9%
10 years	-8%	-15%
20 years	-13%	-23%

How about stocks? In the last 25 years, the Fed has systematically raised interest rates three times. Each time the stock market went up, not down. In the next column is a chart with rising Fed Funds rates highlighted in yellow, and what the S&P 500 did each time.



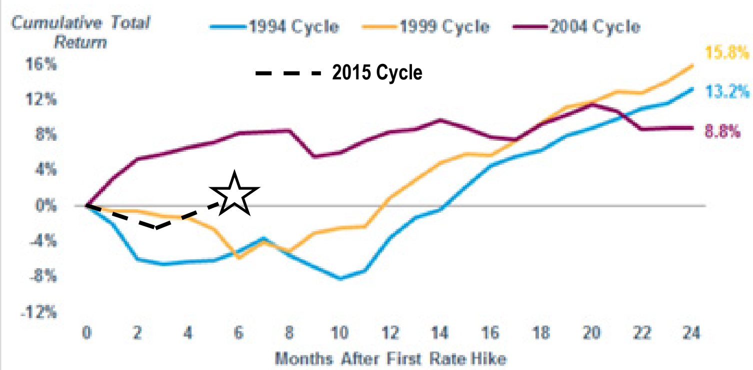
Source: Bloomberg (Data end date: December 31,2013)

- ⇒ 1994 to 1995 rates went from 3% to 6% S&P 500 +50%
- ⇒ 1999 to 2000 rates went from 4.7% to 6.5% S&P 500 +20%
- ⇒ 2004 to 2007 rates went from 1% to 5.25% S&P 500 +50%

Portfolio Updates

Preferred Income

Preferred stocks are a bond in a stock's clothing. So, what has happened to them when rates have gone up? Below is a chart showing the three previous rate-hike cycles, and we have added in (in black) the current rate hike cycle. The bottom line is that preferred stock prices have often wobbled down for the first year following the beginning of rate hikes, but prices have recovered and done quite well a couple of years in. The star shows where we are in the current cycle (sorry about the blurry chart, it is the best we could do).



Cumulative total returns using monthly data from 2/94-1/96 (1994 cycle), 7/99-6/01 (1999 cycle) and 7/04-6/06 (2004 cycle). Returns assume reinvestment of interest and capital gains. Indexes are unmanaged, do not incur fees and expenses and cannot be invested in directly. Source: Schwab Center for Financial Research and Morningstar

For our preferred portfolio, January and February were difficult, but March and April were very kind. The current yield of the portfolio is 5.90% and the average call protection is about 4 years. Not a bad yield in today's world. And if history rhymes, it should be a good place to get income with some stability in principal, if interest rates continue going higher. JR Humphreys, the portfolio manager, has been doing a couple of things in the portfolio. First he is laddering the call dates, so when securities are called, it won't be all-at-once. Second, he has been adding a few positions in "fixed-to-floating" rate preferreds. These are issues that pay a fixed rate for a few years, and then change to a floating rate. These types of preferreds should help mitigate the interest rate risk of the portfolio and help provide a rising income with rising rates.

Making money in the stock market has been exceedingly difficult. Jeff Saut, a highly respected chief strategist at Raymond James said last week, “The past 19 months have been the most difficult stock market I have ever experienced in more than 50 years of investing.”

IntelliBuilD Growth™

IntelliBuilD is the blend of 33 American stocks from *Investors Business Daily* lists. It tends to be heavily weighted toward mid-cap and small-cap stocks, which adds to volatility. Returns in January and February were terrible, March was good, and April was kind of flat. Growth stocks have struggled this year. Just like when you are sick a doctor runs through diagnostic tests, we recently tested our IBD portfolio vs. the S&P 400 Mid-cap index. The tests showed that our portfolio has better valuation, such as a lower price-to-earnings, lower price-to-sales. But at the same time has much higher earnings growth, higher sales growth, and a higher return-on-equity than the index. We are paying less and getting more. The recent underperformance is a puzzle, but eventually the prices catch up to the growth.

Dividend Growth & Income

In this portfolio we buy high quality, dividend paying companies which have had a propensity to raise their dividends. The portfolio has a definite “value” bent to it. We recently did the diagnostics on it vs. the S&P 500. Our portfolio’s valuation measures of price-to-sales, price-to-earnings, price-to-book and dividend yield are all better. And again, our earnings growth, sales growth, book-value growth, and dividend growth rates are all higher than the index. Our portfolio has healthy diagnostics.

Covered Call

The portfolios had a bounce-back in March, but a sloppy April. The “growth” stocks in the portfolio have caused some pain, however the option income has helped. Option writing recently picked up in activity. In our most recent portfolio call, we spoke at length about all three of the above equity portfolios. The call is archived on the website. If you are in any of these, you should take a listen.

Mid-Cap 10

This is a very narrowly focused, 10 stock, momentum portfolio. It has struggled this year, along with the rest of the “growth” world. May has shown a slight bit of improvement.

We have been through tough periods before, and will get through this one. That’s why they call it “work”.

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; you can also reach him, or any other Sheaff Brock representative, at 317-705-5700.

Style	Performance Update Portfolio	April - 2016	2015	2014	2013	2012	2011	2010	2009
Fixed Income	**Preferred Income** - Preferred stocks	1.80	5.22	14.02	-4.57	9.10			
	High Yield Bond	2.05	-7.32	-1.93	8.78	15.38	3.99	15.93	45.69
Growth and Income	**Covered Call Income** - Quality stocks & covered calls	-0.97	-1.20	6.39	23.56	11.56	-10.25		
	Dividend Growth & Income - Dividend paying stocks	-0.53	-7.16	5.20	36.09	12.36	5.36	17.09	24.08
Growth	**IntelliBuilD Growth** - IBD growth stocks	-11.16	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	-0.32	1.14	12.42	30.05	7.83			
	Mid-Cap 10 - Mid-cap growth momentum stocks	-16.76	-12.68	11.84	24.32	23.55	21.88	21.26	38.15
Tactical	**Technical Long/Short** - Long S&P 500, cash, or short	-10.23	-27.13						
Alternative	**Alternative** - Metals, foreign currencies, commodities	5.06	-8.25	-4.23	-0.70	9.02	-7.74		
	Index		**2015**	**2014**	**2013**	**2012**	**2011**	**2010**	**2009**
	S&P 500	1.74	1.38	13.69	32.39	16.0	2.1	15.1	26.5
	CBOE S&P 500 Buy/Write	-0.31	5.24	5.64	13.26	5.20	5.72		
	Barclays Aggregate Bond	3.43	0.55	5.97	-2.15	4.2	7.8	6.5	5.9
	DB Commodity Index Tracking Fund (NAV Total Rtn.)	8.91	-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)