FBB capital partners

August 24, 2015

"Climbing the Great Wall of Worry"

Dear Clients and Friends,

As you have certainly seen, stock markets have become more volatile over these last couple weeks of August. FBB Capital Partners is monitoring the current market choppiness and looking to protect clients on the downside, while also preparing for rising markets. Here are our thoughts on what's happening now, what we think will most likely develop, and how we are positioning client portfolios.

What's driving the selloff?

In a word, China. We are seeing a meaningful slowdown in Chinese economic growth, driving global energy prices, and commodity driven emerging market economies lower. What's more, some investors fear that central bankers are becoming less able to control economic growth, especially in China.

What exactly is happening in China? Economic growth is slipping below 7% and the Shanghai Composite Index is down nearly 40% since mid-June, after doubling in the prior 12 months. In an attempt to stop the hemorrhaging, the Chinese government is using multiple policy tools including interest rate cuts, lending incentives, and their most recent currency devaluation.

The volatility in China is leading investors to ask if the "buy what China is buying" trade is over. Oil is down 27% YTD and the energy index is down 20% on concerns that Chinese-related demand is down, while oil supplies remain stubbornly high. Looking further afield the global market uncertainty has crept into developed markets, including the U.S. and Europe.

Is the sky falling? We don't think so.

FBB Capital Partners views the current market swings as a short-term correction, rather than the end of a post-2008 bull run. The current volatility, in our view, comes from a major economy slowing, rather than from a bubble imploding. We view the current dislocation as more like 2011, when budget deficits led to a downgrade to the U.S. credit rating, driving markets down 20% in the 3rd quarter of that year. Markets recovered as the U.S. economy continued to grow, despite the budget deficits.

In stark contrast, the 2008 and post-2000 bear markets stemmed from sharp declines in volatile asset prices (real estate and technology shares). We believe markets will stabilize once investors recalibrate Chinese economic growth in the mid-single digits.

We continue to have a bullish view of the U.S. economy and capital markets. Most of our client assets are invested in the U.S. market and we view the domestic economy to be much less volatile than emerging markets or commodities. The U.S. economy is growing in the low single digits and U.S. consumers have more disposable income with lower oil prices and less expensive imports. What's more, the U.S. financial system is more secure compared to pre-2008.

In the near term, our sense is that *market choppiness could continue for several weeks or months*, until the first Federal Reserve interest rate increase, which we expect in December or early 2016. This first Fed rate increase could be a clearing event, signaling to markets that the U.S. economy is healthy enough to take on measures to avoid overheating.

How are we responding?

Our focus continues to be on quality portfolio positions. Where the risk/reward profile on positions (or sectors) with emerging economy and/or energy exposure have weakened, we are likely to further reduce position sizes. In addition, we continue to look for opportunities within counter-cyclical sectors to add ballast to the portfolios. FBB's historical preference for dividend paying stocks should continue to add some stability during the current market uncertainty.

In our second quarter client letter, we discussed our reduction in junk bond ETFs. We are now moving up the quality curve by investing in 7-10 year Treasuries, which offer a more secure income stream and an added portfolio hedge with typically inverse price movements compared to equity markets.

In sum, we encourage investors to view rising volatility in the context of broader market moves. While most U.S. stock indexes (and the stock side of portfolios) have fallen from peaks set last year, they are only down modestly year-to-date even after the recent gut-wrenching roller coaster ride. A period of modest backing and filling should be viewed as normal following strong equity market gains over the past couple of years.

As always, your portfolio managers are available to address any concerns or questions you might have. We appreciate your continued trust and confidence in the FBB team as we help you navigate through these choppy waters.

Sincerely yours,

FBB Capital Partners' Investment Committee

T I 301.657.8870 F I 301.657.0566 I www.FBBcapitalpartners.com I 4520 East-West Highway I Suite 450 I Bethesda, MD 20814