Goodman Financial
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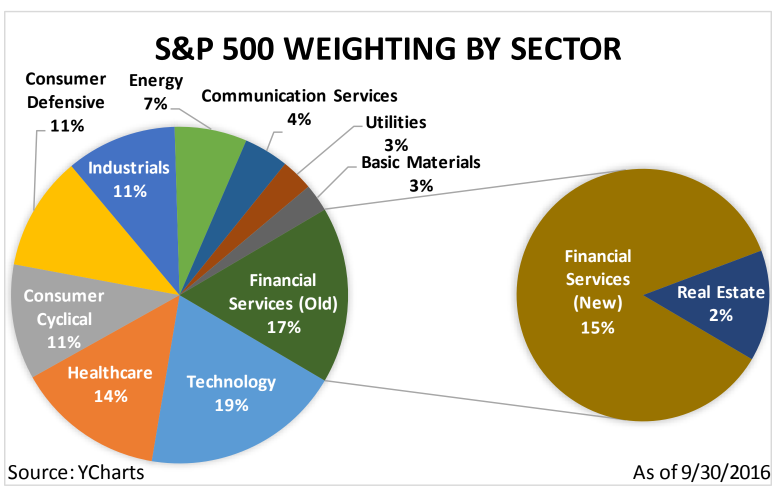
THIRD QUARTER 2016 MARKET & ECONOMIC REVIEW

Major Equity Market Indices: Third Quarter 2016

		Third Quarter 2016*				
Index	Description	6/30/16	High	Low	9/30/16	QTD Return
DJIA	Dow Jones Industrial Average or "The Dow"; A price-weighted average of 30 major U.S. companies.	17,929.99	18,636.05	17,840.62	18,308.15	2.11%
S&P 500	A market-capitalization weighted index of the 500 largest U.S. companies.	2,098.86	2,190.15	2,088.55	2,168.27	3.31%
Nasdaq Composite Index	A market-capitalization weighted index comprised of over 3,000 companies, mostly in the technology and biotech industries.	4,842.67	5,339.52	4,822.90	5,312.00	9.69%
NIKKEI 225	A price-weighted index comprised of Japan's top 225 most established companies.	15,575.92	17,081.98	15,106.98	16,449.84	5.61%
MSCI Emerging Markets	An index comprised of 23 MSCI indices from emerging economies including Brazil, China, India, Mexico, Russia, South Africa, and the UAE.	834.10	927.29	819.19	903.46	8.32%
Stoxx Europe 600	An index comprised of 600 companies based in one of 18 EU countries including Austria, Belgium, Denmark, France, Germany, Ireland, Spain, and the United Kingdom.	329.88	350.62	318.76	342.92	3.95%

* Excludes effects of dividends — Sources: YCharts, MSCI.com, MarketWatch.com, WSJ.com

- The third quarter's performance is somewhat skewed upward due to the Brexit sell-off in June causing indexes to begin the quarter down. Another interesting feature of this quarter was an unprecedentedly calm August, particularly in the U.S.
- U.S. stock market indexes had positive third quarter performances. The NASDAQ benefitted the most from the information technology rally, with the sector up 12.4% over the quarter. The utilities and telecom services sectors finished down 6.7% and 6.6% for the quarter, respectively. Investors appear to be taking gains after seeking dividend yield in those sectors amid low fixed-income yields and in recognition of the likelihood of rising interest rates.
- The Nikkei 225 continues to climb, and the Japanese yen continues to strengthen. The Bank of Japan, the country's central bank, has struggled to reverse decades of stagnation and recent fears of deflation. A fiscal stimulus plan and expansionary monetary policies have not been able to induce inflation, GDP growth, or currency devaluation.
- Emerging markets have benefitted from continued sluggish growth in developed economies and China by attracting investors seeking growth in a slow-growth environment. Additionally, higher oil prices have benefitted oil exporting countries.
- In September, S&P introduced a new sector: Real Estate. In this sector are REITs (excluding mortgage REITs) and real estate services companies, like commercial brokerages and hotels. Previously, these companies were included in the Financial Services sector. The decision to break out real estate from financial services was due to the fundamental differences between how real estate and traditional financial services firms react to factors in the markets such as interest rates—real estate benefits from low rates while banks and insurance companies benefit from high interest rates. An equally important factor was the growth of REITs' assets and in the investing public's awareness of them. Our communications and presentations will reflect this change as time goes on and as systems and data providers adjust for the new sector. To the right is a breakout of the "new" S&P 500 sectors.



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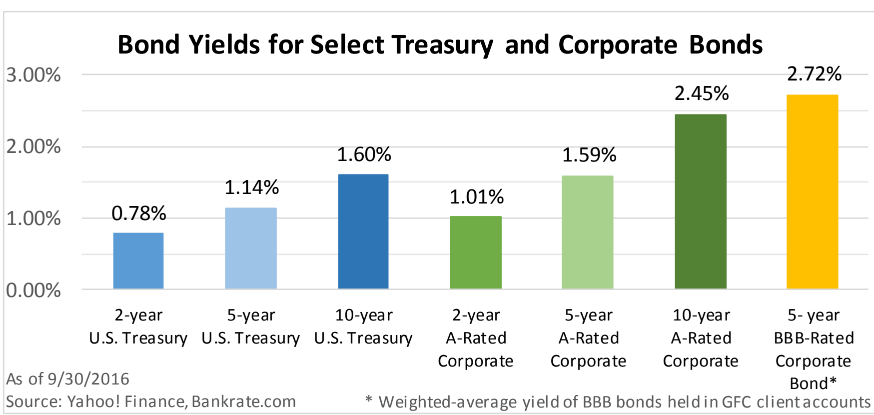
Fixed Income: Third Quarter 2016

	Third Quarter 2016				52-Week Range		
Description	6/30/16	9/30/16	in Basis Points*	Description	9/30/16	Low	High
90 Day Treasury Bill	0.26%	0.29%	3	Federal Funds Rate Target	0.25-0.50%	0.00%-0.25%	0.25%-0.50%
10 Yr. Treasury Note	1.49%	1.60%	11	Prime Rate (U.S.)	3.50%	3.25%	3.50%
30 Yr. Treasury Bond	2.30%	2.32%	2	LIBOR (3-Month)	0.85%	0.32%	0.87%
15 Yr. Mortgage Rate	2.78%	2.76%	-2	5-Year CD	1.19%	1.17%	1.48%
30 Yr. Mortgage Rate	3.48%	3.48%	0	HELOC ($30,000)	4.62%	4.29%	5.01%

* One basis point is equal to 1/100th of 1%, or 0.01%

Sources: Wall Street Journal & YCharts

- U.S. treasury yields rose after Brexit fear subsided in July and then rose again going into the Federal Open Market Committee's September meeting. Since the meeting and the decision to leave the Fed Funds Rate alone, yields have come back down, with all maturities closing slightly above where they began but below their peaks, except the 1-month (not shown) which was unchanged.
- Mortgage rates again approached all-time lows not seen since early 2013. This is good news for borrowers, especially as wages and the employment environment improve. However, this is bad news for banks and non-bank mortgage lenders who have had thin net interest margins for years. A lack of robust, rapid growth has kept rates low.
- The 3-month LIBOR has been increasing due to changes in regulations concerning money market funds that come into effect in mid-October. New rules have forced funds to sell LIBOR-pegged debt and buy short-term government debt.
- The graph below shows the yields of bonds of various credit qualities with varying maturities. Emphasized in yellow is the average yield-to-maturity of bonds rated from BBB+ (Baa1) to BBB- (Baa3) maturing in 2021 held in client accounts—note that this yield is not necessarily indicative of the yield being received by any particular client.



- A look at U.S. Treasury and A-rated corporate bond rates shows slim differences in yields over a fairly long span. This situation is called a "flat yield curve." When the curve is flat, the additional yield on longer-maturity bonds may not be adequate compensation for the additional risks that come with holding them, particularly when one considers how low current yields are.
- Because yields are low even on 10-year bonds, it is beneficial to consider investment-grade bonds with lower ratings (BBB-rated bonds) in order to find yields high enough to justify undertaking incremental risk while maintaining the quality of a portfolio.
- Due to the likelihood of interest rates rising in the near future, which will cause the value of currently outstanding bonds to fall, we have focused on buying bonds with maturities in 2021 or sooner to reduce the magnitude of that change.

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Economic Indicators: Third Quarter 2016

Indicator	Description	6/30/16	9/30/16	QTD Change
Average Weekly Initial Claims for Unemployment Insurance	The number of new filings for unemployment insurance benefits. **A decrease in the number of claims suggests fewer layoffs.** *Most economists believe claims below 300,000 indicate a healthy labor market environment.*	270,000	249,000	-7.78%
Unemployment Rate	The percentage of total labor force that is unemployed but actively seeking employment. **The unemployment rate ticked up slightly but is still relatively low.**	4.90%	5.00%	10 bps
Average Weekly Earnings	The average weekly salary earned by private, nonfarm employees. **Average weekly earnings slightly increased. This suggests more disposable income for consumers and could be the result of a tightening labor market.**	$881.33	$887.18	0.66%
Index of Consumer Sentiment	This index reflects consumer attitudes towards the state of the economy. **Consumer confidence has somewhat diminished, but is still relatively high.**	93.50	91.20	-2.46%
Manufacturers' New Orders for Consumer Goods and Materials (Millions) *	The number of new orders placed for consumer goods. **Fewer new orders indicates lower demand for U.S.-produced consumer goods in the near term.**	$185,084	$184,500	-0.32%
Manufacturers' New Orders for Nondefense Capital Goods, Excluding Aircraft (Millions) *	This index is the producer's counterpart of new orders of consumer goods and materials. **New orders for nondefense capital goods increased during the quarter, suggesting increased business confidence in the economy.**	$62,437	$63,319	1.41%
US Capacity Utilization: Manufacturing *	The ratio of production capacity being used to produce finished products compared to the total capacity available. **Capacity utilization ended slightly down, suggesting some slow down in demand.**	75.4%	75.3%	-13 bps

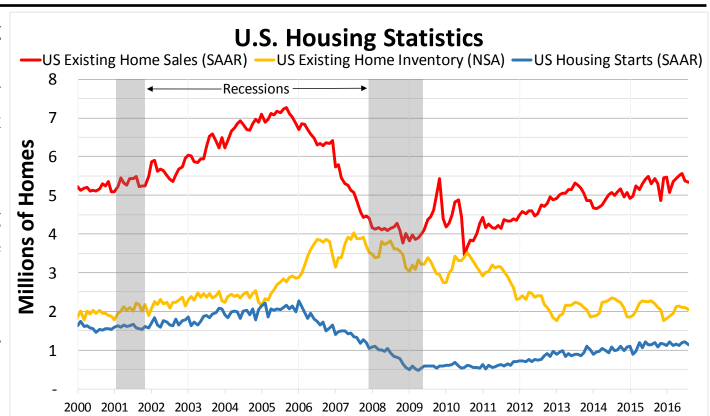
*These items are as of August 31, 2016, the date of the most recently published statistics

Sources: YCharts, Federal Reserve Bank of St. Louis, The Conference Board, U.S. Bureau of the Census

U.S. Economic Health

The graph to the right shows three measures of the U.S. housing market since January 2000: existing home sales, existing home inventory, and housing starts. While the housing bubble was a key contributor to the Great Recession, an improving housing market is fundamental to the recovery.

Increasing existing home sales coupled with declining existing home inventory creates an environment receptive to new home construction—demand is outpacing supply. This state of the market is attributable to a combination of the maturation of Millennials, Baby Boomers and Gen-Xers working through Great Recession-era financial troubles, and a generally improving economy. Low unemployment and growing wages underlie this trend.



Source: Census Bureau, NAR

Housing starts are seen as an important leading indicator of economic growth, as homebuyers must exhibit confidence in their future to make such a large, long-term commitment. Housing starts also signal a willingness in banks to take on additional risk through construction and mortgage lending. Concurrently, home construction employs low- and middle-skill laborers, boosting wages and employment. During the recession, housing starts fell to the lowest recorded level, and current levels are still below historic norms. Even considering the growth in multifamily housing and the potential for modest increases in interest rates, housing appears poised for a period of growth, especially in markets outside of major metro and tech areas.

While a considerable amount of media attention was paid to housing markets that skyrocketed after the recession (e.g. San Francisco, Austin, and New York City), the rest of the country had not been as explosive. Per the Case-Shiller Home Price Indexes, home prices in previously hot markets have cooled and prices elsewhere are ticking upward. According to the Mortgage Bankers Association, mortgage applications and home purchase volumes are also up nationwide. While the stock market has shown that Wall Street has recovered, the housing market may finally be signaling the same about Main Street.