REPUBLIC
WEALTH ADVISORS

July 11, 2016

Dear Friends,

At the halfway point, domestic stocks have made little progress this year. The second quarter brought a recovery of January/February losses but was not otherwise impressive. Similarly, positive year-to-date returns in many segments represent nothing more than a recovery of 2015 losses. Despite generally quiet trading, much was happening beneath the surface.

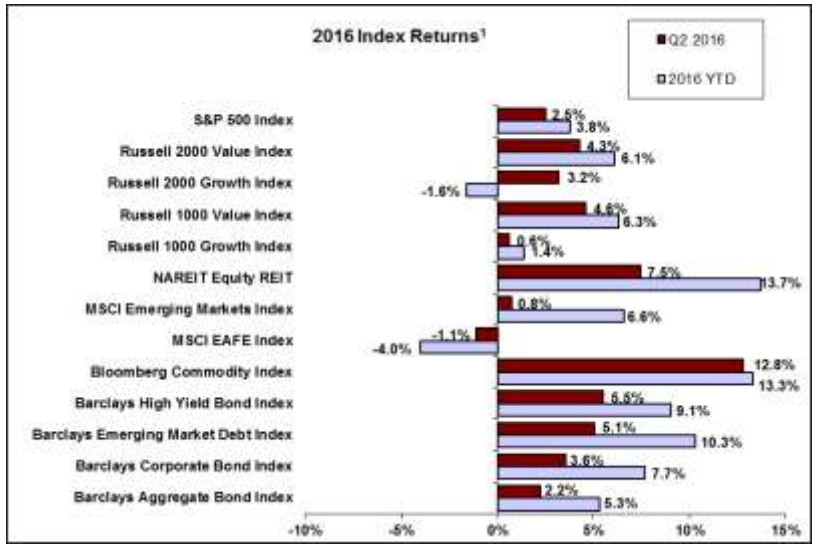
With benchmarks staying in a fairly tight range, the second quarter was much less volatile than the first. The trips outside that range marked two important moments. The first was the Labor Department's release of the May employment report in early June. The data showed only 38,000 net job growth in May, far less than economists expected. This, combined with revisions to past reports, called the ongoing economic recovery into question, and in turn reduced expectations the Federal Reserve would raise interest rates.

The other important moment was the United Kingdom's June 23 "Brexit" referendum. Few observers expected it to pass, but it did and immediately threw European politics and economics into confusion. The British pound plunged and it appears likely the UK will go into recession. Worse, Brexit fallout could roil the already-fragile Eurozone financial system.

How this will affect U.S. markets is unclear. The pound's fall makes UK assets less expensive in dollar terms, which gives British companies a competitive advantage for global business. This could affect some US exporters. We'll learn more as companies release mid-year earnings reports and forecasts in the coming weeks.

Looking at the quarterly numbers[1], the S&P 500 gained 2.5% in this three-month period. Value stocks again outperformed growth in both large-cap and small-cap benchmarks by a wide margin. As happened in the first quarter, the difference was starkest in smaller stocks: The Russell 2000 Growth Index fell 1.6% while the Russell 2000 Value Index gained 6.1% for the quarter.

Outside the U.S., emerging markets continued to outpace the developed world. The MSCI Europe, Australasia and Far East Index (EAFE) dropped 4.0% in USD terms and an even worse 6.8% in local currencies for the first half. The MSCI Emerging Markets benchmark rose 6.6% in US dollars and gained 3.6% in the home currencies. Brazil's main MSCI index rose a stunning 46.5% in USD and 18.6% in the local currency. Global stock returns are much less impressive when you look back further. Many markets are flat over the last two years and the EAFE is nearly flat over the last ten years. Earnings growth has been modest or negative in many equity markets.



An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged with no associated expenses, and investors cannot invest directly in an index. Past performance is no guarantee of future result. The index returns are all "Total Return" with dividends reinvested, which means the return includes not only the change in price for securities in the index, but any income generated by those securities.

Treasury bonds outpaced most equity benchmarks in the second quarter. The ten-year Treasury yield made a dramatic move to end the quarter at 1.49%, down from 1.78% three months earlier. Yields fall as prices rise, so strong safe-haven buying from abroad continued to make U.S. Treasury bonds the world's refuge of choice. American investors did well too, notching a 7.95% year-to-date total return (income plus price gains).[2] The Barclays Aggregate Bond Index had a 2.2% total return for the quarter while investment grade corporate bonds returned 3.6%. The emerging market bond index had another strong quarter, up 5.1% in U.S. dollar terms while the high-yield bond benchmark gained 5.5%.

In economic news, slow but steady growth kept the U.S. recovery alive, with inflation-adjusted Gross Domestic Product growing at an annualized 1.1% in the first quarter. This is well below the 2.8% 50-year average and below the 2.1% average since the last recession ended. The unemployment rate dipped to 4.7% in May, but job creation appeared to be slowing.[3]

On the inflation front, the U.S. Consumer Price Index rose 1.1% for the year ending rate in May, while "Core" CPI (which excludes food and energy prices) rose 2.2%. Core inflation was higher because falling energy prices pulled the headline rate lower. Consumer finances look stronger, with debt loads stabilizing and household spending up. Average existing home sale prices are almost back to the previous October 2005 peak. Commercial real estate also performed well, making real estate investment trusts (REITs) an attractive income category.

Crude oil prices recovered some lost ground after a sharp decline earlier in the year. The European Brent crude oil benchmark ended June at $48.37, up from recent lows but far below the $111.93 level where it ended just two years ago in June 2014. Gold prices had a very strong quarter, rising from $1,234 at the end of March to $1,321 on June 30.[4]

As we move into the second half of the year, we remain confident in your investment strategies. We will continue to monitor progress toward your financial objectives. Please remember to contact us if there are any changes in your financial situation or investment objectives or if you wish to impose, add, or modify any reasonable restrictions to our investment management services. A copy of our written disclosure statement discussing our advisory services and fees continues to remain available for review upon request.

As always, we welcome and look forward to the opportunity to spend time with you to address your unique financial goals. If you have any questions regarding these reports or other questions about your investments, please contact us at (512) 506-9395 or (281) 408-2538.

Sincerely,

Kenny Landgraf, David Levy, Fred Hanish, and John Langston

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[1] MSCI, Inc. Russell Investment Group, Standard & Poor's, FactSet, JPMorgan Asset Management
[2] Barclays Capital, FactSet, JPMorgan Asset Management, St. Louis Fed, Federal Reserve
[3] Standard & Poor's, FactSet, FRB, BLS, BEA, JPMorgan Asset Management
[4] U.S. Department of Energy, FactSet, JPMorgan Asset Management, Thomson Reuters, WSJ Market Data Group