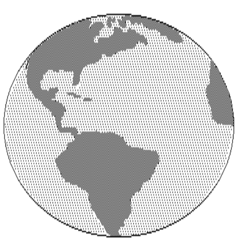
MOSAIC FINANCIAL PARTNERS, INC.

Market Watch
1st Quarter 2016

April 2016 MosaicFP.com

Summary

- US markets fell 13.3% in January and early February, raising concerns that a recession could be on the horizon. These concerns were further amplified by China's turmoil, the rising dollar, and worries over US corporate earnings.
- Alternative investments were generally positive for the quarter, led by emerging market bonds, global real estate and timber.
- Value stocks finally outperformed growth stocks at all levels. Large company value stocks were up 1.6% for the quarter versus 0.7% for growth. Smaller stocks were more dramatic, with value outperforming growth 1.7% to -4.7%.
- Bonds benefitted from a "flight to safety" arising from the recession worries. All bond categories rose for the quarter and all were positive for the year.
- Portfolio results for the twelve month period still look bad as they include the difficult middle quarters of 2015.
- Consumers are primed to help the US economy continue to grow: sentiment is positive, debt is low and housing values and net worth have been rising.



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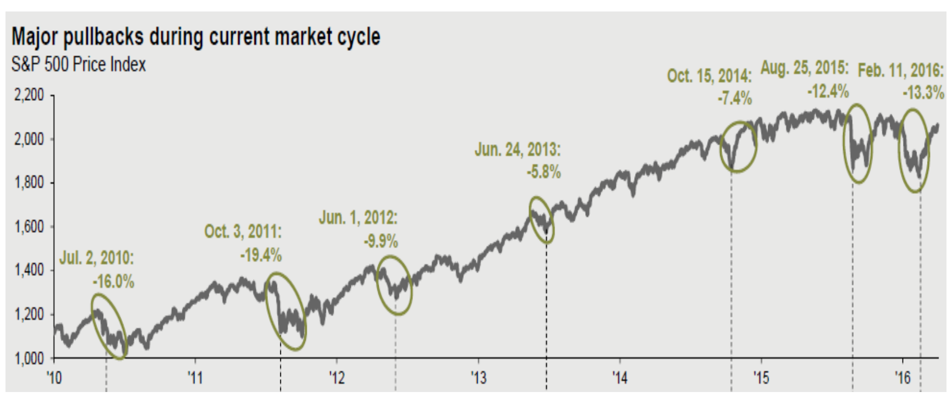
Overview

As you look through your report this quarter, you'll see a lot of negative numbers. Mosaic reports performance on a twelve month period, which currently reflects the period from April 1, 2015 to March 31, 2016. The second and third quarter of 2015 were particularly difficult and overwhelm the twelve month numbers herein. But, the final quarter of 2015 was actually reasonably positive despite the negativity of the first several weeks of 2016. The turnaround at the end of the quarter may, in fact, represent a sustainable trend. At the end of the quarter, oil prices were strengthening, the dollar was weakening, consumer sentiment was strengthening, China's troubles were stabilizing, and value was once again outperforming growth. Despite the negative numbers for the twelve month period, we think there is reason for an improved outlook.

Despite a tough start, the quarter ended moderately positive.

The first quarter of 2016 had nearly everyone worried as it began, with stock markets around the world suffering sharp market declines throughout January and well into February (the biggest pullback since 2012). But by the end of March, most markets had recovered nicely.



Despite touching two-year lows in February, the S&P 500 and Dow Jones Industrial Average indexes finished the first quarter slightly higher than at their beginnings—up 1.35% and 2.2%, respectively. However, other closely watched US market indexes ended the quarter in negative territory. The tech-heavy NASDAQ was still down 2.43% and the small US company Russell 2000 fell 1.52% for the quarter.

As in the US, international equities experienced broad sell-offs during the first half of the quarter but also recovered in the last few weeks of the quarter. Developed non-US markets (the MSCI Europe Australia Far East Index—EAFE) fell more than 10% early on but came back to finish down a more modest -2.88%. Emerging market economies experienced even greater declines during the quarter, but enjoyed the strongest recovery in the equity group, finishing the first quarter up 5.75%.

With investors concerned about the equity markets, US bonds benefitted from a "flight to safety". Bond prices rose as the ten-year Treasury yield fell to its lowest end-of-quarter level since the fourth quarter of 2012 (as a reminder, when bond yields fall, bond values rise). Yields on ten-year Treasuries opened the quarter at around 2.27%, but ended it at 1.78% as continued demand drove prices higher.

The stark differences in the first and second halves of the quarter arose primarily for two reasons:

- Oil prices began to recover. They hit a low in the mid-$20s before rising to around $40 by the end of the quarter. This helped lift stocks in the US energy sector and provided a big boost to commodity-exporting economies, such as Brazil and Russia.
- The Fed retreated on its intention to raise interest rates. They announced that overall economic conditions were not improved enough to justify a second interest rate hike, at least until summer.

The US Economy—Muddling Along

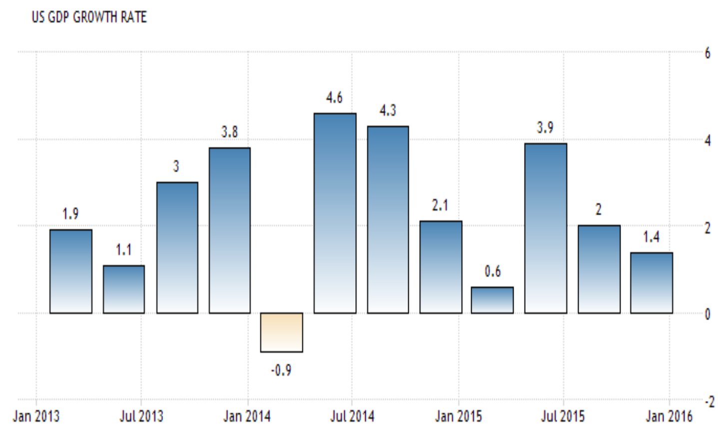
The US economy grew in the fourth quarter at a faster pace than previously estimated, supported by stronger household spending. This helped cushion the negative effect of lower-than-expected export activity. While the US economy is not firing on all cylinders, it still continues to grow at a modest pace. For the first few weeks of 2016, fears about China, falling oil prices, and weak corporate earnings seemed to portend a stalling economy and concerns about a possible recession were widely trumpeted.

More recently, US manufacturing has steadied, construction spending has perked up and the latest inflation and unemployment indicators appear favorable.

Forecast on GDP

According to the Commerce Department, the US Gross Domestic Product (GDP) increased at a 1.4% annual rate in the fourth quarter and expanded at 2.4% for all of 2015.

Consumer spending continues to account for roughly two-thirds of our national GDP and consumer spending continues to rise (attributable to rising incomes, and improving circumstances in both employment and the housing market). With cutbacks in government spending having slowed, the economy currently has more positive than negative influences.



The strength of the dollar has been a headwind to our export markets as this has made American products more expensive for our trading partners. It was therefore something of a relief when the dollar weakened in the last half of the quarter.

Goldman Sachs currently forecasts US gross domestic product (GDP) growth will average 1.2%, low but still on the positive side. Longer term, growth in GDP will come from two sources: growth in our working population and improvements in productivity.

The last decade saw the slowest growth in the US civilian workforce in many decades. This was accompanied by low investment levels in the infrastructure and technology needed to create productivity improvements. These two factors lead some economists to predict continued lower economic growth rates going forward.

Note: If you are interested in the impact of demographics on economic growth rates, an excellent interactive source can be found at http://www.researchaffiliates.com/Our%20Ideas/Insights/DemographicsMarkets/Pages/Home.aspx

Consumer Sentiment

American consumers are in generally good shape. Household net worth is higher than it has ever been and debt payments as a percentage of disposable personal income is as low as it has been in at least 35 years (source: JP Morgan). Many analysts believe that falling oil prices will be a boon to consumers – acting like a tax cut for consumers and fueling spending and growth. Although there has been some lag in consumers' response to falling energy costs, consumer confidence seems to have picked up during the first quarter.

The Conference Board's Consumer Confidence Index for March rose to 96.2 following February's index reading of 94.0. Consumers expressed favorable views on the labor market and business conditions, but remained concerned with the overall economic outlook.

Manufacturing

One of the more hopeful signs recently has been manufacturing. As can be seen in the chart below, the March ISM Manufacturing Index rose to 51.8 in March from 49.5 in February (any number above 50 indicates growth). This was the highest reading since last summer. The details within the report were strong, with new orders showing a particularly large increase. It appears that the recent stabilization in oil prices and the very recent decline in the dollar are improving prospects for the US manufacturing sector.

Employment

Continued improvement in the labor market suggests that the economic trends remain positive. Jobs continue to be added at a healthy pace, at 5%; unemployment is low; a higher percentage of Americans are working; and average hourly earnings have been rising faster than expected.

Inflation

According to the latest Labor Department data, the Consumer Price Index (CPI), excluding the volatile food and energy components, rose to the 2.3% annualized rate in February. For the first time since 2012, the US economy experienced the core CPI number above the Fed's 2% target rate for three consecutive months.

Recession?

Lately, there has been talk about an "imminent recession" from Donald Trump and others. We are not in this camp. As Liz Ann Sonders, the Chief Investment Strategist at Schwab says, "even though this expansion is getting long in the tooth in terms of number of years, economic expansions don't die of old age. They die of excess—typically in growth, inflation, capital spending, monetary policy tightening, etc. If there is one benefit to such a sluggish expansion since mid 2009, it is that excess does not appear to abound."

The World Economy

The first quarter marked a reversal between 2015's best and worst performing global markets. While the developed countries led the performance race in 2015, leadership in the first quarter was turned over to the commodity-oriented emerging markets (EM). This change was driven by the turnaround in oil prices—which rebounded from a low in the mid-$20s to a level nearing $40 at the end of the quarter. This, in turn, strengthened EM currencies and lifted stock prices of commodity-exporting countries, such as Brazil and Russia.

In the Eurozone, economic expansion continued at a modest pace thanks in part to an additional €20 billion per month being injected into the economy by the European Central Bank (ECB). Japan tried its own stimulus approach, lowering a key interest rate below zero in hopes it would encourage more bank lending. China continued to struggle with its many political and economic issues, but it also released its budget which projected growth continuing above 6%.

Europe

Eurostat data shows that in the last three months of 2015 the aggregate economy of the 19 countries sharing the Eurozone, grew by 0.3%. Growth was 1.6% for the full year (compared to 0.9% growth in 2014). While

Europe has had to contend with a refugee crisis, terrorism and governance issues, economic recovery seems to be strengthening after a deeper and longer recession than was experienced in the US.

While conditions are slowly improving, there remain many issues facing the European Union. The average unemployment rate has remained above 10% for more than six years. Moreover, the difference in the jobless rate between countries remains significant. In Spain, Greece and Italy, the unemployment rate is near or above 20% while Germany's unemployment rate is 4.3%. Europe is also being threatened by populist appeals including those relating to the refugee crisis, calls for the UK to exit the European Union, and Spain's struggles to form a new government.

Japan

As in Europe, Japan is struggling to right its economy. The Bank of Japan joined other poor-performing economies in January when it lowered key interest rates below zero. This desperate approach to jump-start the economy remains unproven in its effectiveness, and both the Japanese stock market and the overall economy could suffer if this strategy doesn't work. [If the economy wasn't stimulated by near zero interest rates, will it really respond differently if the rates move a tiny bit lower?] Initial indications are that Japan's GDP contracted at a 1.1% annualized pace in the last quarter.

China

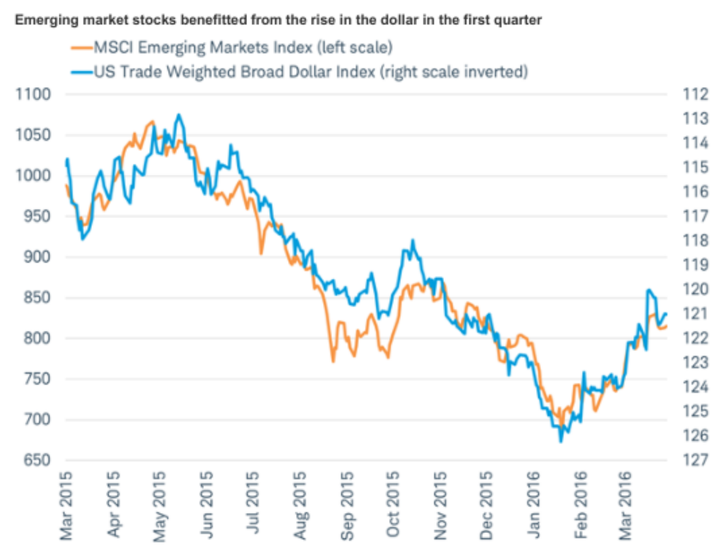
The health of China's financial system remains a concern, with large amounts of capital leaving the country monthly and freedoms being clamped ever tighter. While the economy posted 6.9% growth in 2015, this was its lowest reading since 1990. The preliminary first quarter GDP number of 6.6% suggests a continuing economic slowdown as China moves from an export-driven, low cost economy to one increasingly driven by internal consumption.

While China's growth rate is significant, as the country increasingly focuses on its own internal needs, China is less likely to remain, as much as it has recently been, a prime driver in the economies of its trading partners. And, given its current policy challenges, China's struggles seem likely to continue.

Elsewhere

As can be seen in the chart below, there is a strong relationship between the relative strength of the dollar and the equity returns of the emerging market (EM) economies. While a stronger dollar weakens EM returns a stable or declining dollar can help.

The fortunes of the BRIC economies (Brazil, Russia, India and China) turned in mid-Q1 of 2016 when the dollar began to weaken, the US Federal Reserve deferred further interest rate increases, and oil prices began to recover.



Characteristics of bull and bear markets

Market Corrections	Bear markets			Macro environment				Bull markets		
	Market peak	Bear return*	Duration (months)*	Recession	Commodity spike	Aggressive Fed	Extreme valuations	Bull begin date	Bull return	Duration (months)
1 Crash of 1929 - Excessive leverage, irrational exuberance	Sep 1929	-86%	33	◆			◆	Jul 1926	152%	38
2 1937 Fed Tightening - Premature policy tightening	Mar 1937	-60%	63	◆		◆		Mar 1935	129%	24
3 Post WWII Crash - Post-war demobilization, recession fears	May 1946	-30%	37	◆			◆	Apr 1942	158%	50
4 Flash Crash of 1962 - Flash crash, Cuban Missile Crisis	Dec 1961	-28%	7				◆	Oct 1960	39%	14
5 Tech Crash of 1970 - Economic overheating, civil unrest	Nov 1968	-36%	18	◆	◆	◆		Oct 1962	103%	74
6 Stagflation - OPEC oil embargo	Jan 1973	-48%	21	◆	◆			May 1970	74%	32
7 Volcker Tightening - Whip Inflation Now	Nov 1980	-27%	21	◆	◆	◆		Mar1978	62%	33
8 1987 Crash - Program trading, overheating markets	Aug 1987	-34%	3				◆	Aug 1982	229%	61
9 Tech Bubble - Extreme valuations, .com boom/bust	Mar 2000	-49%	31	◆			◆	Oct 1990	417%	115
10 Global Financial Crisis - Leverage/housing, Lehman collapse	Oct 2007	-57%	17	◆	◆	◆		Oct 2002	101%	61
Current Cycle								Mar 2009	204%	86
Averages	-	-45%	25					-	152%	54

Brazil is in the midst of a political crisis as its president Dilma Rousseff faces a potential impeachment process. Still, Brazil's long-term opportunities seem attractive should they experience meaningful political change.

Russian financial stability remains a concern, particularly with uncertain oil and commodity price outlooks. While Putin remains popular, his staying power will increasingly rely on economic recovery.

India remains a relative bright spot within the BRIC economies and is well positioned with regard to external financing needs. India is faring well in terms of productivity gains and could continue to present infrastructure development opportunities.

Investments

US Equities

All major US stock market indices experienced a volatile first quarter. Both the S&P 500 and Dow Industrial indexes were down more than 10% at the midpoint of the quarter. Each recovered to finish the quarter in positive territory—up 1.35% and 2.2% respectively. Telecom and Utilities were the best performing sectors in the quarter. The S&P 500 is now 58.3% above its prior high point before the Great Recession (in other words, it has taken nine years to get total growth of 58.3%).

The US market appears to be reasonably priced. Using the forward P/E (current stock price divided by estimated future earnings over the next twelve months), the S&P 500 is now priced at 16.6 times forecasted earnings versus the index's twenty five year average of 15.8. The current dividend yield for the S&P 500 stands unchanged at 2.3%.

One of the issues that has caused Mosaic portfolios difficulty in recent years has been the relatively weak performance of "value" stocks as compared to the performance of "growth" stocks (Mosaic has long maintained a value orientation in our portfolios). As can be seen in the chart below, in the first quarter of this year, value finally produced the better results (as they have on average for the last century of investing).

1Q 2016	Value	Blend	Growth
Large	1.6%	1.3%	0.7%
Mid	3.9%	2.2%	0.6%
Small	1.7%	-1.5%	-4.7%

2015	Value	Blend	Growth
Large	-3.8%	1.4%	5.7%
Mid	-4.8%	-2.4%	-0.2%
Small	-7.5%	-4.4%	-1.4%

International Equities

For American investors, the relative valuation of the dollar versus other currencies is an important investment consideration. When the dollar strengthens, it makes travelling abroad cheaper, but it also causes overseas earnings and stock prices to be worth less in dollar terms. For example, if the dollar's value increased by 4% versus the euro, a 10% return in France would only be a 6% return to a US investor. Conversely, if the dollar's value were to fall by 4% instead, the French stock would provide a 14% return to that same investor.

2015	YTD
REITs 2.8%	REITs 5.8%
Large Cap 1.4%	EM Equity 5.8%
Fixed Income 0.5%	High Yield 4.1%
Cash 0.0%	Fixed Income 3.0%
DM Equity -0.4%	Large Cap 1.3%
Asset Alloc. -2.0%	Asset Alloc. 1.3%
High Yield -2.7%	Comdty. 0.4%
Small Cap -4.4%	Cash 0.1%
EM Equity -14.6%	Small Cap -1.5%
Comdty. -24.7%	DM Equity -2.9%

With currency differences in mind, one can understand the impact of a strong dollar to US investors holding international investments. Since mid 2014, the dollar has increased by roughly 20% against other global currencies (in some cases, the increase has been much more substantial). As the dollar has strengthened, returns from our international holdings have suffered. We know that this will not always be so. Toward the end of the first quarter, the dollar did indeed begin to weaken relative to other global currencies.

Despite some dollar weakness at quarter's end (favorable for US investors), international markets still posted mixed results. Most developed economies posted negative results in both local currency and in dollar terms. In the first quarter of 2016, developed international markets (represented by the MSCI EAFE index) fell 2.9% for American investors (down 6.4% in euro terms). Japan experienced the weakest performance among developed economies. Year to date, Japan was down 6.4% in dollar terms and 12.5% for Japanese investors. Over the last 15 years, the MSCI EAFE index has risen by 4.8% annually (compared to the S&P 500's rise of 5.99% per year).

The MSCI Emerging Market Index returns (traditionally more volatile than the developed markets) benefitted from both a weaker dollar and a rebound in oil and commodity prices. During the first quarter, the

Index rose 2.8% in local currency and was up 5.8% for US investors, making it our best performing stock category. The rebounds in commodity and oil prices have boosted the growth prospects of exporters such as Brazil (up 28.6% in dollar terms) and Russia (up 15.8% in dollar terms), whose economies are highly dependent on commodity exports.

While Q1 news was positive for Brazil and Russia, China and India struggled with their own economic headwinds. China's market was down 4.8% while India's fell 2.5% (both in dollar terms). Over the last 15 years, the emerging markets asset class has been one of the strongest equity sectors. Investors willing to contend with the category's volatility have enjoyed a compound annual return of 9.69%.

Fixed Income

The bond market continued to perform well in 2016. In theory, the expected increase in interest rates this summer should have pushed bond yields higher, causing bond prices to fall. However, given the volatility of the equity markets during the first quarter of 2016, Treasuries were in high demand among investors seeking a "safe heaven" from the turbulent stock market. This pushed bond prices higher, while bond yields declined. Since bond returns are a combination of the interest received (the yield) and the price change, bond returns this quarter were strong.

As can be seen from the chart below, during the first quarter, returns for all major US bond sectors were positive.

	1st Qtr.	1 Year	3 Years
Ultra-Short Term Bonds	0.46%	0.57%	0.46%
Short Term Bonds	0.98%	1.04%	0.95%
Short Term TIPS	2.14%	1.53%	-0.48%
Intermediate US Bonds	2.45%	2.06%	4.91%
Foreign Bonds Hedged	3.78%	2.86%	4.92%
Intermediate TIPS	4.84%	2.18%	-0.89%

Alternatives

In building an investment portfolio, it is desirable to employ a variety of investments—each of which can add positively to returns but which may be driven by different economic or market factors. The result is a portfolio where some of the investments will rise or fall at different times and for different reasons. We seek this "non-correlation" of investments in hopes that in most circumstances, there will be investments generating positive returns even when others in the portfolio do not. It is for this reason that alternatives are expected to both improve overall returns and lower portfolio volatility. However, it's important to remember that since these different investments may be independent of one another, it is still very possible that, at times, they will move in similar directions. When they all struggle, as seemed to be the case the last couple of years, or when they all rise in unison, it does not disprove the concept. Just as the performance in a number of our asset classes seemed to reverse their trends in February, we think there are indications that the tough period alternatives have experienced recently may have also shifted.

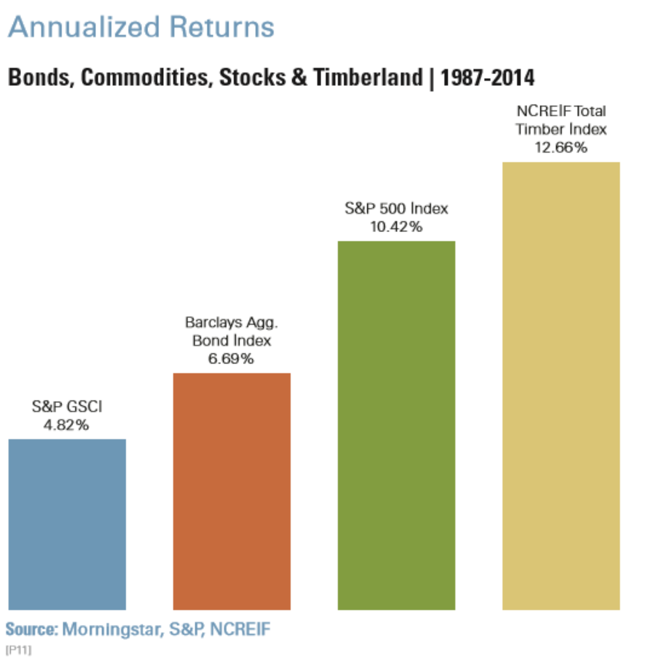
Most Alternatives weathered the tough start to 2016 and ended with positive quarterly results.

Like the economy in general, most alternative holdings fell in the first part of the quarter and came back up to produce largely positive returns during the first quarter of 2016. Master limited partnerships (MLPs) had a similar ride, but the early drop was more severe, thus they were unique in ending the quarter down.

- **REITs**—Publicly listed real estate companies around the world, represented by the NAREIT Global Real Estate Index, rose 5.08% over the quarter. Bucking the negative trend that made up the recent twelve month period. Global real estate was up 0.59% over the full year.
- **MLPs**—The Alerian Master Limited Partnership Infrastructure Index, (which tracks energy transportation and storage facilities) lost 5.65% for the quarter and is down 32.11% over the last 12 months (ending 3/31). MLPs have tracked the price of oil, and thus showed a nice recovery at the end of the recent quarter. This was not enough to overcome the steeper drop at the start of the quarter. Despite the severe tumble of the last couple of years, as we have expressed in recent emails, we continue to believe in the fundamentals of this business strategy and in its investment future.
- **Managed Futures**—As measured by the S&P Diversified Trends Indicator Index, which represents this category, managed futures were

essentially flat for the quarter but declined 4.92% for the twelve month period.

- **Merger/Arbitrage**—While the returns the last few years have been weak, it is the strategy's stability of returns that attracts us. In 2008, when the S&P fell nearly 40%, the fund lost only 2.3%. Returns for this category were up 2.18% for the quarter and 4.23% for the full year. Returns are expected to increase as interest rates rise.
- **Timber**—As measured by the FTSE NAREIT Timber REIT, timber posted positive results for the quarter up 5.33%, and is up 1.91% for the last 12 months. The big news in this sector was that the second largest Timber REIT (Plum Creek Timber) was acquired by the largest one (Weyerhaeuser). This transaction was finalized in Q1. While the returns for timber over the last few years have been weak, over a longer holding period this sector has generated strong returns (see chart below). While no one can predict what the future will hold, we do expect future returns to improve relative to our recent past.



- **Emerging Market Debt**—Fundamentals for emerging market bonds generally remain under pressure due to slow growth, exposure to the commodity downturn, and uncertainty about China's financial and structural reform efforts. Despite weak longer-term fundamentals, dollar-denominated emerging market bonds had a positive quarter. Emerging markets bonds (issued in dollars) were up 5.94 % during the quarter and up 5.88% for the last year.
- **BDC**—For those portfolios with this exposure, we use BIZD as the broadest representation of this sector. BIZD now has a three year track record. While the recent three year period has generally been difficult all around, the sector, which was created out of 1980 legislation, has proved to be a solid performer. BDCs rose 4.48% during the first quarter but fell 4.41% for the year. BIZD is currently yielding about 9.5%.

Summary

Looking ahead to the second quarter, more volatility is likely. While the positive economic trends seen in the second half of Q1may continue to lift stocks, the value of the dollar and oil prices will likely weigh on stock market performance. Ironically, a potential bright spot could be an increasing inflation expectation (inflation has now been above Fed's 2% target rate for three consecutive months). If somewhat higher inflation lifts bank lending rates, we could see a greater willingness for banks to lend and this could indeed support business investment and a stronger economic growth outlook.

A key message from the first quarter is a reminder that double-digit stock market pullbacks are common, and don't necessarily mean stocks are headed for a prolonged and deep bear market. In fact, the world's stock market went through a decline of more than 10% during more than two-thirds of the past 35 years and yet more than half of the time, these calendar years ended with a gain.

Not overreacting to short-term pullbacks is critical to long-term investing success. Having a well-designed portfolio is important, but the ability to stay disciplined through the market's inevitable ups and downs is paramount. This includes avoiding the temptation to chase the markets for fear of missing out, as well as resisting the urge to sell when markets correct. Here at Mosaic it is our job and duty to be with our clients during times of uncertainty and remind you to stay the course.

We thank you again for your confidence, and for allowing us to be of service to you.

Your Team at Mosaic Financial Partners

Sources: *Morningstar, JP Morgan Asset Management, Reuters, Bloomberg, Charles Schwab, NY Times, US Bureau of Labor Statistics, Thebricspost.com*