CAPSTONE
Investment Group

Monthly Market Returns

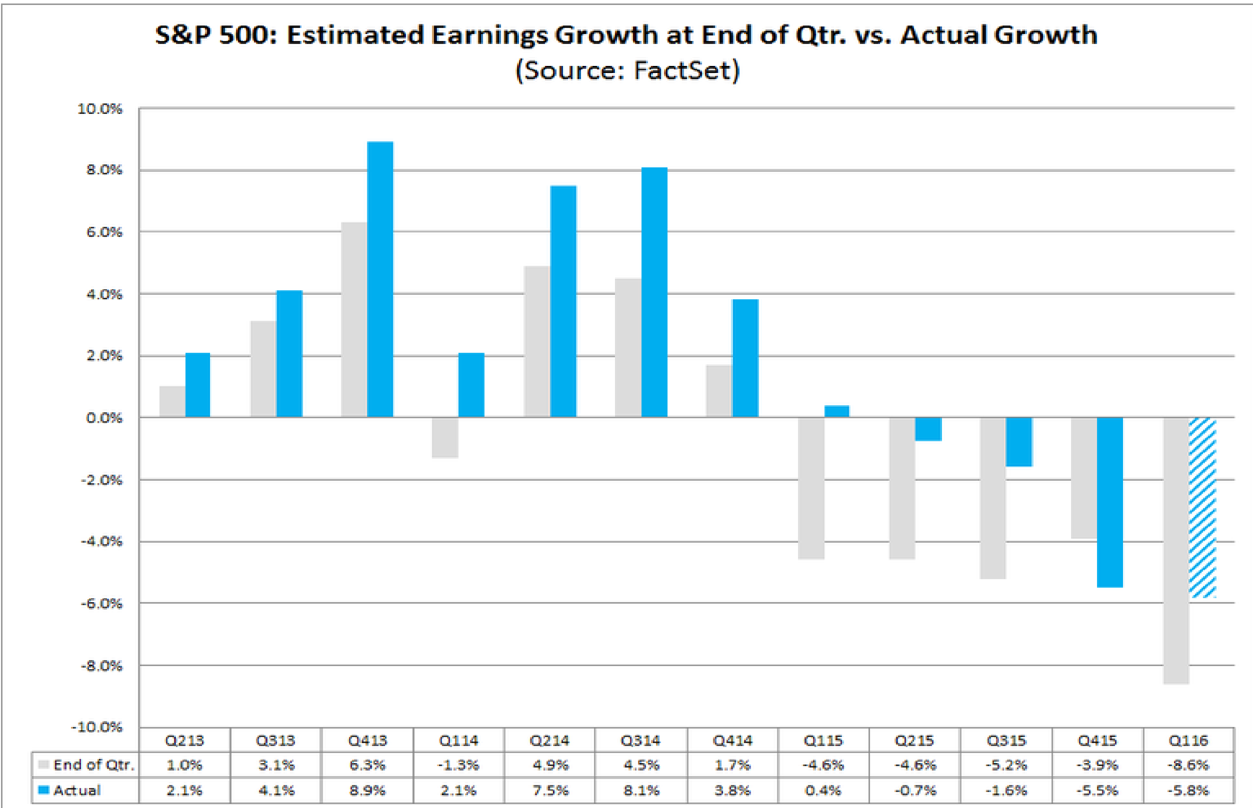
Index	1 – Month Return	Year to Date Return	1 Year Return
S&P 500	0.38%	1.73%	1.11%
Russell 2000	1.67%	0.07%	-5.83%
MSCI EAFE	2.94%	-0.14%	-9.33%
Barclays Aggregate Bond	0.38 %	3.41%	2.61%
Brent Crude	21.54%	30.05%	-3.96%
Gold Spot Price	4.66%	20.43%	10.03%
MSCI Emerging Markets	0.50%	6.07%	-18.29%

The strength that equities enjoyed in the month of March has largely been exhausted in the month of April. The notable movers continue to be oil and gold. Brent crude is now pricing at $46/brl, off of its recent $48 high. While a return to $25 is unlikely, we believe that short term weakness in crude is more likely than not given the fact that the Saudi's continue to pump and the supply/demand dynamics are little changed. We believe the market is pricing in the hopes & expectations of supply diminishment both as a result of coordination from OPEC producers and from the reduction of US shale players.

Gold continues to show strength and our thesis is that the strength will continue. If the chief argument against gold is that it is an asset that produces and yields nothing, what happens when that argument is fairly leveled against currencies at, near or below 0% yield? Central bank excess will likely continue to benefit the yellow metal.

Q1 Earnings

Q1 Earnings for the S&P 500 are in, and the earnings recession continues. Even when removing the dismal energy sector from the equation, S&P 500 earnings continue to contract at a -2.8% annual pace. As usual, the majority of S&P 500 constituents continue to beat previously lowered estimates but the outlook does not support present prices, in our view.



	Q213	Q313	Q413	Q114	Q214	Q314	Q414	Q115	Q215	Q315	Q415	Q116
End of Qtr.	1.0%	3.1%	6.3%	-1.3%	4.9%	4.5%	1.7%	-4.6%	-4.6%	-5.2%	-3.9%	-8.6%
Actual	2.1%	4.1%	8.9%	2.1%	7.5%	8.1%	3.8%	0.4%	-0.7%	-1.6%	-5.5%	-5.8%

Market Support Levels

Below is a snapshot of the S&P 500 going back to 2012. The red lines are "channels" that help us identify where we're at in terms of overarching direction. It is our view that the market is in a downward channel that began in early 2014. This overarching, downward trajectory does not mean you can't have moves to the upside, it simply means that the macro trend is negative. Presently, the market failed to hold above the upper end of that channel and as such we are more likely than not to move lower in the near term before finding additional support. Translation: The S&P 500 will likely go down and we'd look for it to find buyers closer to 1800, a 12% drop from present levels. This is not to say the market can't go higher, it is simply to say that the charts tell us to be defensive because there's far more weighing on the averages than there are catalysts to find new highs.

China

While official government data indicates GDP growth that is slower, albeit largely in line with consensus, there is a great deal of turmoil building beneath the surface. What growth that has occurred in China in the first quarter can hardly be considered sustainable. In Q1 2016 alone China's total debt grew to a record of 237% of GDP. For comparison sake, this figure stood at just 148% at the end of 2007. Leverage appears to be running amok in China in an attempt to forestall a more severe slowdown.

If you add to this figure the net indebtedness of China's banks and financial institutions, the debt grows to 280% of GDP. Much of this lending is driven towards yet more infrastructure projects and consumer mortgages. Local Government Financing Vehicles (LGFVs) which are used by Chinese cities to circumvent official spending limits raised $83bn in bonds in Q1, a 178% increase year over year.

It is our opinion that much of China's debt binge is increasingly directed to non-productive assets and cannot alone solve the problems facing their economy. A rapid increase in indebtedness such as we are witnessing

generally leads to one of two outcomes: financial crisis and/or slower growth. While it is impossible to accurately predict how, or if such strain will make its way into the broader markets, one of the most likely transmission mechanisms for Beijing's woes is via currencies. China has already devalued the Yuan twice in the last 18 months, each time sending shockwaves around the globe. Given the challenges facing the Chinese government and the unsustainable pattern of "growth," future currency devaluations simply become more likely and as such the odds of broader market disruption increases.

Japan

Japan is entering a rough patch, to put it mildly. Their exports fell for a 6th straight month in March; down 6.8% from a year earlier. Keep in mind this is the same Japan that has instituted negative interest rates which in theory should encourage lending, economic growth and depress the value of their currency, the Yen. The opposite has in fact occurred. Business lending has stalled, economic growth has fallen off a cliff and the Yen has actually appreciated against a basket of other major currencies. On top of that the Japanese government has become the number 1 investor in Japanese stocks as they have directly printed Yen to purchase shares. The Japanese bankers have pulled out virtually every trick they can think of but they cannot trump the demographic realities of their people. Japan should serve as a cautionary tale as to the limits of central bank intervention and the unintended consequences of "whatever it takes" monetary policy.

Death of an Industry

It's not often that we witness, in protracted, real time the death of an entire industry, but such is the case with respect to US coal as evidenced by the demise of Peabody Energy who filed for Chapter 11 bankruptcy protection on 13 April of this year. Until their undoing, Peabody was the largest private sector coal company in the world. Coal prices have been crushed as natural gas has become the preferred source of fossil fuel in the United States. Peabody's chart ending on 13 April is shown below. We highlight this development only to remind ourselves of the rapid pace with which our world is evolving. There are no sacred cows in the markets and nothing guaranteed. Proper strategy and diversification are critical to success. This maxim is even more true today as the landscape continues to shift and we must continue in an attitude of sober humility as we approach each new day.

Until next month,

The CAPSTONE Team

Investment Group, LLC

2401 Bristol Ct. SW Suite D-101 Olympia WA 98502 T: (360)570-9888

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