Monthly Market Returns

Index	1 – Month Return	Year to Date Return	1 Year Return
S&P 500	6.78%	1.35%	1.78%
Russell 2000	7.98%	-1.52%	-9.76%
MSCI EAFE	6.02%	-3.74%	-10.67%
Barclays Aggregate Bond	.92%	3.03%	1.96%
Brent Crude	13.6%	3.51%	-19.45%
Gold Spot Price	.02%	16.4%	4.32%
MSCI Emerging Markets	13.03%	5.37%	-14.14%
Morningstar Global Allocation	4.80%	1.50%	-4.92%
Morningstar Global Tactical	.64%	-.26%	-5.01%

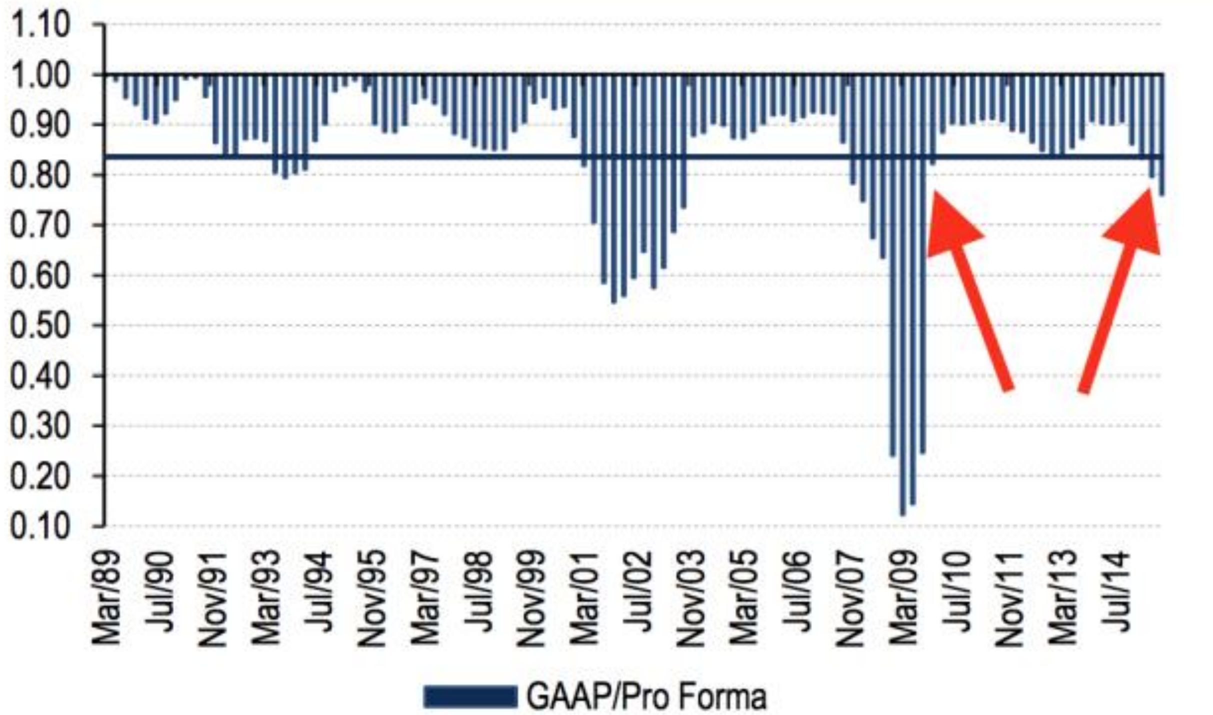
March has been a fantastic month as the above return figures indicate. Support levels on the S&P have held up very nicely and we've been rewarded for sitting tight and allowing the market to work for us. The US Industrial Output figures that were released this past month were relatively weak but do not necessarily point towards recession. The results of Super Tuesday seem like something from the distant past given how much continual news/noise has accompanied this nomination cycle. The delegate count at this point is providing little in the way of influence to capital markets, which is not to say that politics won't matter to the market, it's simply to say that right now they don't seem to be of much consequence. What has mattered and what will continue to matter more than almost any other input is the stance of the US Federal Reserve on interest rates. As 10 is to 1 so is the monetary policy of the Fed to any other metric in determining the near term direction of capital markets.

This past week Chairman Yellen again assuaged any fears of aggressive tightening, assuring the market that rates will stay as low as they need to for as long as they need to. Markets responded positively as they have in the past on such dovish rhetoric. Our belief is that rates will likely stay lower for longer, in fact, rates may not rise at all this year. We also believe that, while the equity markets have shown remarkable resiliency these past few weeks, the risk for broad-based equity weakness is increasing, not decreasing. Let's look at a couple of items that demonstrate that concern:

The first is the thrilling world of accounting conventions. Few of you likely have much interest in how a company reports its performance, but we care very much. We especially take interest when more and more companies deviate from conventional accounting principles, otherwise known as GAAP (Generally Accepted Accounting Principles) and increasingly use Pro Forma accounting rules. Hang with me here: Pro Forma rules are meant to be used infrequently to help account for one-off events, good or bad, that don't necessarily speak to the overall performance of the company. For instance, a company undergoing restructuring because of a buyout may have a myriad of one-time expenses that hurts the bottom line but won't be repeated. It is, however, concerning when "one time" sorts of charges begin appearing more than one time. The chart below indicates that more and more companies are electing to report their earnings on a Pro Forma basis:

Chart 11: "GAAP gap" widened further– still most extreme since the crisis

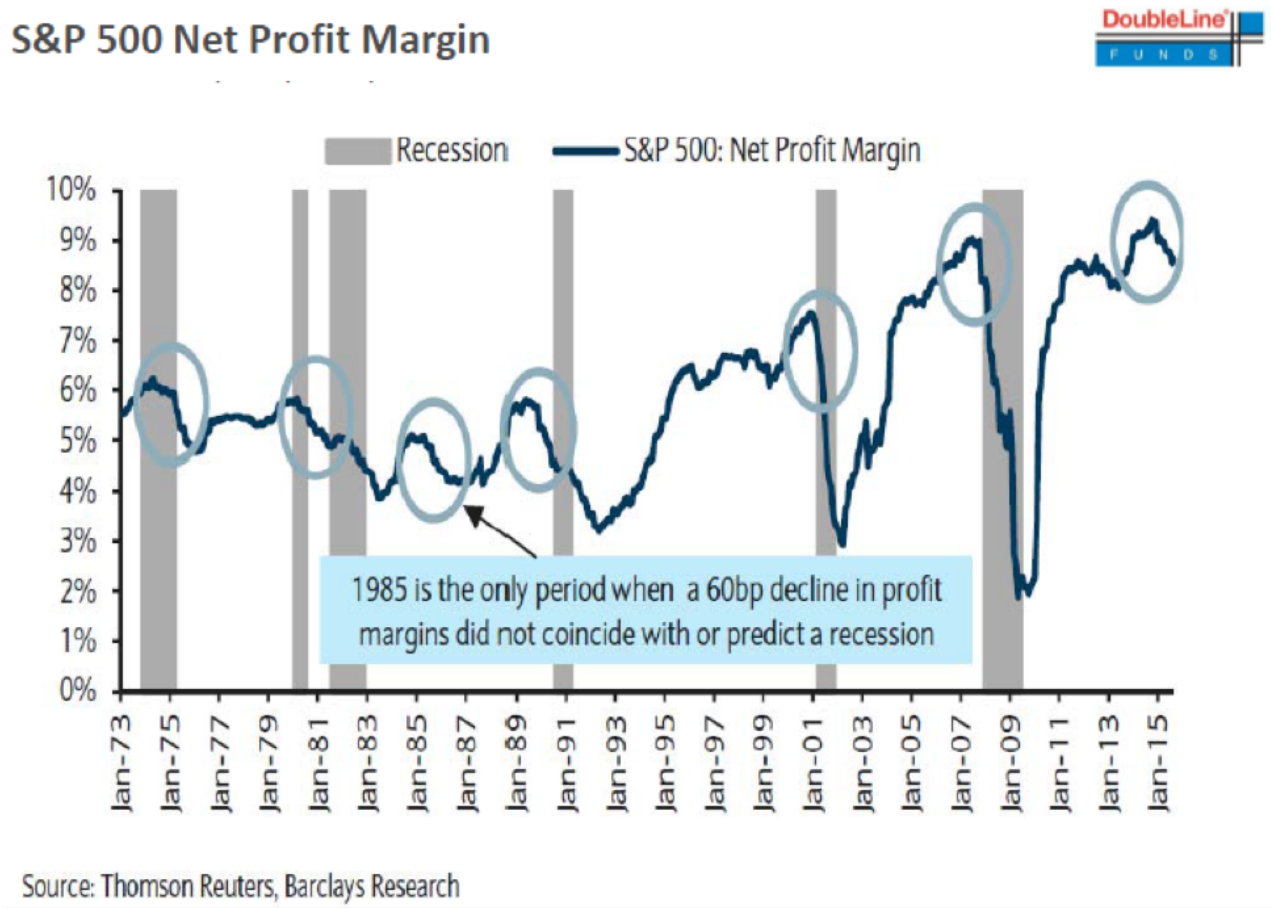
Ratio of trailing 4-quarter GAAP to pro forma S&P 500 EPS, 1989-4Q15



Source: S&P, FactSet, BofA Merrill Lynch US Equity & & US Quant Strategy

The lower the little blue lines, the more companies are reporting "one time charges" and deviating from Generally Accepted Accounting Principles. Why would they do this? Two reasons: more and more companies are undergoing increasing stress and restructuring, or, more companies are experiencing slower growth and as such opt for more favorable accounting conventions to make their earnings look better. Either way, seeing more companies report their earnings in this fashion is a negative indicator for stocks in the near term.

The second major area of concern for equities is Profit Margins, which are stretched beyond belief and have a nasty habit of "reverting to the mean" which in this case means going down. The chart below indicates that S&P 500 Profit Margins are hovering at all-time highs and beginning to falter. The only time that peaking and falling profit margins have not been a precursor to recession was in 1985. To be clear, we are not saying that falling profit margins cause recessions but rather they can serve as leading indicators of a slowing economy.



These are simply two of the brighter and more obnoxious warning lights flashing on our stock market dashboard. As such, we are thinking two steps ahead and are prepared to become more defensive for both Growth and Income clients should conditions warrant. We are enjoying the recent rally but are not on any level comforted by it nor are we operating on a false sense of security. Until proven otherwise, equities should be owned with caution in the near term and clear strategies should be in place to mitigate future volatility. As always, please talk to us if you'd like to learn more about how these broad observations apply to you specifically.

Another item to embolden the bears is Chinese growth data, which is presently tracking at a 4.1% annualized pace for the first quarter of 2016. This is 35% below the annual targets for growth given by the Communist Party at the end of 2015. Long story short, unless China finds another gear their lackluster growth stands to apply even more pressure on a slowing global economy.

This coming month we will be watching the following:

- Market Support Levels
- Chinese Economic Data

Until next month,

The CAPSTONE Team

CAPSTONE

Investment Group, LLC

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