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The Compass

Wealth management tips, trends and articles that provide confident navigation for high net worth clients.

August/September 2015
Thank you for your continued trust, loyalty and generous referrals. As always, we encourage you to share this newsletter with friends, family members and colleagues.

Mid-Quarter Commentary as of August 28, 2015
By John M. Silvis, CFA
Chief Investment Officer

After going over four years without a correction of over 10%, the equity markets, led by the S&P 500 Index, finally succumbed to the mounting uncertainty falling -12.5% from the high of 2,134 registered earlier in the year on May 20th. Global markets were not immune either, with the MSCI ACWI index declining -14.8% from its peak, while the MSCI Emerging market index fell into bear market territory with a decline of -27.7%. Most of the selling was driven by a couple of issues focusing on potentially slower global growth in the coming months. Actions recently by the Chinese government to lower interest rates and institute measures to prop up their falling stock market is again raising fears that a “hard landing” may be taking place in China with economic growth slowing faster than anticipated.

We do not believe the recent sell-off is the end of the secular bull market we have experienced going back to the low of 2009. However, we acknowledge that we could see further downside in the coming weeks before giving way to the resumption of the positive trend we have seen in the market over the last few years. While the markets have rebounded in the last few days, it is important to point out in secular bull markets the average decline for drops of 10% or more going back to 1928 has been -15.6%. As we have stated in the past, seasonally we are in the worst part of the year with August-October being the worst of any three month rolling period going back to 1952, according to Ned Davis Research. So seasonal volatility is to be expected for a few more weeks. Sentiment remains low, with investors projected to pull out over $100 billion from equity mutual funds year-to-date through August. The current environment should set up well for a buying opportunity that will lead us into a seasonal rally into year end.

From an economic perspective, the domestic economy got a shot in the arm this week as second quarter gross domestic product, often referred to as GDP, was revised up from 2.3% growth to 3.7% following the pattern of last year where we saw a weak first quarter followed by a strong rebound into the second quarter. The revision was driven by an increase in capex spending and rebuilding of inventories. We continue to think the pattern will play out again this year and we’ll see better growth in the second half of 2015 with GDP finishing the year closer to 3% than the range of 2 to 2.5% we have seen in the last few years. Unemployment continues to drift lower, declining to 5.3% and job growth remains strong. We believe the economy, while not at full potential, will continue to grind higher in the coming quarters. According to EvercoreISI, on average a recession starts five years after the first Fed hike, indicating the economy should remain on solid ground. With declining oil prices over the last few weeks, gasoline prices should drop approximately 40 cents in the next six weeks while mortgage rates have come down as well. Both should continue to help consumers.

The Federal Open Market Committee (FOMC) is set to meet again in September. The uncertainty surrounding the upcoming Fed decision in September is increasing due to softer economic data and the rising threat of slower global growth. EvercoreISI is currently giving less than 50% odds that they raise rates at the next meeting. Those odds have been fluid and could change in the coming weeks. The Fed has laid out two conditions for raising the fed funds rates: a move towards full employment and inflation returning to their long term target of 2%. You can make an argument that with a low unemployment, the criteria has been met. However, wage growth has not shown consistent signs of improvement over the last few months raising some concerns. Inflation remains low and has declined in recent months indicating the target will not be reached in the near future.

The international developed markets were not immune to the recent correction as equity markets across Europe and Japan saw steep declines as well. The U.S. Dollar has appreciated over 15% in the last year, putting pressure on foreign currencies like the Euro and the Japanese Yen. This has led to an increase in exports in those countries and should help growth going forward. Global deflation is still a major concern with central banks around the world reiterating more stimulus is possible. Globally, PMI numbers are still well above 50, indicating firm growth in the coming months. Over 68% of countries still have positive readings above 50, increasing since May.

China has been the epicenter of the events over the last few days. The fear that the Chinese government may make a policy misstep has increased over the month as they deal with a declining stock market and a slowing economy. It is continuing down the path of transitioning to a consumption economy driven by what they hope will be a growing middle class. We would expect more stimulus in the coming months as the government walks a fine line. Commodity prices are putting downward pressure on the economies of both Russia and Brazil, as both are struggling with lower oil prices and growing recessions. We remain cautious on emerging markets.

On the positive side, fundamentals still look good with second quarter earnings coming in ahead of lowered expectations. We still believe that the second half of the year will see year-over-year increases in both revenue (though muted by the rising dollar) and earnings. The Energy sector has been by far the biggest laggard since the beginning of the year, declining nearly -20%. Healthcare and Consumer Discretionary stocks have been the best performers so far in 2015, both rising around 5% year-to-date. We believe the cyclical sectors will fare better heading into the end of the year and remain overweight Technology, Discretionary and Industrials. The S&P 500 Index usually peaks *after the last federal funds rate increase, not the first*.

Fixed Income Commentary as of August 27, 2015
By Rick D'Amico, CFA
Manager of Investments

As of August 27th, 2015 at 2:44 p.m., the 10-year Treasury is yielding 2.17%, which is remarkably the same exact yield level where we began the year. Needless to say, 2015 has been anything but uneventful, as 10-year yields plummeted to a low of 1.65% on January 30th, only to spike to a high of 2.49% on June 26th. Much of the volatility in 2015 has been centered around FOMC communications, as the market tries to decipher when (and if) the Fed will raise interest rates in 2015. More recently, the market has been struggling with another sharp pullback in the commodity markets along with fears of a hard landing in China. This has led to another drop in rates, resulting from lower inflation expectations, U.S. dollar strength and a flight to quality. In our view, the Fed will more than likely push back its September rate hike, with the hope that the recent China stimulus takes hold and economic data improves, eventually giving them enough cover to finally act in December. As for 10-year yields, technical analyst Jeff deGraaf of Renaissance Macro Research is in the camp that rates will remain range-bound for the remainder of 2015, albeit a fairly large range, between 1.80% and 2.60%.

Year-to-date, the Barclays U.S. Aggregate Index has returned a modest 0.48%. Yield curve positioning and sector allocations have been important as there has been a fairly large dispersion in returns. For instance, intermediate term U.S. treasuries have been one of the best performing sectors thus far, returning 1.49%, while long corporate bonds have suffered the most, returning a negative 5.19%. Since July 1st, high yield spreads have widened 150 basis points, while investment grade spreads have widened 25 basis points. With corporate credit spreads widening for much of the year, the relative attractiveness of credit has improved and our portfolios are currently positioned to take advantage of the credit-sensitive sectors in the fixed income market.

Meet Geoffrey Palya

Earlier this year, we welcomed a new team member to Fairport. Geoffrey Palya joined the firm in April as Portfolio Administrator. Geoff works closely with the Investment Team to achieve diversification and allocation objectives in client accounts. He is responsible for implementing security transactions and assists the CIO in developing investment strategy. Geoff began his career as an International Trade Analyst at Victory Capital Management, where he also worked in Domestic Security Operations and eventually as a WRAP/SMA trader.

"Geoff is a great addition to the Fairport team," said John Silvis, Chief Investment Officer at Fairport. "His experience with capital markets and his unique skill set will be invaluable in helping us to exceed the expectations of our clients."

Geoff earned his B.B.A. in Finance and Business Economics from Ohio University in 2011. He is on track to receive his MBA with a concentration in Finance from Cleveland State University this fall and is currently a CMT Level I candidate. He is a dedicated Browns, Indians and Cavs fan and enjoys spending time outdoors with his fiancé.

Practice Group Spotlight on Family Business Owners: Engaging Next Generation Leaders
By Andrew R. Connors, CFP®, CEPA
Partner & Family Business Practice Group Leader

If you work with or are part of a family business, you are all too familiar with the troubling statistics regarding succession planning and engaging the next generation of leadership. In working with many family businesses, I see a pattern of consistent behaviors amongst those able to defy the odds. I had the opportunity to lead a discussion recently with a group of family business owners who have successfully "passed the baton" from one generation to the next. Below are five best practices to prime the next generation to take the reins.

1) **Recognize that transitioning leadership is a process.** In order for the transition of leadership to be successful it must be viewed as an ongoing process, not a single event. As part of this process, the next generation has to *want* to assume the role of leadership; they cannot be forced or coerced into it which almost always ensures failure. The most successful results come when the next generation has an ownership mindset. It's the difference between thinking like an owner and thinking like an employee. It is important for the next generation of leadership to have "skin in the game" by buying into ownership. This means having their own financial resources committed to and invested in the great future of the business.

2) **Start the grooming process early.** After understanding that transitioning leadership is process, it is equally important to understand that starting this process early is critical. The most successful family businesses realize that their human, or family capital is their greatest form of wealth and it needs to be managed just like any other asset. Starting early is about embracing the notion of "patient capital" – making long term investments with a long term time horizon and not being focused on short term results. Understanding the dynamics of a business and what it means to be the leader takes time and deliberate grooming. A mentor can play a key role in this process and need not be a family member; in fact, some of the most impactful mentors are non-family members as their perspective and advice is often viewed as more impartial.

3) **Communicate, communicate, communicate.** In the absence of consistent and clear communication, individuals (whether they be other family members or employees of the business) will jump to their own conclusions about the future of and stability of the business. To this point, it is becoming more and more common that lenders require a formal succession plan to be in place as a part of lending covenants. Transparency and communication around future leadership is part of a well-conceived and deliberate plan.

4) **Establish and leverage an outside advisory board.** A challenge faced by a number of family businesses is having outside perspective around strategic issues. In addition to providing strategic perspective, an outside advisory board can be part of the leadership transition planning and mentoring process for the next generation. These boards are most effective and impactful when they are comprised of a large percentage of non-family members, usually individuals with

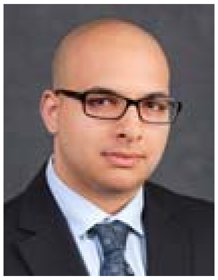
industry experience and/or skills that align with the future growth trajectory of the business. An advisory board can also be helpful in providing a level of accountability that may be absent.

5) **Create and LIVE a family mission statement.** Having a family mission statement that reflects a shared vision and sense of purpose helps create a strategic mindset for the future. Without a vision, it is likely that there is also little structure around leadership succession. A family's mission statement should embody and align values, vision and purpose. Many family businesses generally agree about what is important, however very few actually take the time to document their mutual agreement in a written document. A family mission statement can be as simple as defining the set of common values that are important to the family and the business. It can also be more complex in identifying current and future leadership roles and other governance issues. Many successful family business groups use their mission statement as a tool to engage the next generation. It also helps provide next generation leaders with a sense that they are stewards of not only the business, but also the family legacy.

The bottom line is that family businesses that have been successful in engaging the next generation, molding future leaders and transitioning leadership have done so when they started early with clearly defined timelines and goals, viewing the transition as an ongoing process that requires deliberate planning. Success is not an accident.

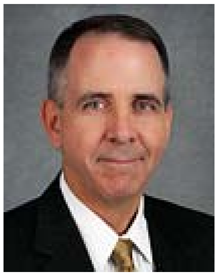
Fairport News

Fairport believes in supporting the community as a company and through encouraging employees to participate and hold leadership positions in professional, charitable and community organizations. Read about our new designations, recent accolades and community involvement.

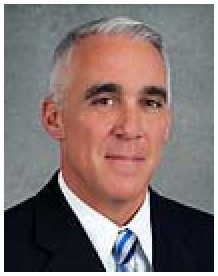


Antonio Belmonte has passed Level III of the CFA® exam and may be awarded the CFA charter upon completion of the required work experience. He will join the three existing Fairport professionals (Rick D'Amico, Aaron Nuti and John Silvis) that hold the Chartered Financial Analyst® designation. The Chartered Financial Analyst® (CFA®) credential is one of the most respected and recognized investment designations in the world.

Congratulations on a well-deserved achievement, Antonio!



Ken Coleman graduated from Leadership Cleveland, Class of 2015, and joins over 1,600 local change makers who proudly count themselves among LC alumni. Leadership Cleveland is a prestigious 10-month program of leadership development, civic education and civic engagement for leaders. Participants represent a diverse group of recognized and established leaders from across a wide variety of organizations representing the private, nonprofit, and government sectors. Ken joins Heather Ettinger, LC Class of 1996, in congratulating the incoming LC class that includes Fairport clients, professional partners and friends.



Paul Zappala was profiled by Orion Advisor Services, LLC (Orion) in their fall newsletter. Orion is the portfolio accounting service utilized by Fairport. Paul is always in close contact with Orion, working to enhance and streamline our client experience. Click here to find out some things you didn't know about the man who wears many hats at Fairport as Chief Compliance Officer & Director of Operations and Information Technology.

Fairport is pleased to announce that it has been named to the Financial Times 300 Top Registered Investment Advisors, as of June 18th, 2015. The list recognizes top independent Registered Investment Advisor firms from across the U.S.

FT FINANCIAL TIMES | Top Financial Advisers 2015

FT 300 Ranking June 2015

More than 2,000 elite Registered Investment Advisor firms were invited to apply for consideration, based on their assets under management (AUM). The “average” FT 300 firm has been in existence for 23 years and manages $2.6 billion in assets. The 300 top Registered Investment Advisors hail from 34 states and Washington, D.C., and, on average, saw their total AUM rise by 18% in 2014.

The 2015 Financial Times Top 300 Registered Investment Advisors is an independent listing produced by the Financial Times (June, 2015). The FT 300 is based on data gathered from Registered Investment Advisor firms, regulatory disclosures, and the FT’s research. As identified by the FT, the listing reflected each practice’s performance in six primary areas, including assets under management, asset growth, compliance record, years in existence, credentials and accessibility. Neither the Registered Investment Advisor firms nor their employees pay a fee to The Financial Times in exchange for inclusion in the FT 300.

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