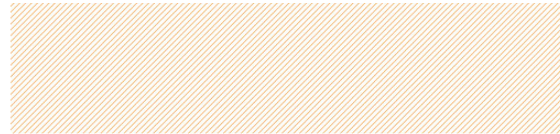
WILSON CAPITAL
INVESTMENT ADVISORY



As an investment advisory, we feel investors should have an information outlet for the financial markets that is thorough, but does not require a prerequisite degree in economics. We hope this makes our commentary informative and educational for all levels of investors. We have also included a brief glossary at the end of this commentary that defines terms marked with an asterisk (*).

Quarter in Review

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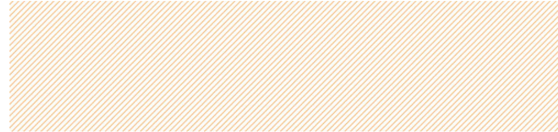
Asset Class†	1st Quarter 2016 Return
U.S. Bonds	3.0%
U.S. Large Cap Stocks	1.4%
Commodities	0.4%
International Stocks	-0.4%
U.S. Small Cap Stocks	-1.5%

While lately it seems as though volatility in the equity markets is commonplace, this quarter's volatility was even outside of the "normal" range. The 1st quarter of 2016 had the largest intra-quarter swing in the S&P 500 since 4th quarter 2011, during what we now know was the early part of this 7-year-old bull market.

The usual suspects of lower oil prices, fear of rising interest rates, and concerns of global growth shouldered much of the blame for the move downward to start out the quarter. As oil continued to slide towards the oft-prognosticated bound of $30 a barrel, it seemed investors began imagining nuclear power and electric cars for the masses and it was only a matter of time until oil reached $0. As predicted, sanity kicked in right around $30 a barrel ($29.85 to be exact), and oil rebounded to settle the quarter around $40 a barrel.

The quarter saw strong showings from stocks in defensive sectors* like Utilities (up 15%) and Telecommunications (up 11%), along with a reversal of fortune for high-growth stocks like Amazon and Netflix, which were down 12% and 11% respectively. These results are not abnormal during times of high volatility and show a desire for safety in these turbulent times. Investors begin to hesitate to follow the latest trendy stock and return back to the basics.

Outlook



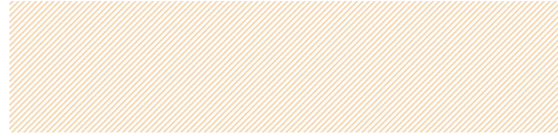
After such a volatile quarter in nearly all markets, it is apparent that the current environment is full of wide ranging opinions on the future. There are bright spots, such as continued improvements to the U.S. employment numbers, but those are countered by negative news like the continually lackluster foreign economic indicators.

Something that has made financial headlines in recent weeks and is likely to continue as we turn into the second quarter is the trend in companies issuing so-called “pro-forma” or headline earnings. U.S. companies are required to report their earnings according to a set of rules called Generally Accepted Accounting Principles (GAAP)*. Since GAAP is universal and its rules may not always fit with every situation, occasionally companies report a separate set of earnings that executives feel better match up to the reality of company operations—a pro forma earnings report. These pro forma earnings reports are typically issued after unusual and infrequent events, such as a natural disaster, that affect the bottom line.

Recently, there has been a bit more open interpretation of what constitutes unusual or infrequent. In 2015 several companies took some interesting liberties. Caterpillar, the heavy equipment manufacturer, adjusted its earnings by $600 million due to “restructuring” costs, despite having $300 million in such costs in 2014 and expecting $250 million again in 2016. The most ubiquitous and perhaps more concerning trend is the practice of removing any compensation paid in company stock* by many technology companies such as Facebook or Twitter. Facebook’s GAAP earnings for 2015 were $3.6 billion, but the pro-forma earnings which excludes stock-based compensation was $6.5 billion. This is interesting considering stock comprises a great deal of employee compensation and has been done each quarter since the IPO of the company. Unusual? Nope. Infrequent? Hardly!

How this affects investments depends on who you ask. The companies doing it feel as though they are giving investors and the analysts who track their stock a more “realistic” look at the company’s true business operations. In Caterpillar’s case, executives view the restructuring as only a phase and with Facebook the stock given to employees doesn’t directly affect their capital for day-to-day operations. The opposing view is that pro-forma earnings are imaginative at best and a lie at worst.

It is too early to tell whether pro-forma earnings will ever amount to more than creative accounting, but Warren Buffet once said, “"you only find out who is swimming naked when the tide goes out”. If that’s the case, it may not be the best time to head to pro-forma beach.



Glossary

Defensive Stocks – These are stocks from companies that have non-cyclical lines of business that remain steady through most environments, but often do not have high growth prospects. Utilities and Telecommunications stocks fall into this category because electric power and telephone use are relatively steady even in economic downturns.

Stock-based Compensation – Method of rewarding employees by giving shares of company stock rather than cash. Used regularly by companies to pay executives since their performance is often tied to the stock price, it has now become a regular component of tech companies to pay all levels of employees.

† Indices used to represent asset classes:
U.S. Large Cap Stocks – S&P 500
U.S. Small Cap Stocks – Russell 2000
International Stocks – MSCI ACWI ex-U.S.
U.S. Bonds – Barclays Aggregate
Commodities – Bloomberg Commodity

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