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Q2 Market Update

(values as of 6/30/2016; % changes for Q2, not YTD)

U.S. Stock Indices

S&P 500	2,099 (+1.90%)
Dow Jones	17,930 (+1.38%)
Nasdaq	4,843 (-0.56%)
Russell 2000	1,152 (+3.40%)

Global Stock Indices

FTSE (London)	6,504 (+5.33%)
DAX (Germany)	9,680 (-2.86%)
CAC (France)	4,237 (-3.37%)
Nikkei (Japan)	15,576 (-7.06%)
Emerging Mkts	834.10 (-0.32%)

Bond Indices (Bloomberg)

U.S. Gov't.	129.45 (+2.11%)
U.S. Corporate	145.95 (+3.54%)
U.S. Hi-Yield	158.47 (+5.69%)
Eurozone	143.25 (+1.88%)
Emerging Mkts	160.25 (+4.89%)

Commodities

Gold (per oz)	1,322 (+7.28%)
Silver (per oz)	18.71 (+21.25%)
Oil (WTI, barrel)	45.80 (+23.98%)

Fixed Income Yields

U.S. 2-Year Treasury	0.58%
U.S. 10-Year Treasury	1.49%
U.S. 30-Year Treasury	2.30%
U.S. High-Yield Index	7.32%

Currency Exchange Rates

Euro/Dollar	1.11
Pound/Dollar	1.33
Dollar/Yen	103.29

Car Buying vs. Leasing: A Primer

With interest rates of all types sitting at or near historic lows, buying a car has rarely been easier. As a result, U.S. auto sales hit an all-time high of 17.47 million in 2015, and sales in the first half of 2016 continued at a record pace. But as vehicle prices also continue to climb, an increasing percentage of car buyers have turned to leases rather than outright purchases. Indeed, according to the credit monitoring firm Experian, the portion of new vehicles that were leased also set a record in 2015—a rate of more than 30%, up from 24% in 2010.

What explains the newfound interest in car leases over purchases, and might a car lease make sense for you? We'll take a look at the main differences between buying and leasing, and the various implications for you and your overall financial picture.

The financial factors

From a financial perspective, it's important to recognize that the out-of-pocket monthly cost will nearly always be lower for a lease than for an outright purchase, all other factors being equal. In simple terms, that's because a car loan is based on the full price of a new car, whereas a lease payment is based on only a percentage of the car's price tag (essentially, the spread between the car's retail price and its estimated "residual value" at the end of the lease term).

To demonstrate the point, analysts at the automotive information firm Edmunds evaluated the relative costs of buying or leasing a standard car (a 2014 Honda Accord, retailing for about $28,000) over a standard time horizon (six years, the average holding period for a new car purchase). In the case of the lease, the lessee actually signed two consecutive three-year leases, since a three-year contract is standard for most car leases (note that this also means two separate cars are involved rather than just one car, a point we'll revisit later). In the case of the purchase, the car buyer made an 18% down payment, then financed the balance on a 5-year loan at 3% interest.

As expected, the projected monthly cost was significantly lower for the lessee than for the buyer—$344 versus $415, a difference of about $850 annually. Over the course of 6 years, the lessee would pay a total of $24,768 on 72 lease payments, whereas the buyer would pay a much higher total of $30,012 (between the down payment and 60 monthly loan payments).

However, at the end of the 6-year period, the lessee had nothing to show for their sizeable expenditure—the dealer owned the car, and the lessee had nothing. The buyer, though, owned a 6-year-old car worth an estimated $11,000, which could either be sold in a private sale or traded in to a dealer. Subtracting that "residual value" from their out-of-pocket expenditure leaves a true cost of ownership of just $19,012 for the buyer, nearly $6,000 less than that of the lessee.

And while the Edmunds analysis did not explicitly say so, the overall financial advantage for the buyer increases the longer the holding period becomes, since the monthly payments cease for the buyer, but continue into perpetuity for the lessee (insurance and maintenance factors also come into play, but we'll ignore them for now for simplicity's sake).

The buy-versus lease decision, then, comes down to a simple tradeoff: the lease boasts lower monthly costs, but typically a higher total financial cost over time. Of course, since many potential buyers don't have the budgetary flexibility to afford an extra $850 per year for the car loan (nor the $5,000 up front for the down payment), leasing can often be the only feasible option, despite its higher long-run cost.

Even for buyers who can afford the higher payment, though, the decision to purchase isn't necessarily a slam-dunk. Remember, the extra money that is required in order to purchase the rapidly-depreciating car represents cash that can no longer be directed elsewhere, such as a retirement account or a college savings plan (or toward paying down other debt). For younger buyers with expensive student loan debt, or employees who might be sacrificing a 401(k) contribution in order to create budgetary room, that opportunity cost can be significant, eroding the financial benefits of buying.

Furthermore, maintenance considerations will need to be considered. In the case of two three-year leases, the lessee's car will almost always be covered under a manufacturer's warranty, and maintenance costs will by definition be limited. But the buyer will own the car long past the expiration of any warranty, and the costs of keeping the car on the road could quickly mount, further eroding the financial advantage.

Because those two factors can vary widely from person to person, they don't lend themselves well to a simple analysis. That said, for most Americans with modest savings and positive cash flow, it's likely that the most prudent course of action is to purchase an economical, reliable car, and to hold it for at least six years.

The lifestyle factors

Of course, the buy-versus-lease decision is not purely a financial question, but a lifestyle question as well. As we've established already, leasing a car enables a lessee to secure a newer, nicer car for a smaller out-of-pocket payment. That dynamic might help explain why the younger generation, already burdened by student loan debt, has turned to leasing in such overwhelming numbers.

However, car lease contracts often include a litany of potential penalties or fees that can increase the total cost of the lease and make leasing less attractive. Primary among these are annual mileage limits and wear-and-tear penalties, both of which can amount to thousands of dollars. A buyer who tends to put a high number of miles on a car might drive their leasing cost higher, as might a buyer who tends to be hard on their vehicles (perhaps they have children, or an off-roading habit). Yes, buyers might also have to consider the impact of those factors on the trade-in value of their car, but they won't have to pony up extra money out of pocket, as a lessee would.

	LEASE	BUY
Lease or Loan Period	6 years (Two 3-year leases)	5 years
Retail Cost	$28,211	$28,211
Down Payment	None	$5,112
Monthly Payment	$344	$415
Interest Rate	–	3%
Total Out-Of-Pocket Payments	**$24,768**	**$30,012**
Trade-In Value	$0	$11,000
Total Cost of Ownership	**$24,768**	**$19,012**

Source: Edmunds, via NY Times

As with the purchase of a house, a number of situation-specific factors can impact the financial analysis. Is the residual value of the car in question expected to be high relative to the initial purchase price, or low? What investment return (or interest charge avoidance) can the lessee earn on any out-of-pocket savings? What other factors in the car buyer's budget should be considered?

At Cypress, we're happy to help clients consider how the various complexities of the car buying decision fit into their broader financial picture. Car buying doesn't need to be a stressful experience; working to make an informed decision can improve your lifestyle without compromising your financial health.

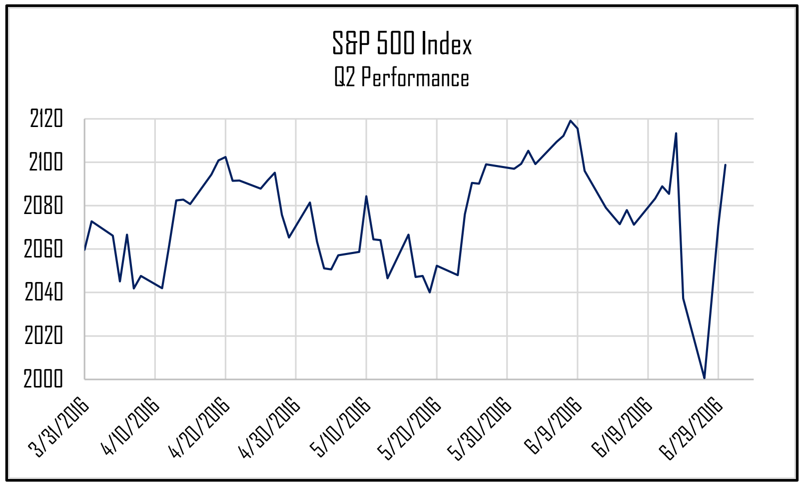
THE 10-YEAR TREASURY YIELD REACHED A NEW ALL-TIME LOW IN JUNE

Equity Overview – Domestic Equity Markets

After a highly volatile first quarter, U.S. stock indices continued their choppy trading in Q2, as an endless parade of headlines kept traders and investors on edge. A largely lackluster Q1 earnings season (led by continued weakness in energy-related companies) was mostly shrugged off by the markets, as was a particularly weak jobs report for the month of May, released on June 3rd. Investors preferred to focus their attention on two major macro events, both of which took place in the middle of June.

The first event was the June meeting of the Federal Reserve Board, at which the committee had previously been expected to continue its rate-hiking process with another quarter-point increase in the Federal Funds Rate. However, perhaps spooked by the weak May jobs report and the looming Brexit vote, the Fed decided to hold off on raising rates, at least until their next meeting. Markets seemed to take comfort from the Fed's decision to delay further monetary tightening, as the S&P 500 rallied back above 2,100 and threatened to make new all-time highs.

However, that rally proved to be short-lived, as the unexpected result of the Brexit referendum a week later knocked global markets for a loop. Major U.S. indices shed nearly 4% in the day following the victory for the "Leave" contingency, but they remained well above the year's lows established in January, and bounced back significantly to end the quarter, finishing once again near all-time highs around the 2,100 level.



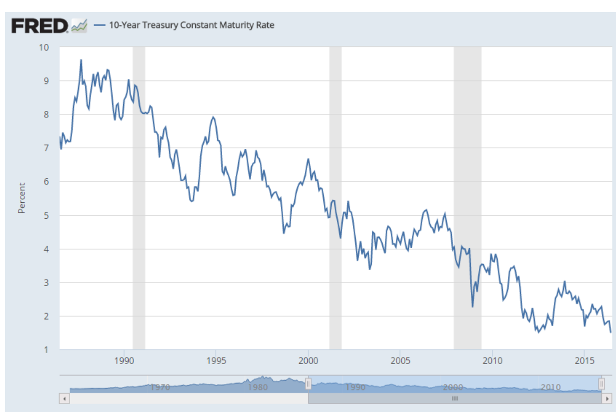
Source: Yahoo! Finance

Bond Yields Take Another Leg Lower – Fixed Income

The combined impact of the Federal Reserve decision and Brexit vote result was to send interest rates across the board tumbling to new low levels.

The yield on 10-year Treasury bonds opened Q2 at 1.83%, but tumbled to a record low of 1.43% before settling at 1.49% to close the quarter.

Longer-dated bonds behaved similarly, as the yield on 30-year Treasuries plunged from 2.65% to 2.25%, also matching all-time lows.



And yet, despite the continued downward pressure on interest rates, yields on U.S. government bonds remain high in comparison to the rest of the developed world. The German 10-year bund, for example, closed the quarter with a negative yield, at -0.13%. The same was true in Switzerland (-0.58%) and Japan (-0.22%), while even those nations with positive yields still mostly had lower rates than the U.S.

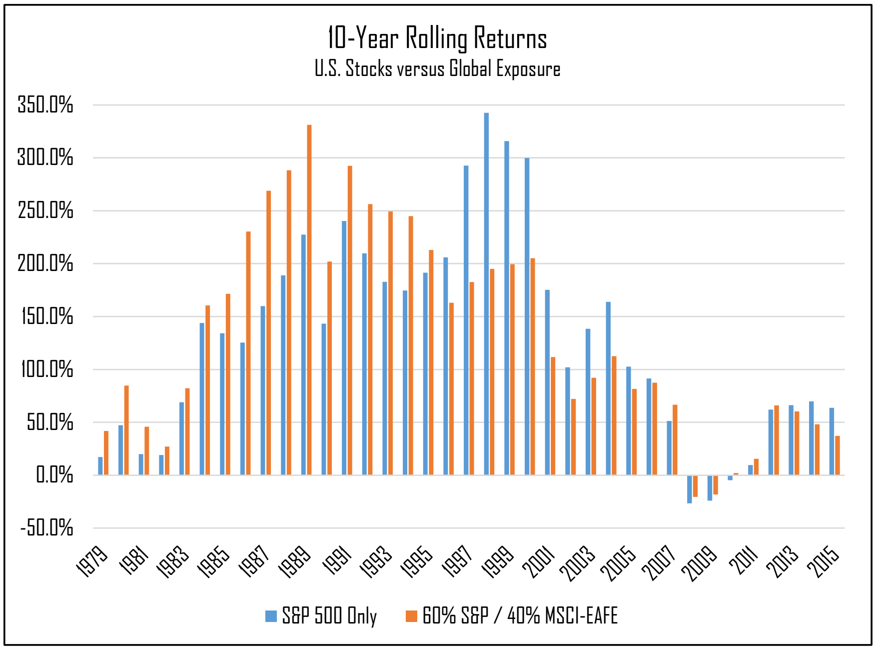
In large part, these divergences have to do with differing policies from central banks, but the international data does help demonstrate the fact that while bond yields are indeed low in historical terms, they can always go lower, and they very well might.

U.S. STOCKS HAVE OUTPERFORMED INTERNATIONAL STOCKS IN 6 OF THE LAST 7 YEARS

International Stocks: Why Bother? – Global Markets

In the aftermath of the Brexit vote, markets around the world responded swiftly and violently to the political and economic uncertainty that the "Leave" result presented. The British Pound lost roughly 10% against other major currencies, and several global stock markets were hit hard by the news.

While U.S. markets were quick to bounce back after the initial shock of the unexpected result, other global markets were not as resilient. The differing reactions fed a continuation of what is now a significant multiyear trend, that of U.S. stock market dominance over international markets.



Despite continued volatility, the S&P 500 has managed to post a 2.7% gain through the first two quarters of the year. But the MSCI EAFE Index (which tracks non-U.S. markets, with a heavy emphasis on Japan and western Europe) has struggled, posting a 6.3% year-to-date decline.

If the trend of U.S. market outperformance continues throughout the remainder of 2016, then this will mark the fourth consecutive year (and sixth in the last seven) that U.S. markets will have experienced better returns than their international counterparts. And the underperformance has not been small, either; a dollar invested in the international index at the end of 2009 would have returned just 1.8% through the end of Q2, whereas the same dollar invested in the S&P 500 would have returned a whopping 88.2%. Unsurprisingly, many investors have grown impatient with international investments and begun to question the wisdom of holding them in their portfolio in the first place.

The frustration is understandable, but a longer-term perspective paints a much different picture of the role of global exposure. While U.S. stocks have certainly been the stars of the investing world in the post-financial crisis period, they were the laggards in the years immediately prior—from 2002 through 2007, international stocks outperformed every year, with an average annual outperformance of 7.7%. Taking an even longer view, the analysis continues to look good for international stocks—in the 46 years that the MSCI EAFE has been calculated, the index has outperformed the S&P 500 in 24.

To better evaluate the long-term value of holding international stocks in a portfolio, we compared a U.S.-only stock portfolio to one composed of 60% U.S. stocks and 40% international stocks. Looking at historical rolling 10-year returns, we found that the portfolio with global exposure outperformed the U.S.-only portfolio in 23 out of 37 10-year periods, a strong beat rate of 62%.

Given the clear tendency for U.S. and international stocks to trade roles as the leaders of the global market environment, we think that now would be an inappropriate time to spurn international stocks. On the contrary, we think they could be primed for another period of outperformance over U.S. stocks, and that keeping a global perspective will continue to pay off over the long run, as it has in the past. Recency bias may be a strong psychological factor, but we shouldn't let it guide our investing approach.

Sources: MSCI Barra, Yahoo! Finance