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**We welcome your call or email if you have any thoughts you would like to discuss.**

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Investors gained just a bit of ground during the first quarter, as markets adjusted to a stronger U.S. dollar and the likelihood that the Federal Reserve may soon raise short-term interest rates. Collapsing oil prices appear to have stabilized around $50 per barrel. The political drama in Greece temporarily slipped from the news headlines, although their debt problems have not gone away. Another dry winter has prompted California Governor Jerry Brown to enact historic mandatory cutbacks in water usage for the state. It has been an interesting few months for the capital markets, and we are expecting some turbulence ahead, especially during this quarter's corporate earnings reports.

Our top concern right now is corporate profits, which are due to be reported within the next couple weeks. Since last summer, the U.S. dollar has surged by more than 20 percent against other primary currencies around the world. While that is good news for American consumers as foreign products and travel become more affordable, it is a headwind for U.S. companies that sell abroad. In addition to making our goods and services more expensive to foreign buyers, a rising dollar means that overseas profits translate into fewer dollars when companies report consolidated financials. Companies that comprise the S&P 500 index derive almost half of their revenues from international sources, so the stronger dollar is expected to take a bite out of earnings. Analysts have lowered their outlook to just four percent profit growth this year for the S&P 500 index, down from a previous estimate of eight percent.

Interest rates also remain a source of anxiety for Wall Street, even though the Federal Reserve has reliably followed through on everything they said they would do. Last year's decline in 10-year Treasury yields confounded the widely held view that rates would rise when the Fed ended its bond-buying program. Now, it appears the Fed is likely to take the next step by raising short-term rates sometime in the second half of this year. While short-term rates are expected to begin a gradual ascent, longer maturity yields are being restrained by weak conditions in Europe and Japan. Exceptionally low yields in those regions make U.S. rates look generous by comparison. Many global factors influence interest rates, and fixed income investors will want to tread carefully through this phase of monetary policy.

On a positive note, lower oil prices and the stronger dollar are providing some tailwinds that could help push Europe and Japan towards economic recovery. Exports represent a large portion of those economies, and the U.S. is an important market. A stronger dollar should boost international sales to American consumers. Cheaper oil has a disproportionate benefit to European and Asian countries that generally import a higher portion of their total petroleum demand than is the case with our domestic economy.

Greece has slipped from the news radar lately, but their debt problems have not gone away. The new leftist-led government was elected on a campaign that railed against the austerity provisions that have generated high unemployment and social unrest. However, without ongoing support from the Eurozone, Greece will simply run out of money in the very near future. As the song goes, "meet the new boss, same as the old boss." It is a predicament that threatens the participation of weaker countries within the euro system, and one that is straining Germany's patience for essentially serving as the system's central bank. The Greek drama is not resolved, and we expect it will resurface as a concern in the coming weeks.

Water has become a hot topic as California is entering a fourth year of extreme drought conditions. Pointing to depleted reservoirs, Governor Jerry Brown enacted historic restrictions on water usage, while treading lightly on the state's $45 billion agriculture sector. This is no oversight, as California is the top agricultural state in the country, producing over a third of the nation's vegetables and nearly two-thirds of the country's fruits and nuts. Unfortunately, the math is as troublesome as the politics. Agriculture uses about 80 percent of the water, which means that even draconian cuts in residential consumption are unlikely to have more than a minor impact on conservation efforts.  Of course, it is ironic to be highlighting the dire consequences of arid conditions out west when so much of the country has struggled with floods and heavy snowfall this past winter.  If companies can get oil from the far reaches of the globe to pumps in Los Angeles, one might think an enterprising effort could successfully transport water from areas that have a surplus.  The solution is probably just a function of price and politics.

Capital markets are facing some challenges as we head into this quarter's earnings season.  A surging dollar and potential for rising short-term interest rates are big topics on their own.  Sprinkle in oil, Greece, California's drought and geopolitical events such as the pending nuclear deal with Iran, and investors are evaluating a difficult mix of contentious issues.  We believe portfolios are in good shape to weather the possible turbulence ahead, although we encourage you to call if you have any questions or topics you would like to discuss.



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