Advisory Notes

Valicenti Advisory Services, Inc.

September 2015

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Valicenti Advisory Services, Inc.

400 East Water Street
Elmira, NY 14901-3411
607-734-2665
Fax: 607-734-6845

447 East Water Street
Elmira, NY 14901-2637
607-733-9022
Fax: 607-734-6157

24 West Market Street
Corning, NY 14830-2617
607-936-1203
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Third Quarter Market Review: The Fed, China and the White House

The third quarter treated us to a volatile August after a slight improvement in July. The Dow Jones Industrial Average (DJIA) dropped over 1,000 points at the opening on August 24, as fears accelerated based on the slowing of China and the commodity based countries Brazil, Australia, Russia and Canada (BARC). The quarter's performance is the lowest since the third quarter of 2011, which was -13.84 for the S&P500. (See chart below.) Although unfortunate, occasional periods of negative returns are historically normal and provide for the repricing of assets.

The weakening global economies from the collapse in the energy and commodity markets "stalled out" the Fed's decision to raise interest rates in the third quarter. This reaction clearly demonstrates that the Fed is very concerned with global growth at the expense of domestic monetary policy. The strong dollar has also been a headwind for the economy, as multinational firms had negative currency adjustments, which affected earnings.

A silver lining does exist, however, in these storm clouds. The Fed will be waiting on the sidelines until domestic and global growth gets stronger before making any big shift in rates. A recent survey by the National Association of Homebuilders (NAHB) showed its highest sentiment index number in ten years. Consumer confidence remains high as prices at the pump continue to fall and unemployment stays low.

The 2016 run for the White House will also add to the volatility in the markets. The

(See **Third Quarter** *on page 2)*

Market Table

Valicenti Advisory Services, Inc.
Comparative Index Period Returns
From 06-30-15 THROUGH 09-30-15

	DJIA	S&P 500	NASDAQ	Russell 2000 Index	Lehman Muni Bond Index	Citi Corp Corporate Bond Index	U.S. Treasury Bill Index (90 day)
06-30-15 to 07-31-15	0.67	2.15	2.84	-1.22	0.80	0.53	0.00
07-31-15 to 08-31-15	-6.36	-6.35	-6.86	-6.40	0.22	-0.56	0.06
08-31-15 to 09-30-15	-1.25	-2.53	-3.27	-5.07	0.80	0.47	0.00
Cumulative Returns-Q3 06-30-15 to 09-30-15	-6.91	-6.75	-7.35	-12.22	1.82	0.43	0.06
YTD Returns 12-31-14 to 09-30-15	-6.88	-5.61	-2.45	-8.63	1.95	-0.32	0.06

The Fed Changes its Focus

In last month's *Bull & Bear* Bulletin (contact us if you would like to be on our email distribution list or access the article on our website), we discussed how the lack of clarity from the Federal Reserve (Fed) on the timing and the magnitude of a possible interest rate increase resulted in additional market uncertainty and volatility. Unfortunately, we did not receive any clarity from the Fed's September meeting. Although, while not raising interest rates, the Federal Reserve did use different language to justify keeping rates unchanged.

Historically, the Federal Reserve outlined inadequate labor market conditions to raise interest rates. This time Fed Chairwoman Janet Yellen cited increased concerns about global economic conditions and market volatility. The change in language is important to note, as it may indicate that the Fed is no longer focusing on just the U.S. economy but how its actions could result in additional economic pain for the global economy.

Having previously outlined how higher interest rates in the U.S. may only serve to further strengthen the U.S. dollar against other major currencies, resulting in capital flight, weaker commodity prices and slower economic growth for many foreign countries, we will concentrate on the Fed's new focus on market volatility, in this month's article.

While equity markets have swung widely the past month, the real stress the Fed may be watching is in the bond market. Credit spreads or the difference in interest rates between "risk-free" Treasury bonds and corporate bonds maturing at the same time, have been climbing since the Fed concluded its monthly asset purchases by last October.

There are different credit spreads for each level of credit worthiness (similar to a person's credit score). The better a company's credit rating, the less interest a corporation usually pays when it issues debt in the bond market. Wider credit spreads often indicate that the bond investors are more concerned about their ability to be repaid by corporations at the time of maturity and this can make it more expensive for businesses to issue debt, to refinance existing debt, to finance asset purchases or expansions, etc.

The Federal Reserve may be viewing the continued widening of the credit spreads as signs of growing financial market distress. Looking back over the past ten years, credit spreads have typically widened ahead of most major equity and economic slowdowns (when reviewing Chart 1, please note that the interest rate spread was inverted to provide a better overlay with the S&P 500 Index). The main concern would be that if this trend continues the Fed would ultimately be forced to be more accommodative in policy actions, not less, as an interest rate hike would represent.

Credit spreads warrant special attention, especially as they are widening to levels resembling the early stages of the last recession. However, despite their decent predicable value, this time could be different. There was a massive issuance of oil and gas-related bonds over the past five years in response to the success of fracking technology and higher oil prices. With oil and gas prices now near five year lows (Chart 2), the widening of credit spreads may be more representative of stress within the Energy Sector than it is of a broader financial stress (Chart 3).

We will continue to monitor the credit spreads for signs of broader financial stress. In the event that spreads continue to widen and we see signs of possible corporate bond defaults, we will take necessary action to reduce our clients' risks and will adjust their portfolios accordingly. Furthermore, we have been highlighting the growing levels of concern in the market over the past few months, which are adding to the figurative "Wall of Worry", but we still feel the economy is likely to soften similar to 2011 versus a full recession. We will do our best to keep our clients informed, as we work through this volatile time period.

Andrew R. Clark, CFP®
Vice President of Investment Research, Portfolio Manager

Third Quarter

(Continued from page 1)

cast of candidates has certainly created a spectacle from the insults between Donald Trump and Carly Fiorina, controversy with Hillary Clinton, the question of Vice President Joe Biden entering the race and the strange timing of House Speaker John Boehner's resignation.

We will continue to watch the markets intensely. Although the equity markets have shown no real trend as of late, a pullback is generally healthy for the long-term market and we will seek opportunities to invest at reasonable prices.

Joseph M. Valicenti
President/CEO

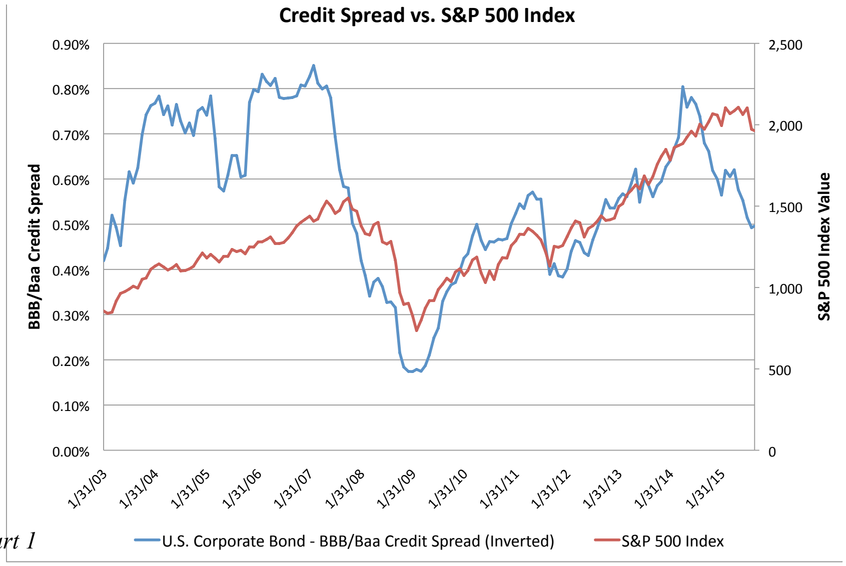


Chart 1

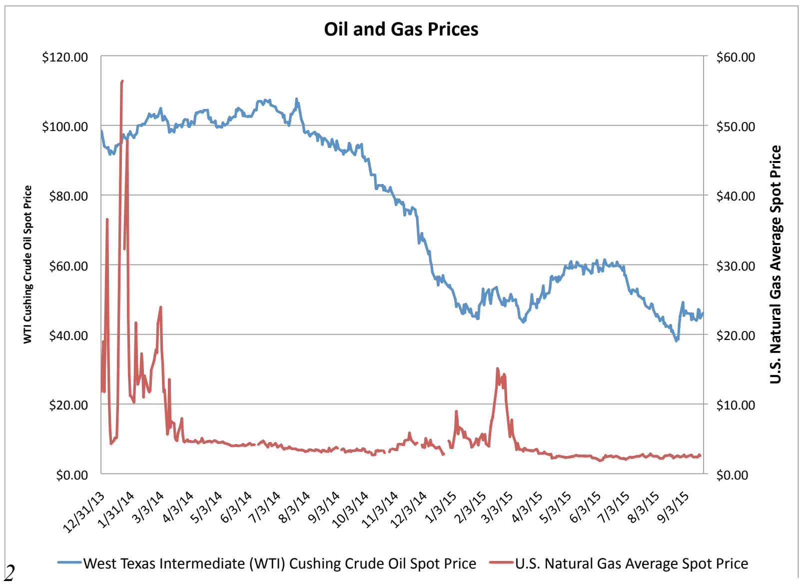


Chart 2

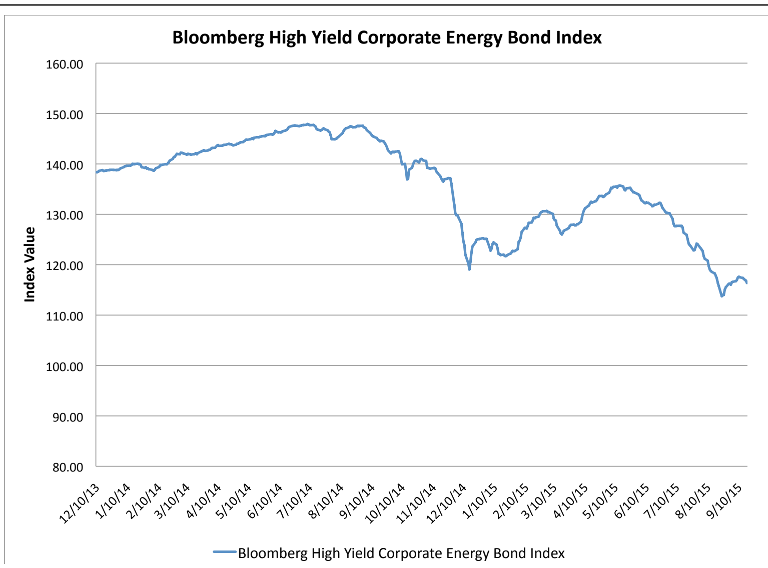
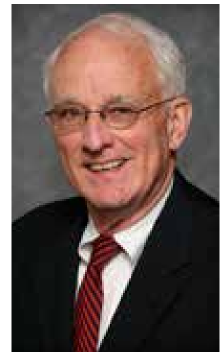


Chart 3

Source of charts: Bloomberg.com

New Location and Open House



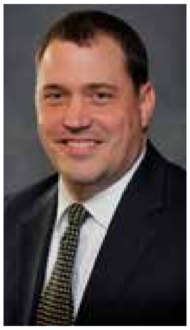
With the continued growth of both our Tax and Business Services Department and our affiliate, Valicenti Insurance Services, Inc., these two groups have moved to our recently renovated building at 447 E. Water Street. Keeping in mind that our clients come first, we felt having this new location across the street from our main office would benefit all of our clients, particularly those who utilize our multiple services.

Our open house will be on October 28 from 4:00 p.m. – 7:00 p.m. at the new location. If you wish to attend, please RSVP to Melissa Dixon at (607) 734-2665 or dixonmb@valicenti.com. We look forward to seeing you!

Ralph H. Roberts, Jr.
Vice President/Client Services

The highest compliment our clients can give is the referral of their friends and family. Thank you for your trust!

Market Symmetry



The sideways nature of the markets through the first half of the third quarter of 2015 ran into a strong uptick in market volatility in the middle of August. While the S&P 500 Index saw its first greater than 10% decline since 2011, the market stabilized fairly quickly and retraced roughly half the loss in the following four weeks leading into the September Federal Open-Market Committee (FOMC) decision. From a sector perspective, Utilities, Consumer Staples and Consumer Discretionary sectors have outperformed more recently. This is instructive in as much as it tells us that the longer term strong outperformance in the Technology and Heath Care sectors has slightly faded for now. The FOMC decision to not raise interest rates in September was accompanied by a slightly more dovish statement than was expected, driven by slower global growth concerns and already tightening financial conditions. Government yields have seen some volatility alongside equities, but longer term yields generally have been stable and in a range over the last three months. Negative influences are impacting underlying market sentiment to a greater degree for the time being.

Positive Influence	Negative Influence
Low Inflation	China Devaluation & Slower Growth
Labor Market Conditions	Renewed Monetary & Fiscal Policy Uncertainty
Personal Consumption	Goods Manufacturing Sector
Housing Activity	Reduced Global Growth Expectations
U.S. Growth Outperformance	Low Commodity & Energy Prices
	Financial Conditions Tightening

Positive Market Influences:

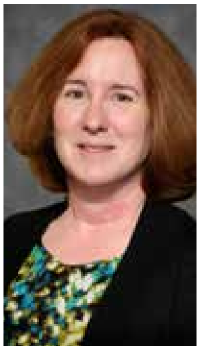
- Low Inflation – Market measures of core consumer price goods inflation, which strips out volatile food and energy prices, remain low. Core Personal Consumption Expenditures (PCE) is presently coming in around 1.2% and core Consumer Price Index (CPI) as of the end of August, is running around 1.8%.
- Labor Market Conditions – Average monthly gains in nonfarm payrolls are running at +247K over the last twelve months and average hourly earnings have risen 2.2% over the same period. Underemployment and labor force participation rate issues are serious concerns but broad labor conditions have been stable.
- Personal Consumption – Year-over-year growth in real personal consumption expenditures for goods and services combined is running near 3.2%, as of July.
- Housing Activity – While a backdrop of strength has not materialized, a mildly optimistic scenario for housing exists due to mortgage purchase applications, average loan sizes and housing starts all trending positively. These measures are still below pre-crisis levels; however, existing home sales have reached seasonally adjusted annualized levels equal to those seen in early 2007.
- U.S. Growth Outperformance – The expectations for U.S. growth and expected inflation verses those in Japan, the Eurozone and in the developing world are generally viewed as having relatively stronger outlooks. This should remain true even if some of the outside forces weighing on global growth begin to soften expectations in the U.S.

Negative Market Influences:

- China Devaluation & Slower Growth – At the end of July, China policymakers widened the trading band within which the Yuan trades against the U.S. Dollar. This was cause for speculation about additional currency devaluation that may or may not be on the table. Slower growth is necessary for rebalancing the Chinese economy away from an unsustainable investment led engine, but the ultimate trajectory of growth and the effects on the global economy are uncertain.
- Renewed Monetary & Fiscal Policy Uncertainty – The most recent Fed decision to not lift rates combined with an element of slightly more dovishness from a handful of FOMC members has turned the policy clarity we found in Q2 on its head. Messaging on balance still indicates a liftoff later this year but global data is trending downward and uncertainty has crept up on the market once again. Talk about a potential 2015 government shutdown and a presidential race coming up next year may create further fiscal policy uncertainty as well.
- Goods Manufacturing Sector – Many regional manufacturing survey outlooks are trending towards or are already showing contraction. The ISM Manufacturing Purchasing Managers Index is still showing expansion, yet it has been trending downward since the beginning of the year.
- Reduced Global Growth Expectations – Gradual developed market growth combined with reduced expectations for output in the emerging economies has reduced outlook for global growth for the year.
- Low Commodity & Energy Prices – WTI and Brent Crude prices as well as other raw materials rallied somewhat in Q2; however, they reverted downward again this quarter. Lower input costs are a positive in many ways, yet the low price environment can be indicative of slowing demand and is pressuring some producers with potential higher costs of capital.
- Financial Conditions Tightening – Corporate credit spreads have widened somewhat and the rise in the dollar

(See **Market Symmetry** *on page 5)*

Federal Student Loans



If you have a high school student in your family, you are most likely considering the cost of post-high school education. According to the College Board, the average cost of tuition for 2014-2015 was $31,231 for private colleges and $9,139 for in-state tuition at public schools. The 10-year historical rate of increase for college tuition is about 5% and last year (2014-2015) the average tuition increase was 3.7% for private colleges and 2.9% at public universities. Keep in mind that these figures are just tuition and do not include other costs such as fees, supplies, room and board, which may easily total an additional $10,000 to $15,000 per year.

Given the expenses, it is likely that you will be considering student loans as part of the payment planning process. There are generally two types of student loans – federal, where the loan is funded by the federal government and private, where the loan is funded by a lender, such as a bank, credit union, state agency or school. Federal loans are further broken down into four categories:

1. Direct Subsidized Loans – student must show financial need
2. Direct Unsubsidized Loans – financial need not necessary
3. Direct PLUS Loans – for graduate students and parents
4. Federal Perkins Loans – school based loan program for those with exceptional financial need.

For Direct Subsidized and Unsubsidized Loans, the student can borrow from $5,500 to $12,500 per year, depending on certain factors including the year in college. For example, first year students are limited to a loan amount of $5,500. This amount increases to $6,500 in the second year and to $7,500 in the third and subsequent years, with larger amounts available to independent students and dependent students whose parents cannot obtain a Direct PLUS Loan.

The school determines the amount the student can borrow by a Subsidized or Unsubsidized Loan based on the cost of attendance, other financial aid and financial need for the Subsidized Loans. There are interest rates charged on the loans, currently set at 4.29% for undergraduate and 5.84% for graduate or professional. For the Subsidized Loans, the U.S. Department of Education pays the interest while the student is in school at least half time and for the first six months after the student leaves school. There is a loan fee on all Direct Subsidized and Unsubsidized Loans, which is a percentage of the loan amount and is deducted from each disbursement.

Once the student graduates or leaves school, the "grace period" begins. The student will have six months before loan repayment begins. Approximately two

(See **Student Loans** *on page 6)*

Market Symmetry

(Continued from page 4)

against world currencies has led to a small increase in the tightness of financial conditions.

Daniel P. Burchill
Security Analyst

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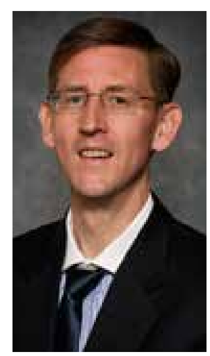
Investment Strategy



The U.S markets showed increased volatility in the third quarter, but not from any recent news, as the stories remained the same. Growth in China continued to slowdown, commodity prices weakened and the Federal Reserve policy and the question as to when U.S. interest rates will begin to rise remained uncertain. The true concerns regarding the Federal Reserve and interest rates appear not to be that they will raise rates, but the speed at which the rate hikes will occur.

With all the persistent headwinds, the U.S. economic conditions are still showing modest improvement. Consumers are more comfortable and seem willing to invest in homes and on big-ticket items such as cars. In addition, the U.S. employment picture is still improving.

The U.S. market valuations do not appear to be overextended; therefore, we continue to look for opportunities as they present themselves. We will use market pullbacks as buying opportunities within the U.S. fixed income and U.S. equity markets. Our focus continues to be on companies with strong balance sheets, strong cash flow and strong earnings growth.

With market volatility likely for the foreseeable future, we will remain flexible with our asset mix. Fixed income will be in a range of 30–40%, equities 35–60% and cash 5-20%. This asset mix will vary based on client income needs, risk levels and client specific directives.

Jeffrey S. Naylor
Executive Vice President/CFO

Student Loans

(Continued from page 5)

months before the first payment is due, the student will receive repayment information from the loan servicer and be notified of the first payment due date. Payments are usually due on a monthly basis.

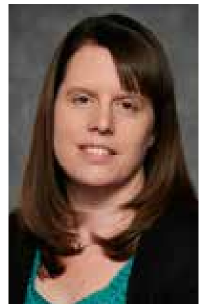
As you may see by the numbers, there will be a large balance owed, even if the student qualifies for the maximum amount of Direct Loans. This is where the Direct PLUS Loan comes into play. With Direct PLUS Loans, the U.S. Department of Education is the lender and the borrower is the parent or guardian for undergraduate students. The borrower must not have an adverse credit history and the maximum loan amount is the student's cost of attendance, which is determined by the school, minus any other financial aid received. The interest rate on Direct PLUS Loans is currently 6.84%, which is fixed for the life of the loan. There is also a loan fee on the PLUS loan, which is deducted from each loan disbursement. The percentage varies depending on when the loan is first disbursed and the rates are currently in the 4.3% range.

Funds from the Direct PLUS Loan are first released to the school to pay for tuition, room and board and other charges. If any funds remain, these will be given to the student to pay for other education expenses. The loan enters repayment once it is fully disbursed. If you are a parent borrower, you can request a deferment while the student is enrolled at least half time and for an additional six months after the student has graduated or left school. Interest will accrue on the loan throughout the deferment.

For any student loans and for any financial aid, the Free Application for Federal Student Aid (FAFSA) must be completed. Once the FAFSA is processed, the student will receive the Expected Family Contribution (EFC) which the college or career school will use to determine how much aid the student will receive.

Ann S. Nolan, RP®
Administrative Assistant

Do You Want To Go Paperless?



As a reminder to our clients, we offer electronic delivery of your daily account data along with PDF delivery of your quarterly financial reports. If you are interested in this service, we will send you a temporary password (initial password is active for 24 hours) to access your data and document vault. Once you log in with your temporary password, you will be prompted to change the password to a permanent password of your choosing.

Each day, your daily data including holdings, gains/losses, transactions and income information will be uploaded to the website for you to view at any time. Every quarter, you will receive an email with links to your quarterly reports that are saved in a secure "vault" on our website. The reports may be viewed by going to our website, www.valicenti.com, and logging in or by clicking on the links within the email.

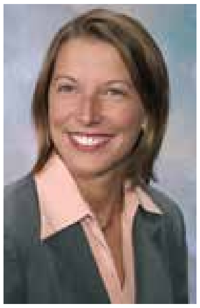
If your account is held at Charles Schwab & Co., Inc., you may also have access to your account through Charles Schwab's client website, www.schwaballiance.com. First time users will need to choose the "New User" link to the right of the Login ID area to set up your account. Once you've set up your account and log in credentials, you may view data such as balances, positions, account history and research.

Schwab also offers edelivery of account statements, trade confirmations, shareholder materials and tax forms. In order to enroll in this service, once you are logged into www.schwaballiance.com, go to the Service tab and choose Paperless. Your account will come up with a list of reports that are eligible for edelivery. Please note that Schwab offers a discounted equity trade commission rate for those accounts that are fully enrolled in edelivery.

If you are interested in these services, please contact us at (866) 734-2665 or email, jenkinstl@valicenti.com and we will begin the enrollment process with you.

Tracy L. Jenkins
Vice President of Operations

Fall and Watercraft Coverage



We've enjoyed a fantastic summer season in this beautiful Finger Lakes region. Unfortunately, now that fall is here, the kids are back to school and the weather is cooling down. It's time to think about pulling your boat out of the water and putting it away until next year.

As you begin to prepare your boat for the winter, take the time to make sure it still has the right insurance protection. After all, we are here to make sure you're ready for the next boating season!

First things first: Insurance

If you have a small boat with limited power, you may have some coverage under your New York homeowners or renters insurance policy. If you aren't sure, please check with us. Of course, larger and faster boats, along with personal watercraft, require their own policies and we can help with those as well.

Do you even need boat insurance during the offseason when your boat isn't in the water? Well, that depends. Keep in mind that your boat can still be damaged no matter where it is. Often, damage from fire and theft isn't covered unless you have a watercraft policy. There is always the chance that we could get a streak of great weather in October or early November that lures you to take the boat out for a day or two! There are plenty of reasons to keep year-round coverage, but if you have questions about seasonal policies, we encourage you to call us.

While you're thinking about insurance, consider your current watercraft coverage. Is your boat older? It might be time to move to "cash-value coverage" instead of "agreed value". Do you have a lot of expensive fishing equipment? Make sure you have enough optional coverage so that your gear isn't at risk. You might also want to consider uninsured boater coverage and a personal umbrella policy, which provide more liability protection than a standard watercraft policy.

Remember, you might be able to save money on your insurance by taking a boating safety course, increasing your deductible or bundling your policies with one company.

Now: A different kind of protection

After you've squared away protecting your boat with the right insurance options, it's time to think about protecting your boat in a more literal sense – by properly preparing it for winter. Below are some general tips to follow but, of course, you should check your owner's manuals for manufacturer recommendations.

Your engine

Follow manufacturer instructions when winterizing your engine, but you'll want to flush the engine with fresh water and make sure to drain fuel from the carburetor to prevent a buildup of deposits. Use fogging oil in the cylinders to lubricate cylinder walls and pistons.

Stern drive

Do a thorough inspection and remove plant life or barnacles from the lower unit. Drain the gear case and clean the lower unit with soap and water.

Fuel tanks

Following the product instructions, fill your fuel tanks to avoid a buildup of condensation and add fuel stabilizer.

Fresh water system

Drain the fresh water tank and water heater and pump a nontoxic antifreeze into the system. Then, turn on all faucets until you see the antifreeze coming out.

Interior

Remove all valuables from the boat. Clean drawers thoroughly and turn cushions on their edges to allow air to circulate. Clean the refrigerator and freezer.

Cover it up!

A cover will keep your boat clean and protect it from water and UV rays, which can break down hoses and fade upholstery.

Now, with your boat safely stowed, is it time to focus on other toys this winter? Snowmobiles, perhaps?

Suzanne M. Valicenti
President/CEO

Valicenti Insurance Services, Inc.

For ALL Your Insurance Needs

Personal Insurance
- Auto
- Homeowners
- Umbrella
- Recreational Vehicles
- Motorcycle
- Watercraft

Business Insurance
- Property
- Liability
- Automobile
- Professional Coverages
- Workers Compensation
- NYS Disability

Life & Health Insurance
- Life
- Long Term Care
- Disability

Group Benefits Plan
- Health Insurance
- Dental Insurance
- Life Insurance
- Disability Insurance
- Customized Benefit Insurance

The mission of Valicenti Insurance Services, Inc. is to provide personalized insurance products and services with unparalleled customer service to protect the assets of individuals, families and businesses that we serve.

Tips if You Travel for Charity Work

Have you donated your services to charity this year? Did you travel as part of your service? If so, some travel expenses may help lower your taxes when you file your return next year. Here are several tax tips that you should know if you travel while giving your services to charity.

First of all, your charity work must be the real focus of the trip. You cannot deduct expenses if you only have nominal duties or do not have any duties relating to the charitable function for significant parts of the trip. Next, you cannot deduct the value of your services that you give to charity. This includes income lost while you work as an unpaid volunteer for a qualified charity. The Internal Revenue Service (IRS) does not regard services given in the form of volunteer work as deductible. Believe it or not, donating blood is considered a "service" which is not considered deductible by the IRS even though you are giving something of value. A pint of blood can have a value range of $150 to $265 per pint.

To deduct your costs, your volunteer work must be for a qualified charity. Qualified organizations must be eligible to receive tax-deductible charitable contributions. They include nonprofit groups that are religious, charitable, educational, scientific and literary in purpose or work to prevent cruelty to children or animals. Most groups must apply to the IRS to become qualified. Churches and governments are qualified so they do not need to apply to the IRS. You should ask the charity about its IRS status before you donate. You can also use the Select Check Tool on IRS.gov to check the charity's status.

You may also be able to deduct some costs you pay to give your services. This can include the cost of travel. The costs must be necessary while you are away from home giving your services for a qualified charity. Deductible costs must be one of the following:

- unreimbursed
- directly connected with the services
- expenses you had only because of the services you gave
- non-personal, living or family expenses

Charities need our help. It is good to know that the government gives us benefits to help those charities in need. The Tax and Business Services Department is available to answer any questions you may have in regards to traveling for charity work or any of the services listed below.

Paul E. Hornbuckle, CPA
Vice President of Tax and Business Services

For ALL Your Tax and Business Services Needs

Taxation

- Personalized Tax Preparation: Individual, partnership, corporation, estates, trusts, and exempt organizations
- Tax Planning for individuals and businesses
- Audit assistance or representation before tax authorities
- Online research capabilities for Federal and all 50 states
- Semi-annual client newsletter

Accounting Services

- Financial statement analysis and preparation
- Bookkeeping
- Payroll
- Sales tax returns

Business Consulting

- Business Entity Design: Sole Proprietor, Partnership, Corporation and Limited Liability Company (LLC)
- Business plan design and execution
- Analysis of business direction and strategic planning
- Fringe benefit evaluation