



## Market Commentary – Fourth Quarter 2015

**January 19, 2016** – The fourth quarter rally across global stock markets left diversified investment portfolios with a modest loss for the year, a notable improvement over the position investors had found themselves in only a few months earlier. US markets once again outperformed in dollar terms both international developed and emerging markets, while bonds posted a modest loss in the face of rising interest rates and widening credit spreads. Oil prices fell another -18% during the final three months of the year, as global supply continued to outpace demand with little signs of slowing.

The S&P 500 Index returned +7.04% in the fourth quarter, ahead of the +3.6% return of mid and small capitalization stocks. Mega mergers and acquisitions continued to dominate headlines, with Dell's acquisition of EMC, Pfizer's acquisition of Allergan and the announced merger of DuPont and Dow Chemical. Healthcare and technology sectors were among the best performers in the quarter. With the price of oil and other commodity prices continuing to fall, stocks with exposure to energy and metals were among the worst performers. Traditional brick-and-mortar retailers were also hard hit, as high levels of inventories, warmer weather and a continued shift to online shopping led to aggressive price discounting in the all-important holiday shopping season. From an investment style perspective, growth continued to outperform value in the fourth quarter and for the full year 2015.

Outside the US, international developed markets returned +4.71% in the fourth quarter. European markets rose during the first two months of the quarter in anticipation of further actions by the European Central Bank to stimulate growth. The Euro continued to weaken vs. the dollar, providing a boost to European exports while depressing returns in dollar terms for US investors. Despite lowering its outlook for growth and inflation, the Japanese stock market rose +9.3% in the fourth quarter on the strength of automobile companies and healthcare. Emerging markets rose +0.66% in the quarter, capping off a difficult year driven by a host of challenges including slowing growth in China, concerns over rising default rates across heavily indebted EM countries and lower commodity prices. Chinese markets moved +5.0% higher during the quarter, as the government continued to take actions to stimulate growth despite diminishing marginal returns.

Bond markets faced a number of headwinds during the fourth quarter, as interest rates rose modestly and the yield on the 10 Year Treasury increased to 2.27% leading to a decline of -0.57% in the Barclays US Aggregate Bond Index. High yield bonds continued to see a widening in yield spreads (difference between interest rates paid on low quality bonds vs. comparable Treasuries) as the risk of rising defaults across the energy and materials sectors increased. Rising yield spreads are typically an indicator of market stress and have been closely watched by both stock and bond market investors in recent months.

***Breadth of market leadership remains in focus.*** Much has been said during the past year of the narrow breadth of market leadership, which can be summed up as the low number of underlying companies with positive returns within widely followed indices like the S&P 500. Whereas the S&P 500 Index returned +1.38% for 2015, the ten largest companies by market capitalization within the S&P 500 Index produced a return of +17%, with the remaining 490 stocks averaging a decline of -5.0%. For this reason, the headline return figure for the S&P 500 in 2015 was a poor indicator of actual returns experienced by most US investors with broadly diversified portfolios. In 2015, investors with outsized exposure to high growth/high valuation momentum names such as Amazon and Netflix benefitted to the detriment of more valuation-sensitive investment strategies. Despite the willingness of investors to "pay up for growth" in today's slow growth environment, I continue to focus my attention on investment strategies that emphasize high quality companies trading at attractive valuations with the capacity to pay and grow dividends. In investing, one of the largest determinants of future returns is the price you pay to acquire an asset. Momentum companies trading at high valuations must continue to grow rapidly and spend heavily to maintain their premium valuations and stock prices. And when the growth rates eventually slow or disappoint, the valuations investors are willing to pay for these companies shrink along with the share price (sometimes with dramatic consequences).

***The collapse in oil prices continues to dominate investor focus.*** Commodities continued to fall sharply in the fourth quarter with the Bloomberg Commodity Index declining -10.5% and losing -24.6% for the full year 2015. Oil prices, having fallen -18% in the fourth quarter, have now declined from \$61 per barrel in late 2014 to below \$34 per barrel as of the end of 2015 (-44.0%). Though I believe the decline in oil prices is likely to benefit global consumers and businesses by lowering the cost of fuel and related inputs, it has been devastating for oil exploration and production companies, oil services companies, pipeline operators (MLPs) and governments that are heavily reliant on oil production and sales to fund budgets. OPEC (Saudi Arabia) has demonstrated its willingness to tolerate lower oil prices, despite significant dissension among its ranks, with oil production continuing to surge as oil-producing countries pump greater volumes to offset price declines. Despite projections for modest increases in oil demand, the market has remained significantly oversupplied which has pushed oil prices lower. Many US shale producers, saddled with high debt levels, are now facing a rising tide of loan defaults which has raised concern about energy exposure across US bank balance sheets. As sanctions on Iran are lifted, additional new oil supply is expected to be added to the market which will further depress oil prices. A prolonged downturn in oil prices will result in more pain for companies exposed to the energy sector and have a destabilizing effect among many global economies that have relied on oil production to fund public budgets, meet debt obligations and support growth initiatives.



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***The US economy continues to be a tale of two stories.*** Economic data emerging from the US during the fourth quarter was mixed, as manufacturing (12% of US GDP) continued to contract and exports declined due to a stronger dollar making US goods less competitive, weaker demand from overseas and declining capital spending across the global energy and materials sectors. Inflation has remained stubbornly low and below the Federal Reserve's longer term target of 2%, while retail sales figures were mixed during the 2015 holiday season despite surveys showing a relatively upbeat US consumer. Notwithstanding these challenges, data emerging from the services sector of the US economy (largest component of US GDP) has remained relatively upbeat. The US labor market has continued to improve with the unemployment rate falling to 5% and modest increases in wage growth. Recent softness aside, the US housing market has continued to be an important catalyst of US economic growth which has been further supported by the current low interest rate environment keeping mortgage rates low. In December, the Federal Reserve took its first steps to move away from its zero interest rate policy (ZIRP) by raising the Federal Funds Rate to 0.25%. Despite much hoopla surrounding the Federal Reserve's first rate hike and the consensus Wall Street view that we are moving into an age of global monetary divergence, the Federal Reserve remains highly accommodative and I believe it is unlikely we will see interest rates move significantly higher from here in the US as long as the rest of the world remains stuck in a low interest rate environment.

***An Overview of 2016 Risks & Opportunities.*** As we enter 2016, we are faced with a number of key risks that warrant our attention. The US economy faces headwinds including the strong dollar, corporate margin sustainability, troubles in the US energy and materials sectors, and the increased susceptibility to market shocks due to the current slow growth environment. Looking abroad, Europe is forced to content with a surging immigrant crisis, persistently low inflation levels, high unemployment levels and falling export demand from China. Elsewhere, Japan has failed to establish a sustainable path to economic growth and remains highly reliant on the Bank of Japan and its government to fight deflation, boost exports and implement needed structural changes. Some of the largest emerging market nations are struggling in an environment where access to capital is becoming increasingly difficult, and where public budgets are being cut in the face of falling commodity prices. From Russia to Brazil to China, previous emerging market leaders now face uncertain times that are likely to get worse before they get better.

Despite these challenges, I believe opportunities continue to emerge for the patient long term investor. Since the start of 2016, global stock markets have declined more than -9.0% driven by 1) falling oil prices 2) clumsy attempts by Chinese officials to support local stock markets in the face of weaker economic data 3) growing fears of a US economic recession. As long term investors, we are presented with a growing list of attractive US companies that have strong economic moats, healthy balance sheets and attractive dividend yields that have fallen in price -20.0% or more in the past year. If you believe like I do that the US isn't headed into an imminent recession, now may be an opportune time to add to existing and new high quality companies and mutual fund strategies. Falling unemployment and energy prices will benefit US consumer spending, with low interest rates continuing to support housing. Highly accommodative monetary policies throughout the world should continue to be positive for US and international developed markets. As of December 2015, the Euro area reported one of the healthiest readings in its manufacturing sector since April 2014. I remain less optimistic about the emerging markets and see more trouble ahead. I continue to maintain minimal direct exposure to emerging market investments within client portfolios given what I view as serious structural issues which will likely plague many of these countries for the foreseeable future.

***Some Final Thoughts.*** Famed investor Joel Greenblatt once advised *"Invest in a strategy that makes sense, and stick with it."* Those words couldn't be more prescient in today's market environment dominated by high frequency trading and constant media hype focused on timing day-to-day moves in the market. As investors, we make a conscious decision to trade the insecurity associated with investing in a volatile market today in exchange for longer term financial security. While market pundits debate daily whether we are in a bear or bull market, or whether the next 10% move will be higher or lower in the markets, I would prefer to focus my time on more productive pursuits. We cannot know with certainty where the market will be in a day, week or month from now. But when we look back in ten years from now on the current bout of market volatility, will we be pleased that we stuck to our plan and continued to implement our existing investment strategy? I believe we will.

As always, please do not hesitate to call my office to discuss anything contained within this client letter or to schedule a time to meet and review your portfolio. I understand that the recent market volatility can be unnerving and distressing for some investors. This is natural, and my role as your advisor is to help you manage through these tough times and stay the course so we can obtain our longer term investment objectives.

Sincerely,

A handwritten signature in black ink, appearing to read "Liam Timmons", written in a cursive style.

Liam Timmons, President  
Timmons Wealth Management



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### Fourth Quarter 2015 Market Data:

<b>Asset Class</b>	<b>Category</b>	<b>Performance Comparison Peer Group &amp; Benchmark</b>	<b>4Q15</b>	<b>FY15</b>
US Stocks	US Large Cap Stocks	S&P 500 Index	7.04%	1.38%
US Stocks	US Large Cap Stocks	Dow Jones Industrial Average	7.70%	0.21%
US Stocks	US Mid Cap Stocks	Russell Mid Cap Index	3.62%	-2.44%
US Stocks	US Small Cap Stocks	Russell 2000 Index	3.59%	-4.41%
International Stocks	International Developed Large & Mid Cap Stocks	MSCI EAFE Index	4.71%	-0.81%
International Stocks	Diversified Emerging Markets	MSCI EM Index	0.66%	-14.92%
Bonds	Short Term Treasury Market	Barclays US 1-3 Yr Treasury Bond Index	-0.43%	0.56%
Bonds	US Investment Grade Bond Market	Barclays US Aggregate Bond Index	-0.57%	0.55%
Bonds	High Yield Bonds	BofAML US High Yield Master Index	-2.17%	-4.64%
Real Estate	Real Estate Investment Trusts (REITs)	MSCI US REIT Index	6.67%	1.28%
Commodities	Diversified Commodity Market	Bloomberg Commodity Index	-10.52%	-24.66%
Cash	Money Market	Barclays US Treasury Bill 1-3 Month Index	0.01%	0.03%

#### Disclosures:

Historical performance results for investment indices and/or benchmarks have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. You cannot directly invest in an index. Index return information is sourced from Morningstar Office.