INVESTMENT NEWSLETTER

December 31, 2015

The overall US Equity Markets eked out a gain of 0.5% in 2015, but small and mid-caps were net losers in 2015.

Large Cap Stocks - +1%
Mid Cap Stocks - -2%
Small Cap Stocks - -4%

Foreign Stocks lost ground again in 2015.

Developed Economies - -3%
Emerging Markets - -17%

Fixed income interest rates remained at historically low levels.

Short/term rates – 0.01%
Long Term rates - 2.5%

Real Estate recovered its previous losses closing the year up +4%.

Commodities continued their dramatic decline and finished the year down a whopping -33%.

The Investment Letter is mailed periodically to our clients and friends. This letter was prepared from material provided by Bob Veres , Morningstar, The Wall Street Journal, and other sources that we believe to be reliable).

2015 Year End Report:

Despite some entertaining increases and scary downturns, particularly in the third quarter of the year, the overall US Equity Markets ended pretty much where they began, eking out small gains and losses pretty much across the board.

Summary

The US equity markets were essentially flat during the year and international equities continued to wrack up losses in 2015. The Federal Reserve raised interest rates, but the impact on bond yields was modest. Despite a bumpy 3rd quarter, Real Estate continued to be profitable. The big story in 2015 was the continued drop in the price of oil (The spot price for West Texas Intermediate dropped from $53 to $38).

US Equity Markets

Overall - The final three months of the year provided investors with gains that were tantalizingly close to wiping out the losses of the previous three. The Wilshire 5000--the broadest measure of U.S. stocks—gained 5.9% in the fourth quarter of 2015, ending the year down a mere -0.3%. The comparable Russell 3000 index was also essentially flat, gaining 0.5% for the year.

Large Companies- Large cap stocks were comparably flat. The Wilshire U.S. Large Cap index gained 6.8% in the fourth quarter, and managed to finish the year up 1.3%. The Russell 1000 large-cap index finished the year up 0.9%, while the widely-quoted S&P 500 index of large company stocks was up 6.55% in the fourth quarter, but finished down -0.7% for all of 2015—its first yearly loss since 2008.

Midsize Companies - The Wilshire U.S. Mid-Cap index gained 2.3% in the final quarter, but finished the year down -2.6%. The Russell Midcap Index lost 2.4% in calendar 2015.

Small Companies - This was a year to forget for investors in small company stocks. As measured by the Wilshire U.S. Small-Cap index, investors posted a small 2.6% gain over the last three months of the year, but in the end the index had lost -4.9% over the entire 12 months, dragging many diversified portfolios into negative territory. The comparable Russell 2000 Small-Cap Index finished the forgettable year down -4.4%. The technology-heavy Nasdaq Composite Index ended the year up 5.7%.

Foreign Equity Markets

International investments contributed a slight decline to overall portfolio returns. The broad-based EAFE index of companies in developed foreign economies gained 4.4% in the fourth quarter of the year, but finished the year down 3.3% in dollar terms. In aggregate, European stocks lost -6.1% for the year, while EAFE's Far East Index was up 4.7%. Emerging markets stocks of less developed countries, as represented by the EAFE EM index, lost -16.9% for the year.

Commodities and Real Estate

Real Estate was the only bright spot in the major asset classes. The Wilshire U.S. REIT index, gained 7.5% during the year's final quarter, wiping out previous losses to finish up 4.2% for calendar 2015.

Many investors will look at their statements and see lower returns than the indices indicate, in part because a portion of their portfolio was invested in commodities—by far the biggest loser of 2015. Commodity investments are considered an excellent diversifier, and nobody can tell when they're going to add significantly to a portfolio's value, but in the last 12 months, they continued a longstanding losing streak, with the Standard & Poor's GSCI falling -16.6% in the fourth quarter. Some have speculated that the largest contributor, a surprising continuation of the decline in oil prices, may have been accelerated by a Saudi Arabian attempt to flood the oil markets as a failed strategy to put American frackers out of business.

By the end of the year, investors in the commodity index were sitting on a whopping -32.9% loss. Don't look for a return to high oil prices in the near future, as oil production from post-sanctions Iran will soon hit the market, adding to what economists are already describing as an oil and gas glut.

Interest Rates

Meanwhile, bond investors started the year, as in years past, expecting that 2015 would finally see interest rates rise across the board. Many investors have been holding very low-yielding short-term instruments or cash in their bond portfolio allocations as a defensive measure, and had to endure almost zero returns without the satisfaction of having ducked the long-anticipated nasty downturn in bond values. 10-year Treasuries currently yield 2.5% and short term rates remain near 0.

Outlook - Modestly Pessimistic

What's going to happen in 2016? Of course, nobody knows. But many financial pundits are approaching the new year with an unusual degree of caution.

- U.S. stocks are pricier than their historical averages. That doesn't mean they can't get more so, but it seems unlikely that people will pay a lot more for a dollar of earnings in the coming year than they will today. Meanwhile, economic growth is moderate at best, which suggests that, in aggregate, U.S.-based companies have only moderate upside potential.
- Turmoil in High Yield Bond Market. Is the recent downturn is a sign of some long-term problems or a blip on the screen? One could make the argument that companies with low credit ratings have gotten away with giving their lenders extremely low (by historical standards) interest rates. If rates rise, investors may want to sell those bonds, and there could be a sudden rush for the exits, potentially causing liquidity problems for the funds that are holding them. But one would expect those funds to be preparing for this possibility, and similar dour forecasts have, in the past, had a habit of not showing up in the real world.
- China . The Shanghai Composite Index lost 43% of its value during a frightening summer selloff, and China's economic growth has clearly slowed from the pell-mell double-digit growth rates of the past 20 years. But lost in the hand-wringing is the fact that China's primary index finished the year with a 9% gain overall. The selloff simply wiped out most of an enormous bull run in the first three months of the year. More troubling than the losses is the government's willingness to try to manipulate its equity markets, which means it's hard to discern the fair value of individual Chinese stocks.
- Federal Reserve Board and Interest Rates Nobody knows if or when the Fed will raise rates again or what the impact would be, but the fact that it's an election year, and the economy is still not exactly robust, suggests that the central bank's policymakers will proceed very cautiously.

Will that happen in the next 12 months? All we can say is that the markets often punish those who try to outsmart them. If the market goes down in the coming year, it will mean that we all will be able to buy stocks at cheaper prices in anticipation of the next rise—whenever and however it arrives.