January 2016
Market Comments

Interpreting mixed signals for the year ahead

As we enter 2016, the economic and market signals we follow are not presenting a clear picture of the future. Though the short-term is uncertain we take comfort in knowing that over the longer term the world economies will continue to grow and an investment in equities will prove to provide good value. Before we talk about 2016, let's spend some time on 2015. Stocks were generally flat to down in 2015 with wide variations in performance by sector. Consumer, technology, and healthcare sectors performed well, while energy and materials had a losing year. We finally experienced the first rate increase by the FED after seven years of near-zero rates. This should be a sign of confidence, but for now the market sees it as a sign of easy/cheap money going away. The FED is projecting multiple small rate hikes in 2016 and we view this as healthy long term sign that the US economy is in decent shape.

Moving forward we need to make sense of:

1. The US stock market set a record for the worst 10-day start to a year (1)
2. US labor situation is good with unemployment at 5% and strong job creation in December (292,000 jobs) capping a year where 2.7 million jobs were created (2)
3. World economic growth forecasts are reasonable with World Bank at 3.3% World GDP growth in 2016, up from 2.8% in 2015 (3)
4. China suffered from a 15% stock market sell off this year.(4)
5. The US Federal Reserve Bank started to raise interest rates in December showing confidence in the US economy(5)
6. Crude oil prices at $30/bbl are at a 13 year low (6)
7. 2016 brings us a Presidential election

Making sense of these mixed signals is difficult. While economic conditions are good, commodity and equity markets appear to be reacting to fear of world demand slowdowns. Maybe the markets are right this time, but maybe not. We are reminded of false signals by economist Paul Samuelson famous quote:"the stock market has called 9 of the last 5 recessions" (7)

Even with short term uncertainty we have confidence in the long term benefit of owning equities. Stocks have outperformed bonds over the past 20 years, 50 years and 87 years:

	Annual Returns on Investments in		
	S&P 500	*3-month T.Bill*	*10-year T. Bond*
1928-2015	11.41%	3.49%	5.23%
1966-2015	11.01%	4.97%	7.12%
2006-2015	9.03%	1.16%	5.16%

(8)

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Averages appear more sanguine than how markets act from day-to-day and month-to-month. As shown in the previous table, the S&P 500 is up on average 9% per year over the past 20 years [8]. During this period we have seen 13 months where the S&P500 was down over 5% and 13 months when it was up over 5%. Because of the unpredictability of stocks over the short term, our portfolios nearly always have a blend of stocks plus other instruments including bonds, trusts, cash and other income generating securities. Diversified portfolios provide a balance of growth plus stability so we don't need to tolerate the full effect of stock market variations.

One opportunity we see currently is the ability to earn a good return on an income based portfolio. Stocks have been volatile, oil & gas companies are near cycle lows, interest rates are rising providing good income generating opportunities. For many years we have agonized about low rates and returns available from income securities. Currently, a diversified portfolio of income generating securities is yielding 6-7% at current price levels. Some specific examples are:

Bank Preferred Stocks - Major US banks are in much more stable condition than they have been in many years. They have strengthened their balances sheets and added capital as a result of new regulations. Part of their capital structure is Preferred Stock that yields 5%-6%.

Infrastructure MLPs - The businesses controlled by these companies in pipelines, storage terminals and processing facilities of oil and natural gas is required for the future of the US energy industry to exist. Regardless of the price of oil, the barrels need to move from the producer to the refiner and from the refiner to customers. There are MLPs with low commodity exposure in stable fee based businesses that yield 5-10%.

Medium Term Bonds - With the FED starting the interest rate tightening cycle, we have seen more opportunities in low investment grade bonds.

Royalty Trusts - The oil and gas sector is in a cyclical downturn with the yield on debt-free high quality royalty trusts increasing to over 10%. Payouts will go up and down with commodity prices, but a trust with no debt will not go out of business and continue payouts over time. When the cycle turns back up, payouts will increase.

Shifting a portion of your assets into an income focused portfolio or adding new capital with an income goal may make sense. We would be happy to discuss this with you if you have an interest.

As always, we need to keep our asset allocation appropriate for our stage of life. We know that financial requirements and priorities change over time. As we get closer to the point of needing our money, we reduce the allocation to stocks to minimize the impact of short term market moves impacting our way of life. We strive to help you achieve you life goals through thoughtful financial planning and asset allocation that's fit for you.

Though the signals we see don't provide a clear direction for the short-term, we are optimistic over the longer term. The economy is growing, both in the US and throughout the world, providing support for financial markets. With that growth come innovations and technology advances that make our lives better. Advances in healthcare and wireless communication have changed our lives over the past decade and will continue to improve in the future. Working

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together we can help stay on a steady course as we navigate through this uncertain short-term period

All the best in the New Year,

Russ, Ralf, Brett, Bruce and Rob

Sources:

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