Market Update

March 31, 2016

The first calendar quarter of 2016 looked like a replay of all of 2015 with stock prices moving sharply both up and down, and ending with a value very close to the opening value. The S&P 500 index was up 0.8%, the Dow Jones Industrial Average was up 1.5% and the NASDAQ index was down 2.7%. The volatility in stock prices during the first quarter affected small and mid-size company stock prices more than the "blue chip" company stock prices.

Oil prices, interest rates and relative currency values all moved in ways that appeared contrary to rational expectations, and did not reflect the movements in the stock market.

Oil prices initially declined during the quarter, briefly dropping below $27 a barrel. However, prices rallied more than 50% over the next several weeks to $40+ per barrel, before closing the quarter at just under $40. The oil market is in a significant over supply situation and neither a demand increase nor a reduction in oil production appear likely to materialize during the current calendar quarter. The rally in oil prices seems to be based on the hope of OPEC curtailing production, not on any fundamental assessment of global economic growth.

After the Federal Reserve raised the Federal Funds rate by 0.25% in December, interest rate levels rose for all maturities of U.S. Treasury securities. In particular, the ten-year Treasury Note ended the year at approximately 2.2%. By the end of the first quarter the yield had declined to less than 1.9%. The Federal Reserve communicated publicly in December that it expected to raise interest rate levels on Federal Funds three or four times during 2016. However at an early March meeting, the Federal Reserve Chairman Janet Yellen indicated a more cautious approach was warranted. Market participants immediately took that statement to mean that there would be only one or two increases this year. Nevertheless, it is unusual for interest rate levels to decline when the outlook is for rate increases in the year ahead.

Early in 2016 the European Central Bank decided to further stimulate the European Union economy with a monetary policy consisting of even greater negative interest rates. While this policy is of financial benefit to European banks, it also guarantees that depositors will get back less money than they originally put into their accounts. Not surprisingly, all across Europe there was a spike in the sale of safes as individuals decided to safeguard their own funds. Many others, no doubt, decided the best place to secure their cash was between the box spring and mattress. With the U.S. raising interest rates as Europe was lowering theirs, many would have expected the dollar to appreciate relative to the Euro. However precisely the opposite has occurred, as the dollar is now weaker compared to other currencies.

Finally, the unexpected twists and turns in the financial world, combined with the turmoil in the U.S. presidential primaries, has produced an unsettled environment in America. However, we are optimistic that these financial and political issues will eventually be worked out, and therefore we remain committed to equities in client portfolios.

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