Market Update

December 31, 2015

Statistically, the highest equity market returns during a four year presidential term usually occur in the third year. This was not the case in 2015, President Barack Obama's third year. Although the fourth quarter returns started up in October, they were flat in November and then down in December.

Domestic equity indices rose in the fourth calendar quarter, with the Dow Jones Average up 7.0%, the S&P 500 Index up 6.5% and the NASDAQ Index up 8.4%. However for the full year, only the NASDAQ Index was up, by 5.4%, while both the Dow Jones and S&P Indices were down modestly.

Within market segments, large companies did better than smaller companies. While the large capitalization indices cited above provided roughly zero returns on average for the year, small and mid-size companies fared worse than their larger counterparts. For example, a Vanguard Mid-Cap index fund was down more than 5% for the year and a Vanguard Small Cap index fund was down roughly 2% for the year.

The same performance pattern held for international markets. The Morgan Stanley Capital Index of Developed Markets, containing mostly large multinational companies, was down roughly 2% for the year while another index of Emerging Markets with smaller companies, was down almost 10%.

Commodity prices continued to decline during the fourth quarter, largely due to a marked slowdown in China's economy. Oil, the largest globally traded commodity, continued its slide down from $60-$70 a barrel in late 2014, to below $40 per barrel in late 2015. During 2015 oil prices declined more than 30%, and many other industrial commodities had similar price declines.

Interest rates held steady during the fourth quarter, as fixed income markets quickly assimilated the Federal Reserve's 0.25% increase in short term interest rates. The yield on the ten year U.S. Treasury Note closed the year at 2.2%, not very far from where it started the year.

Corporate profits for 2015, soon to be reported, will probably be up about 1%, excluding the energy sector which showed an earnings decline of more than 50% from 2014 levels. In that light, it is not surprising that market returns were near zero, comparable to earnings growth for the year.

Based on the continuation of economic trends for the past several years, I predict another year of 2.0% growth for 2016. Corporate profits are likely to improve somewhat from 2015 levels. The negative profit impact caused by a stronger dollar relative to other currencies in 2015 will probably not recur in 2016. We remain guardedly optimistic about the prospects for continued positive returns from equities and will continue to be invested in equities within client portfolios.

Raymond A. Beplat, CFA

Chief Investment Officer