Monthly Market Returns: Dec 2015

Index	1 – Month Return	2015 Returns
S&P 500	-1.72	1.25%
Russell 2000	-5.03%	-4.47%
MSCI EAFE	-2.34%	-1.00%
Barclays Bond Index	-0.19%	-0.48%
Brent Crude	-12.28%	-25.44%
Gold Spot Price	-0.45%	-10.67%

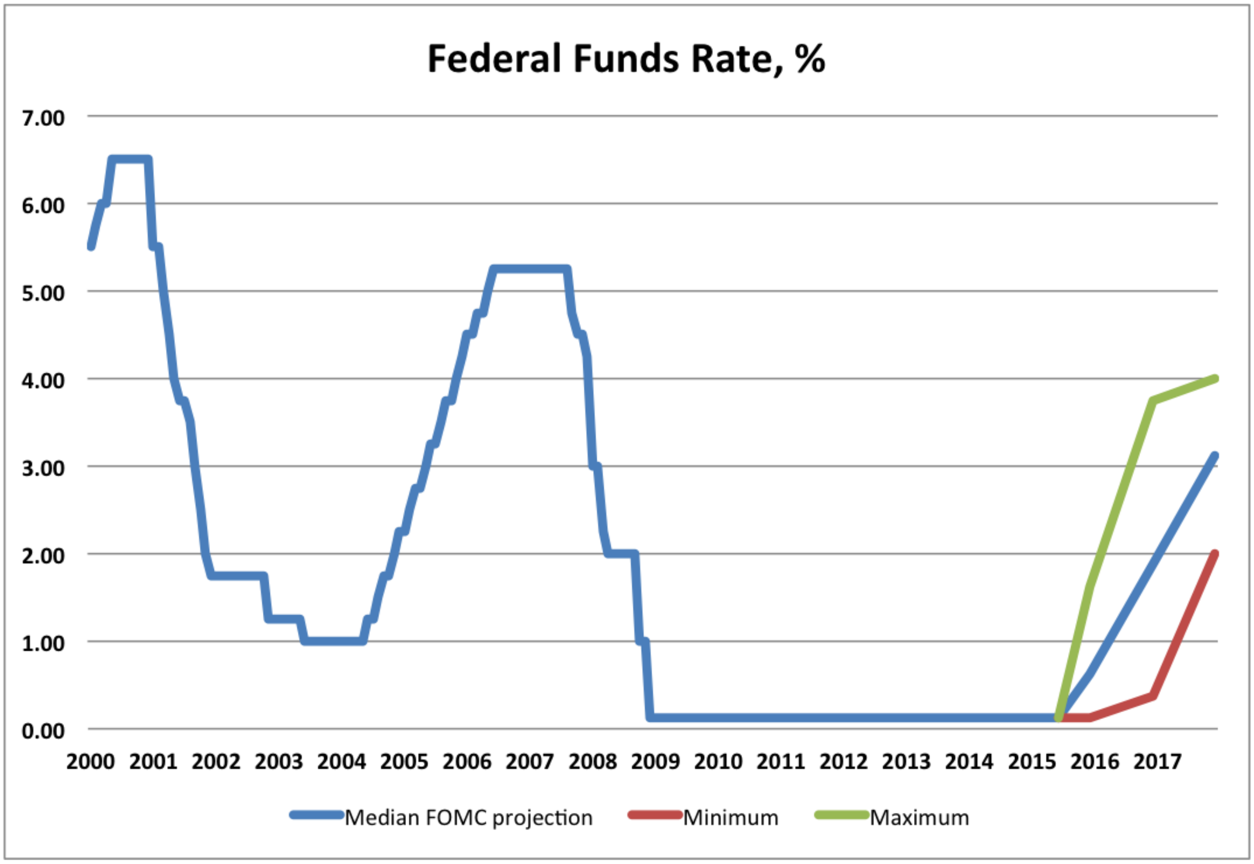
A New Year

Unless you were short crude oil or gold, 2015 was a lackluster year for most investors. While the S&P barely finished in the black it did so amidst heightened volatility and anxiety. The first trading day of 2016, January 4th, did little to assuage the concerns of the prior year as the US market moved down as much as 2.5% and ultimately moved up closing down for the day 1.52%. While the first day of the year has little predictive power concerning how the remainder of the year will pan out, it is worth examining the concerns driving markets to attempt to be realistic regarding the legitimate threats and aware of opportunities that are present.

The predominant concern driving markets since the fall and into 2016 is a potential slowdown in China. In fact, it was a 7% drop on the Hang Seng index yesterday which rippled across the Pacific to our markets driving the downturn. This pullback in Chinese equities was not driven by any piece of economic data rather it was driven by increased tension between Saudi Arabia and Iran. An in-depth examination of China will be contained in our soon-to-be-released 2016 Annual Forecast and is beyond the scope of this publication. Sufficed to say however, markets will continue to respond to the reality and/or perception of Chinese growth prospects or lack thereof. Let's take a look at key items of the past month and what they might portend for the future:

Rate Increase Announcement

On December 15th the Federal Reserve announced a long-anticipated increase to its target Federal Funds rate from 0-.25% to .25-.50%. This marks the first increase in the Fed Funds rate in 10 years and is far more a symbolic move signaling the end to its ultra-easy monetary policy. This move was signaled well in advance by the Fed and we anticipated such a move which proved to be priced-in as evidenced by little movement in equity or fixed income markets on the announcements. Perhaps more importantly, the Fed offered its guidance as to future rate hikes which is contained below:



The above data is taken from the Fed Committee members themselves and offers a range of where interest rates could be in the next 24 months. We think it is likely to see the Fed Funds rate at roughly 1.5% by the end of 2016 but would not be surprised to see the Fed hold at present levels if economic conditions warrant. The Fed is not facing an inflationary threat therefore there is little impetus from a price control standpoint to raise rates. The biggest risk to the market associated with rising interest rates is if rates rise too quickly which we believe to be very unlikely. Rates are indeed now more likely to rise then not but will do so in a very gradual fashion providing little in the way of shock to the demand side of the economy. Barring a major deviation from the projected level and pace of rate increases, we believe that the conversation around interest rates in the US will take a backseat to larger global growth concerns in 2016.

ECB Stimulus Announcement

The European Central Bank, the equivalent of the Federal Reserve for the Eurozone, continues to be plagued by low inflation which it persistently battles by printing money, buying bonds and imposing negative interest rates on certain bank depositors. The liquidity provided in Europe makes the QE program the US Fed embarked upon seem mild by comparison and yet that liquidity has not yet provided much in the way of support for European equities. Today, the Eurozone inflation figures for

December were released and were unchanged month over month, missing the ECB target yet again. In response, the ECB has announced an extension to its bond buying program by another 6 months into March of 2017. The ECB will need to be continually engaged in their own QE experiment that should eventually prove beneficial for European stocks already trading at discounts to their American counterparts.

Oil & Commodities Bounce?

The question posed concerning a potential bounce in commodities was answered with a resounding “no” as 2015 concluded. Energy and commodities provided a great source of volatility and weakness in 2015 that continued into December. While it is likely that the worst is over for crude oil in particular, we don’t see a near term recovery in price. Oil markets will continue to be driven by the Saudi commitment to over-produce to protect the market share they still possess. This desire to punish other producers with lower prices has only been exacerbated over the weekend as Iran, a Shiite nation, has vehemently protested the executions of Shiite clerics in the predominantly Sunni Saudi Kingdom. You’ll recall that Iran is set to have its embargo lifted soon and will be able to bring oil to market albeit at much lower prices thanks to the Saudi’s. Clearly, Saudi Arabia would like to drive out US shale producers but that is a secondary objective to punishing and debilitating regional rivals such as Iran and Russia, both highly dependent on petrodollars.

The greatest opportunity created by the sell-off in oil is in the pipeline segment in the US which has many players not highly exposed to the price of crude. We continue to look for and implement those opportunities where appropriate in our respective models. For the time being, we’ll enjoy the cheaper price at the pump and look for clues of the Saudis blinking in this international stand-off.

<u>What We’re Watching in January</u>

Saudi & Iranian Tensions

US Corporate Earnings & Insider Activity

ECB Stimulus

Sincerely,

The CAPSTONE Team