



2015 4<sup>th</sup> Quarter Market Commentary



# Fourth Quarter Summary

- Growth assets across the globe rallied during the 4<sup>th</sup> quarter, following the first equity market correction in nearly five years (Positive)
- Lawmakers in D.C. avoided a government shutdown by reaching a bipartisan budget agreement for the next two years (Positive)
- Despite a cautious outlook, the Federal Reserve raised interest rates during their December meeting, noting a slowly improving economy and labor markets (Neutral)
- Volatility in the commodity markets continued as oil declined an additional 31% for 2015 (Negative)
- Earnings for the S&P 500 declined by 5.3%, marking three consecutive quarters of earnings contraction (Negative)

# Market and Portfolio Risks

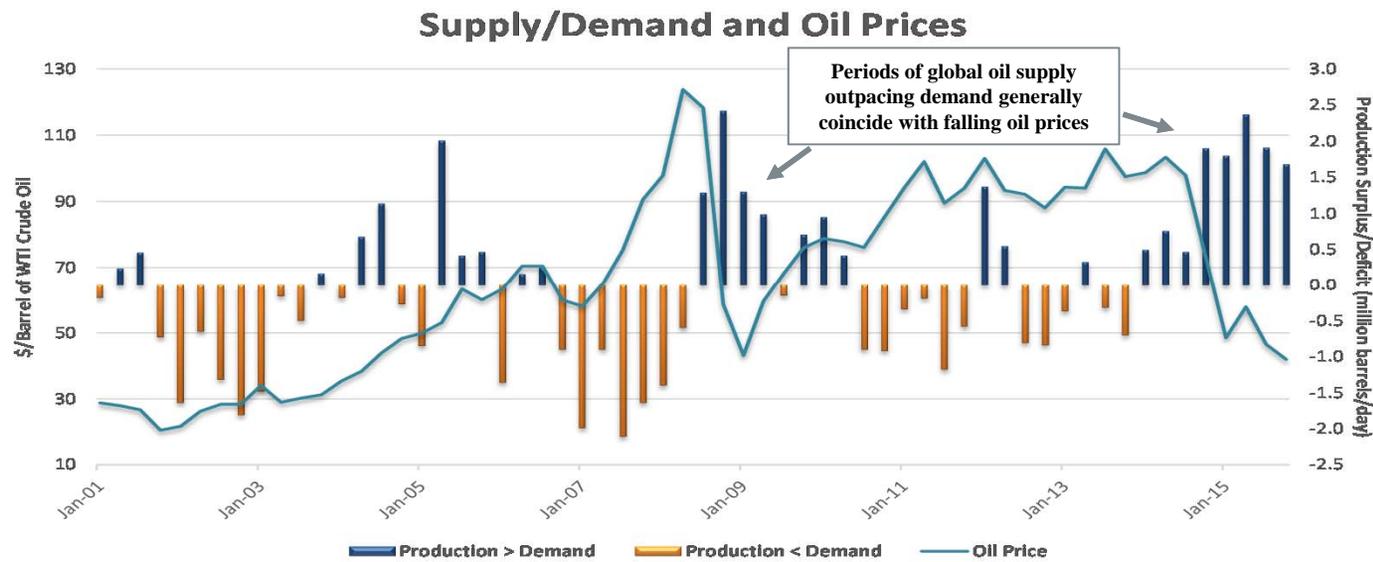
	Capital Preservation			Growth Assets		Real Assets	
	Fixed Income	Global Bonds	Hedged Strategies	Domestic Equities	Foreign Equities	Domestic Real Estate	Commodities
Inflation	Decline	Decline	Stable	Decline	Stable	Increase	Increase
Deflation	Increase	Increase	Stable	Decline	Decline	Decline	Decline
Stagflation	Decline	Decline	Increase	Decline	Decline	Increase	Increase
Chinese Slowdown	Increase	Increase	Stable	Stable	Decline	Stable	Decline
Japanese Government Default	Increase	Increase	Increase	Decline	Decline	Stable	Stable
EU Breakup	Increase	Stable	Increase	Stable	Decline	Stable	Stable
Geopolitical Turmoil (i.e. ME, Russian Tensions)	Increase	Stable	Increase	Stable	Decline	Stable	Increase
U.S. Political Gridlock	Decline	Increase	Increase	Decline	Stable	Stable	Increase
Central Bank Credibility	Stable	Stable	Increase	Decline	Decline	Stable	Increase

**Return Expectations:**

- Decline
- Stable
- Increase

- Stagnant global economic growth and slumping commodity demand have increased deflationary pressures around the world
- Turmoil continued in the Middle East as tensions mounted between Saudi Arabia and Iran
- The Federal Reserve raised the Federal Funds rate by 0.25% in December, marking the first increase since 2006
- A slowing Chinese economy has significantly impacted global commodity prices and has contributed to heightened market volatility in both developed and emerging markets

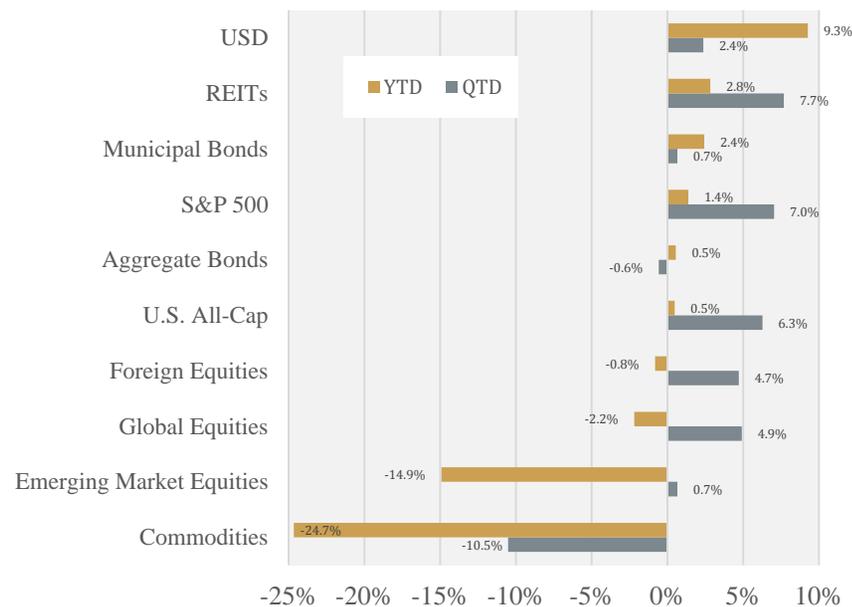
# Oil Market Update



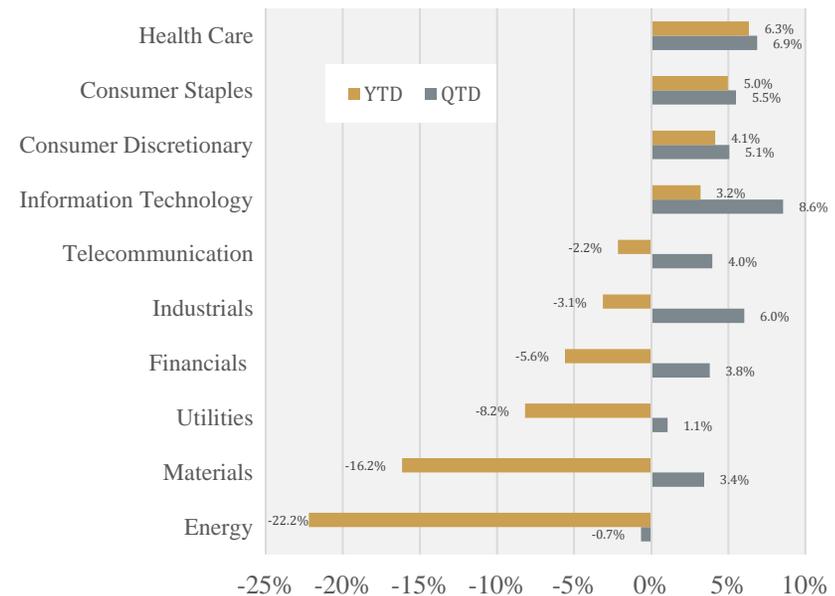
- Global demand for commodities has drastically slowed over the last several years, suppressing prices further in oil markets as well as other industrial commodities
- Commodity price headwinds can persist, driven by, for example, diverging monetary policy, additional supply in U.S. shale, incoming Iranian oil supply, and slowing global demand, particularly from China and emerging countries
- These imbalances tend to self-correct over time, stabilizing commodity prices and prices of commodity-linked assets

# Global Market Returns

## Global Asset Classes



## Global Equity Sectors

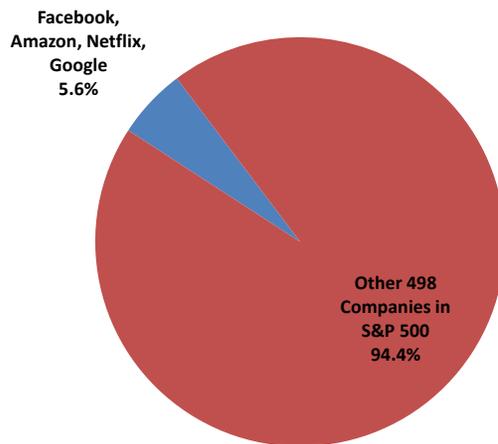


- Despite increased volatility in equity markets, U.S. large cap stocks ended the year in positive territory, rallying in the fourth quarter along with other global equities
- Significant dispersion occurred amongst asset classes and sectors, as accommodative monetary policies in the U.S. pare back
- While most asset classes were positive during the 4<sup>th</sup> quarter, commodities continued to slump on supply and global growth concerns

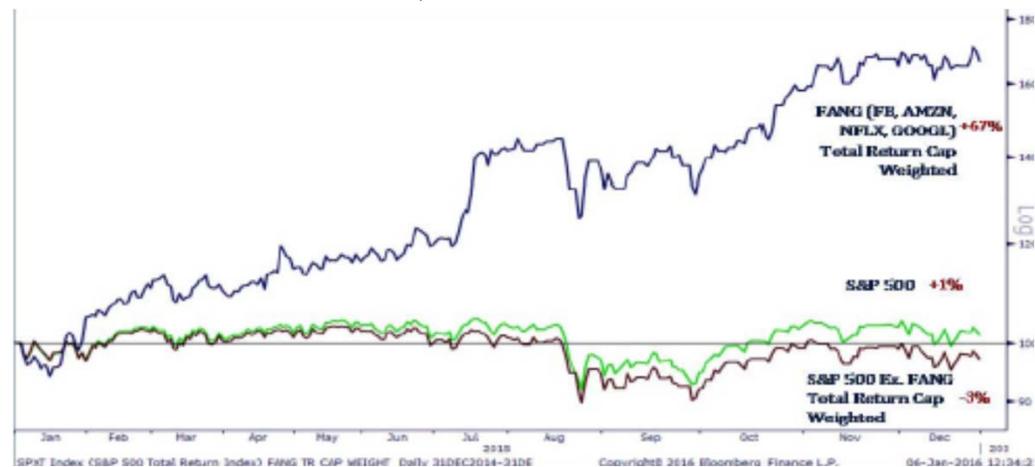
Indices used include the following: MSCI EAFE (Foreign Equities), Barclays Muni 5-yr (Municipal Bonds), ICE USD Spot (USD), Barclays US Agg (Aggregate Bonds), MSCI EM (Emerging Market Equities), MSCI ACWI IMI (Global Equities), Russell 3000 (U.S. All-cap), Bloomberg Commodity Index (Commodities), S&P 500 TR (S&P 500), FTSE NAREIT All Equity TR (REITs). Sector returns are from the MSCI All Country World Investable Market Index

# Top-Heavy Equity Returns

S&P 500 Weightings

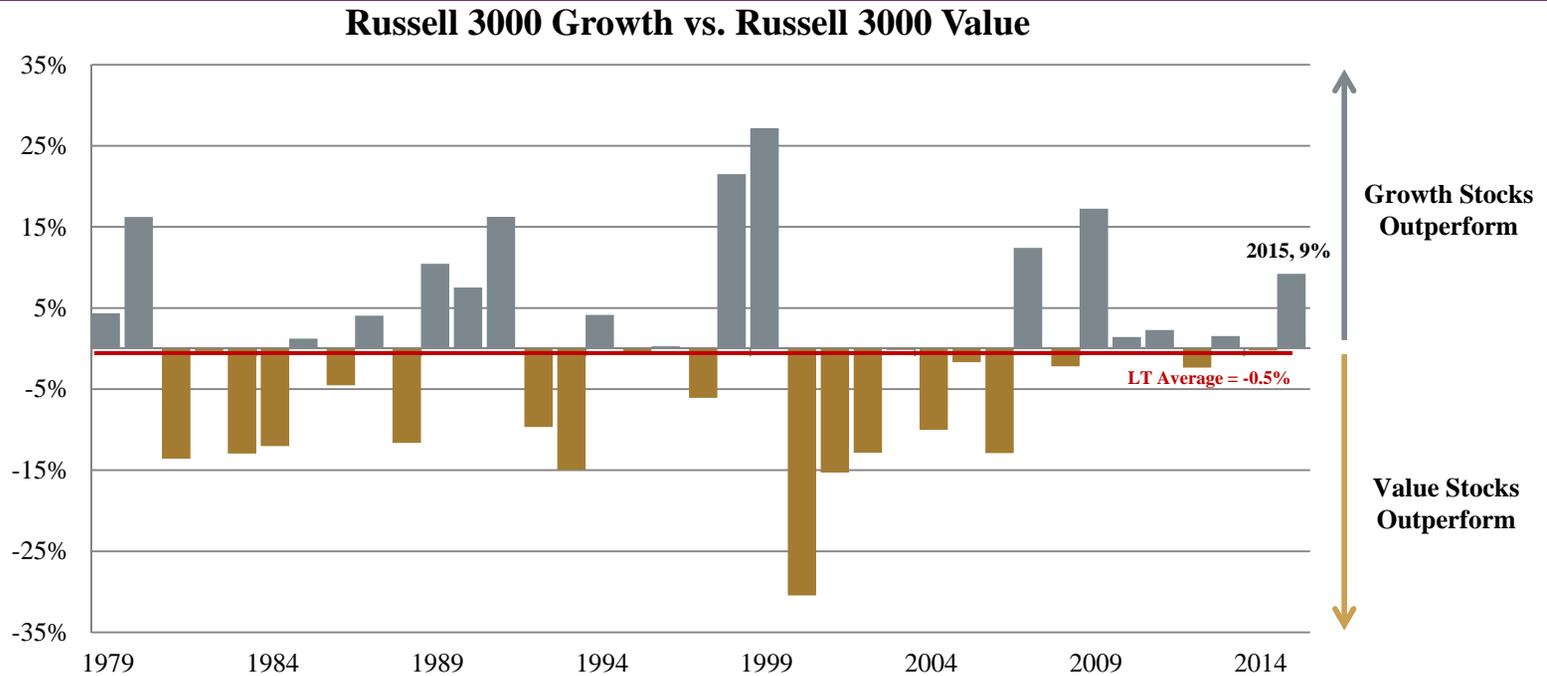


Total Return of FANG (FB, AMZN, NFLX, GOOGL), S&P 500, and S&P 500 Ex. FANG



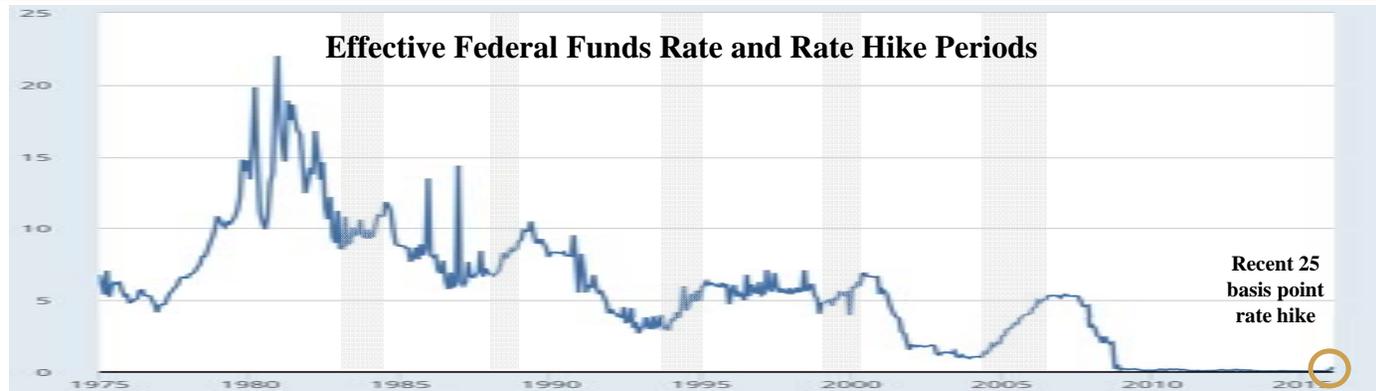
- U.S. large cap stocks, while ending the year in positive territory, relied almost entirely on four large growth-oriented stocks to prop up returns: Facebook, Amazon, Netflix, and Google
- After such outsized returns in 2015, these four companies comprise nearly double the index weighting than they did at the start of the year
- Narrow leadership in markets can lead to buying opportunities, as a much larger number of companies underperformed and may be trading at more attractive valuations

# Growth/Value Dispersion



- U.S. growth equities significantly outperformed value equities during 2015
- Dispersion between growth and value is common throughout history, but had not materialized post-financial crisis as the Fed's policies encouraged broad market equity index purchases
- Historically, these dispersions revert back to the mean and provide rich opportunities for active stock pickers as well as portfolio rebalancing

# Rate Hike Cycles



Interest rates of different maturities move unevenly during rate hike periods

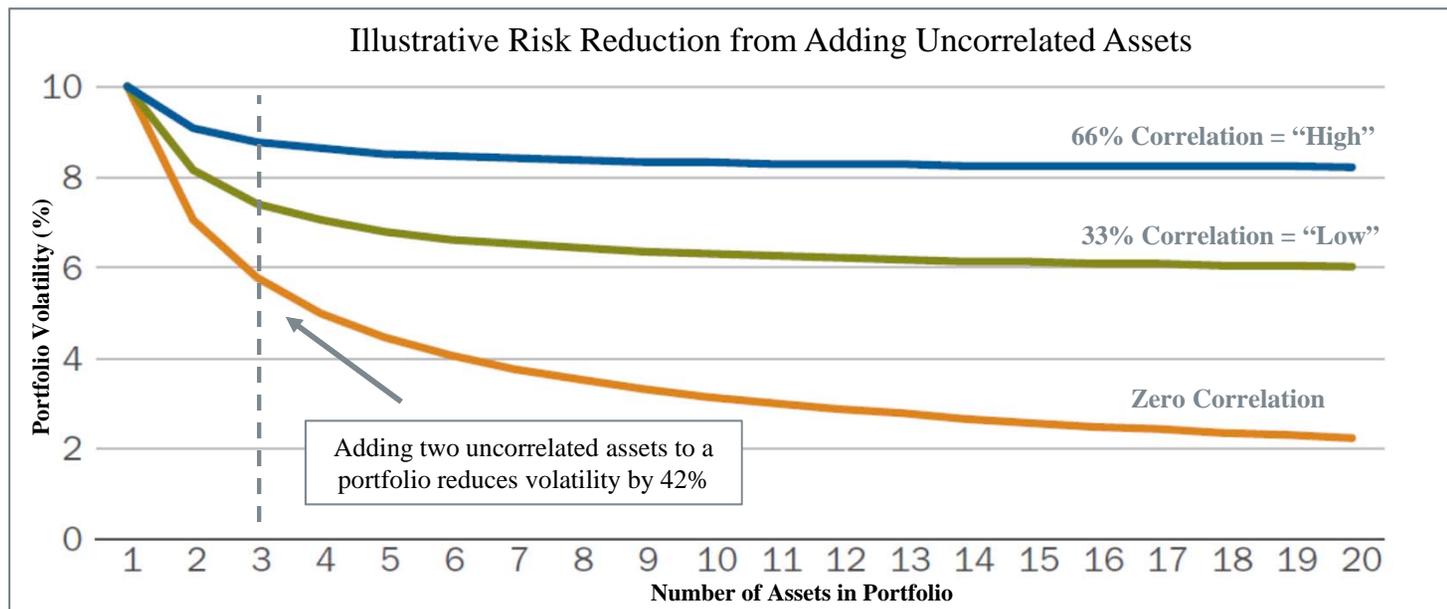
## Market reaction during previous rate hiking cycles

	May 1983- July 1984	March 1988- February 1989	February 1994- February 1995	June 1999- May 2000	June 2004- June 2006	Average
Change in Interest Rates (in percentage points)						
Federal Funds Rate	3.13	3.25	3.00	1.75	4.25	3.08
2-year Treasury	3.11	2.27	3.05	1.21	2.38	2.40
10-year Treasury	2.74	0.85	1.89	0.49	0.51	1.30

- While interest rates generally move in the same direction over longer periods, they rarely move with the same magnitude during rate hike cycles
- Over the last five rate hike periods, shorter-term rates have increased significantly more than longer-term rates, flattening the yield curve
- Fixed income portfolios diversified across maturities can provide downside protection during Fed rate-hike cycles, as income increases in shorter-term bonds and total return opportunities remain in intermediate and longer-term bonds

# Enhancing Diversification

Correlation is a statistical measure of how two securities move in relation to one another



- Traditional asset classes such as equities and fixed income have moved in very different return patterns historically, thus exhibiting low correlation to one another
- However, diversification can be greatly enhanced by adding other asset classes with low to zero correlation, like reinsurance, commodities or hedged strategies, improving the overall risk/return profile of a portfolio

## Investment Themes

- The narrow U.S. large cap market seen in 2015 provides an opportunity-rich environment for active stock pickers as many stocks trade at cheaper valuations than year-end 2014
- Value equity managers may outperform as investors sell fully priced growth stocks to purchase discounted value equities leading the growth-value dispersion to revert back towards the mean
- Traditional U.S. fixed income remains an important component within the Capital Preservation portion of investor portfolios despite Fed rate hikes
- Diversification of volatile, but uncorrelated assets, reduces the overall portfolio volatility and thereby protects the portfolio during times of market stress