January 2016

2015 - In the Rear View

This past year action in stocks felt more like 2011, when overseas tremors reached our shores. While 2015's ride was not as volatile as that of 2011, the S&P 500 did experience its first 10%+ decline in four years (St. Louis Federal Reserve). In both years, the benchmark index ended the year pretty much where it started. In 2015, the relentless drop in commodity prices hit the mining and energy sectors hard, large companies beat smaller companies, and U.S. stocks generally topped international equities.

While some of our core equity holdings like Amazon, Facebook and Netflix outshined the overall equity markets some of our recent purchases lagged behind due to volatility and global market uncertainties in their respective sectors.

In the bond market, expectations of an eventual Fed rate hike probably influenced yields in investment grade issues. But the sharp increase in junk bond yields, especially those with the lowest credit ratings--what I sometimes call the junkiest of the junk--were tied mostly to problems in the energy and mining sectors. We were able to weather this volatility relatively well due to our strategy of holding a diverse basket of bonds in various bond funds.

Our equity mutual fund portfolio also held up well in these volatile times with names like Buffalo Discovery Fund (Ticker: BUFTX) up 5.62 %, Columbia Contrarian Core Fund (Ticker: COFRX) up 3.09% while some names came under pressure due to their respective allocation.

Overall the equity market indices ended the year as follows:

Table 1: Key Index Returns

	2015 %
Dow Jones Industrial Average	-2.23
NASDAQ Composite	+5.73
S&P 500 Index	-0.73
Russell 2000 Index	-5.71
MSCI World ex-USA**	-5.44
MSCI Emerging Markets**	-16.96

Source: Wall Street Journal, MSCI.com 2015 returns: Dec. 31, 2014–Dec. 31, 2015
**USD

2016 – The Road Ahead

China

Lately, international events have played a role in hampering sentiment at home. A slowing economy in China provided just the right excuse for late summer's correction. China's rocky transformation from an industrial-based, infrastructure-driven economy to one that is more balanced remains a headwind to sentiment.

But keep in mind that U.S. exports to China account for less than 1% of the total U.S. economy (U.S. Bureau of Economic Analysis). Hence, it's hard to imagine a scenario where weakness in China pulls the U.S. into a recession.

The Rising U.S. Dollar

In my opinion a stiffer headwind for our exports is the rising U.S. dollar. As you already know, a rise in dollar makes our exports more expensive in foreign markets and thus directly have an impact on domestic corporate profits. Additionally, companies generating revenue in their overseas operations have to report back their earnings in US dollars making them look less attractive to its investors.

Even though the rising dollars creates a headwind for the US economy is the near term, I think in the long term it can become a great catalyst for the US financial markets. You see, the reason the dollar is rising is because economies around the globe like China, Europe & Japan are struggling with issues of their own. Thus investors who have previously enjoyed attractive returns in those markets are now starting to pull out. I believe that those funds would eventually make their way into the financial markets in the United States. If this is true, it can become a great catalyst for a long term bull run in equities.

Nonetheless, we continue to keep a close eye on this key economic indicator for further development.

The Falling Oil Price

Many of us are being treated to the lowest gasoline prices in years. But consumers are benefiting at the expense of producers, and not just the big oil companies. Sharp cutbacks in capital spending in the energy sector, coupled with layoffs, are hampering manufacturing. Yes, low oil and commodity prices help keep inflation in check, but again, that's creating big problems in the energy and mining sectors.

The fall in oil price also creates grave danger in the junk bond market where bonds issued by oil producers and refiners have started to price in the chance of default. While this is troublesome for investors of individual bonds, we have been partly insulated due to the strategy of diversifying our investment in a baskets of bonds through bond funds.

Additionally, it is important to keep in mind that oil and the commodities are going through an economic cycle. While oil is down today, it will eventually find a reasonable bottom and start to move back to a balanced level.

The Historic First Week

The discussion of 2016 cannot be concluded without the mention of the first week of this year. The sharp decline in the stock market in the past 2 weeks is no mystery. The fact is that the first week of January 2016 has been the worst first week of the year in history.

As bad as it may be, history has shown us that a bad first week of a year is not a very good predictor of how the year will end for the financial market. As you will see in the table below, a bad first week has only 50% odds of resulting in a negative annual return for the S&P500.

Worst Starts To A Year For S&P 500				
Date	SPX	Return after 4 days	Return Rest Of January	Return Rest Of Year
1/7/2016	1943.09	-4.93%	?	?
1/6/2000	1403.45	-4.48%	-0.64%	-5.93%
1/7/1991	315.44	-4.48%	9.03%	32.22%
1/6/1978	91.62	-3.66%	-2.59%	4.90%
1/7/2008	1416.18	-3.55%	-2.66%	-36.22%
1/7/1982	118.93	-2.95%	1.24%	18.25%
1/5/1962	69.66	-2.64%	-1.18%	-9.42%
1/6/1955	35.04	-2.61%	4.54%	29.79%
1/7/1969	101.22	-2.54%	1.77%	-9.05%
1/6/1977	105.02	-2.27%	-2.85%	-9.45%
1/6/2005	1187.89	-1.98%	-0.56%	5.09%
1/7/1985	164.24	-1.79%	9.37%	28.64%
1/5/2001	1298.35	-1.66%	5.21%	-11.57%
1/5/1934	9.81	-1.60%	13.86%	-3.16%
1/7/2015	2025.90	-1.60%	-1.53%	0.89%
		Average	2.36%	2.50%
		Median	0.34%	-1.13%
		% Higher	50%	50%

In fact it is not even a good predictor of how the January will end.

The Bottom Line

Thus I suggest that we maintain the position of taking no knee jerk reaction to this historic move. Instead we should choose to stay the course of maintaining a well balanced portfolio based on your specific needs and risk tolerance.

Upon completion of the month of January, we can more diligently access the longer term technical outlook of the financial market and if warranted tweak our strategy to hedge ourselves for further downside over the remaining part of the year.

I hope you've found this review to be educational and helpful. Let me emphasize, it is my job to assist you! If you have any questions or would like to discuss any matters, please feel free to give me or Gina a call.

As we enter 2016, I want to say once again that I'm honored and humbled that you have given me & Gina the opportunity to serve as your financial confidants and advisors.

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Disclosures:

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