Independent Wealth Management

Market & Economic Review

A Quarterly Publication | Historical Perspectives | 3rd Quarter 2015

3Q15 Benchmark Returns

	3Q	YTD
Equities		
S&P 500 Total Return Index	-6.4%	-5.3%
Russell Index 1000 w/Dividend	-6.8%	-5.2%
Russell Index 2000 w/Dividend	-11.9%	-7.7%
Russell Index 3000 w/Dividend	-7.2%	-5.4%
MSCI Developed EAFE (USD)	-10.7%	-7.4%
MSCI Emerging Markets (USD)	-18.5%	-17.2%
Alternatives		
Credit Suisse Hedge Fund Index	-1.1%	0.8%
DJ Wilshire Global REIT Index	0.3%	-5.3%
Credit Suisse Hedge Mgd Fut Index	1.5%	-2.7%
S&P GSSI Natural Resources Index	-19.5%	-22.9%
Barclays High Yield Bond Index	-4.9%	-2.5%
Fixed Income		
90 Day Treasury Bill	0.0%	0.0%
Barclays Muni Bond Index	1.7%	1.8%
Barclays Aggregate Bond Index	1.2%	1.1%
Barclays Global Bond Index	1.4%	-3.8%

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Third Quarter / Key Takeaways

Increasing concern about China's economy, accompanied by a surprise albeit modest devaluation of the yuan currency, helped trigger a sharp drop in global equity markets in late August, with the S&P 500 falling 12% from its high reached just a month earlier. The S&P 500 then bounced briefly from its August 25 low but dropped an additional 2.5% in September, ending the quarter down 6.5%. This marks the first negative quarterly return for the index since 2012.

Developed international stocks, as measured by the Vanguard FTSE Developed Markets ETF, also dropped 12% intraquarter, from high to low. For the quarter as a whole, they were down 9.7%. European stocks did a bit better, losing 8.5% in dollar terms and 7% in local-currency terms.

Emerging-markets stocks fared the worst, dropping 21% from their intraquarter high in early July to their low on August 24. For the quarter, the emerging-markets stock index was down 18%. That return includes several percentage points of losses to dollar-based investors from the continued depreciation of emerging-markets currencies against the U.S. dollar.

Given the broad negative environment for global stocks, let alone that much of the angst was driven by disappointing developments in China, it's not surprising emerging-markets stocks had the worst downside performance.

Moving on to the fixed-income markets, the core bond index gained about 1% during the U.S. stock market's 12% intraquarter drop. While this was strong relative outperformance versus most other (riskier) asset classes, with yields on core bonds so low (around 2.3%), their potential to generate strong absolute/positive returns over any meaningful time frame is very limited.

We believe that part of successful investing involves riding out these nervous markets, where prices are driven by short-term news and investor cycles of emotion, and staying focused on long-term fundamentals. We have positioned our broadly diversified portfolios to withstand a wide range of scenarios, and were satisfied to see the various elements of our balanced portfolios working as expected through the market downturn.

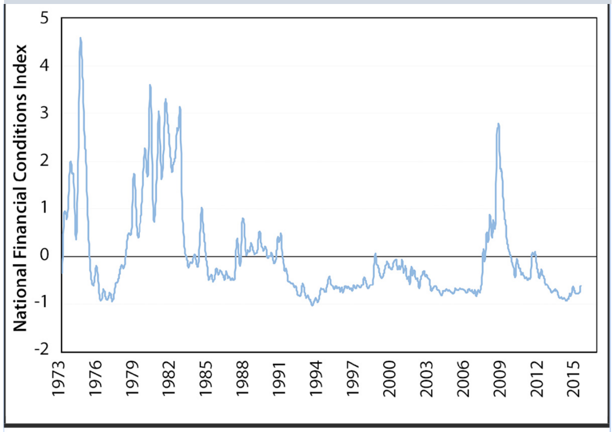
Third Quarter 2015 Investment Commentary:

The Big Question Looms for the October 28 FOMC Meeting

We weren't surprised by the volatility witnessed in the third quarter. But that's not to say we were predicting it would happen or what the triggers or catalyst might be. Short-term market predictions are a fool's errand, and history doesn't exactly repeat. But, knowledge of market history and cycles is useful for putting the present moment into context and thinking through different potential scenarios, risks, and investment opportunities.

The big question looming for the markets over the quarter was whether the Federal Reserve was going to raise interest rates for the first time in more than six years. Ultimately, the Fed decided to hold off on a rate hike, citing that "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." Fed Chair Janet Yellen pointed specifically to the recent developments in China and emerging markets as factors that gave them pause. She also noted the "tightening of financial conditions" due to stock market declines, a stronger dollar, and wider credit spreads since the FOMC's last meeting. Thirteen out of the 17 Fed policy makers indicated they expect to raise rates at least once this year, with six of the 13 expressing a preference for two rate hikes. So on to the October 28 FOMC meeting, when we can go through this all over again!

Financial Conditions Have Tightened in Recent Months, But are Still Relatively Low



Source: Federal Reserve Bank of Chicago. Data as of 9/18/2015.

Impact of Market Volatility on our Asset Class Views and Portfolio Positioning

U.S. Stocks: The market decline made future returns for U.S. stocks look incrementally better. However, valuations appear to be still stretched and earnings are well above normalized levels for a variety of reasons (e.g., due to unsustainably high profit margins). Earnings estimates also continue to decline.

Developed International Stocks: We continue to have a positive view of European stocks. We believe European stock valuations are more attractive than those of U.S. stocks, while European corporate earnings are well below normal (unlike in the U.S. where earnings are well-above their long-term trend).

Emerging Markets: After recent declines in emerging-markets stocks, we now view them as more attractive, to varying degrees, than U.S. and European stocks. This means we believe the risk/reward of adding to emerging-markets stocks is now attractive if appropriate to a clients' risk tolerance.

Investment-Grade Bonds: The events of the latter part of the third quarter did not lead to any material changes in our fixed-income asset class views. We still maintain exposure to core bonds in our portfolios because of the risk management role they play—smoothing overall portfolio volatility and mitigating some of the downside risk of owning stocks in the event of a global growth scare, recession, or worse.

Concluding Comments

The reality of owning stocks is that occasionally, inevitably, we will experience bear market losses. This underscores the importance of our risk management, in which we seek to reduce our balanced portfolios' vulnerability to stock market downturns through strategies that include owning "insurance" assets such as bonds and lower-risk alternatives. Another key ingredient in managing through bear markets is helping our clients accurately assess their risk tolerances and investment objectives. If you are in an appropriately structured portfolio, there is no benefit to selling in a market downturn. In fact, by doing so you risk selling nearer to the bottom and then missing the subsequent recovery. We are likely to view such downturns as potential buying opportunities.

As always, we thank you for your continued trust and confidence as we work together to achieve your financial goals.

INDEPENDENT WEALTH MANAGEMENT