INDEPENDENT WEALTH MANAGEMENT

# Market & Economic Review

IWM

A Quarterly Publication | Historical Perspectives | 4th Quarter 2015

## 4Q15 Benchmark Returns

| | 4Q | YTD |
|---|---|---|
| **Equities** | | |
| S&P 500 Total Return Index | 7.0% | 1.4% |
| Russell Index 1000 w/Dividend | 6.5% | 0.9% |
| Russell Index 2000 w/Dividend | 3.6% | -4.4% |
| Russell Index 3000 w/Dividend | 6.3% | 0.5% |
| MSCI Developed EAFE (USD) | 4.4% | -3.3% |
| MSCI Emerging Markets (USD) | 0.3% | -17.0% |
| **Alternatives** | | |
| Credit Suisse Hedge Fund Index | 0.7% | 0.2% |
| DJ Wilshire Global REIT Index | 4.5% | -1.1% |
| Credit Suisse Hedge Mgd Fut Index | 1.2% | 1.3% |
| S&P GSSI Natural Resources Index | -1.8% | -24.3% |
| Barclays High Yield Bond Index | -2.1% | -4.5% |
| **Fixed Income** | | |
| 90 Day Treasury Bill | 0.0% | 0.0% |
| Barclays Muni Bond Index | 1.5% | 3.3% |
| Barclays Aggregate Bond Index | -0.6% | 0.5% |
| Barclays Global Bond Index | -1.1% | -4.8% |

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## Fourth Quarter / Key Takeaways

**2015 was a poor year for financial markets across the globe and across asset classes (stocks, bonds, commodities, etc.). Among the major global stock markets, the United States was the best performer, but that's faint praise given the S&P 500's 1.4% return. What's more, it was a market in which a handful of large tech/Internet companies (e.g., Facebook, Amazon.com, Netflix, and Google) generated huge gains and helped propel the index into positive territory, while the equal-weighted S&P 500 index actually *fell* -2.2% for the year.**

**One striking feature of last year's investment environment was the difference in the direction of the U.S. economy and U.S. monetary policy versus other major global economies. In December, the U.S. Federal Reserve was sufficiently comfortable with the outlook for economic growth and the potential for inflation to eventually normalize that it made its first increase in rates in nearly a decade.**

**Outside the United States, regaining more normal economic growth and inflation has remained more challenging. Sharply lower commodity prices (most notably oil), Middle East tensions, and China's slower economic growth all weighed on foreign stock market returns. Developed international stocks ended the year down 0.4% while emerging markets fared worse, falling -15.8%.**

**As in 2014, the strength of the dollar exacerbated foreign markets' underperformance for dollar-based investors, detracting 9% from emerging-markets stocks and 6% from developed international stocks compared to their local-currency returns.**

**The worst-performing areas of the markets were commodity-related asset classes. Commodity indexes were crushed, down on the order of -25% to -30% as oil prices hit an 11-year low in December and fell 30% for the year, after plunging 50% in 2014. Energy MLPs, an increasingly popular vehicle for yield seekers (and yield chasers), dropped -35% to -40%, wiping out the previous four years' worth of gains.**

**Fixed-income offered little respite, with the core bond index gaining just 0.3%. High-yield bonds fared worse, down close to -5%, while floating-rate loans lost -0.7%. Investment-grade municipal bonds were a relative bright spot, with the national muni bond index up nearly 3% on the year.**

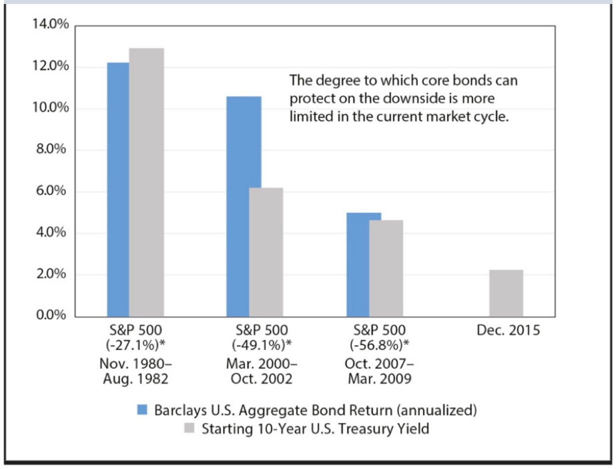
## Fourth Quarter 2015 Investment Commentary:

### Staying the Course: a Critical and Difficult Discipline

Overall, 2015 was a challenging year for the financial markets in general. In this month's commentary, we thought it would be instructive to break the portfolio down into two categories of investments that highlight their different roles: longer-term return generators (higher risk assets); shorter-term risk reducers (lower risk assets); Understanding how we employ the various types of investments we own in our client portfolios should help in setting reasonable expectations of how they will perform.

**Longer-Term Return Generators (higher risk assets):** These are investments or asset classes that we own because of their ability to generate longer-term growth of capital, well in excess of inflation. U.S., developed international, and emerging-markets stocks are our portfolios' primary long-term return generators. However, we expect them to have higher shorter-term volatility and significant downside risk.

**Bond Returns During Recent Equity Bear Markets**




*Source: Morningstar Direct. Data as of 12/31/2015. *Cumulative price return during the period.*

**Shorter-Term Risk Reducers (lower risk assets):** To mitigate the shorter-term uncertainty, volatility, and downside risk that comes from owning stocks, our portfolios also have exposure to core investment-grade bonds. If there is a recession or economic shock that leads to increased risk aversion among investors, core bonds have historically performed well in absolute terms (generating solid gains) and very well relative to riskier assets like stocks that may be down -20% to -30% or more. We'd expect a similar performance pattern this time around if and when stocks fall into a bear market. So core bonds have a very important risk-management role, particularly in our more conservative portfolios. However, given the very low current yield and our expectation for returns in the 0% to 2% range over the next five years, the degree to which core bonds can limit the downside during the current market cycle has been significantly reduced. This past year was a good example of this, with core bonds barely positive while global stocks were negative.

## Concluding Comments

Portfolio performance in 2015 was disappointing,however, it is in the nature of our long-term, fundamental, valuation-driven investment approach to go through periods of subpar performance. It is exactly during these challenging periods that it is most critical, but also most difficult, for an investor to stick with their approach and remain disciplined in order to ultimately harvest the long-term rewards.

We believe our portfolios are well positioned for the long-term, but we think it is prudent to be prepared for potentially increased market volatility and downside risk (as well as positive returns) over the shorter-term. We may even get the opportunity to add to our undervalued positions or establish some others before this market cycle turns. In other words, we believe the key to successful investing ahead is to maintain the healthy patience, perspective, and discipline necessary for long-term investment and financial success.

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