Commentary – January 1, 2016

A bull market is defined as a period in which asset prices are rising and investors are optimistic, confident that their prosperity will continue. Casual readers of the Wall St. Journal, therefore, might have inferred that 2015 was a good year for stocks after seeing its December 31st front page headline proclaiming "Once again, oil and China test U.S bull run". Even those who bothered to read the accompanying article might have deduced that the past year was a positive one, albeit with issues, as the piece concluded "against this backdrop, investors should be relieved if the U.S. bull market survives another year". Yet the two major domestic stock indices, the S&P 500 Index and Dow Jones Industrial Average, posted declines of 0.7% and 2.2%, respectively, for the first time since the financial crisis. These slight losses may be deceiving, as the average S&P 500 index name was down almost 4% and, as of December 28th, 30% of the stocks in the S&P 500 were down 20% from their respective highs. This underlying weakness was even worse elsewhere: 37% of the issues in the S&P 400 Midcap and 46% of those in the S&P 600 Small Cap are in bear market territory. (Bespoke Investment Group Barron's January 4th, 2016) With regards to investor sentiment, I am hard pressed to find anyone in the financial media predicting happier days head, with some pundits downright gloomy:

"future returns will most likely be lower than in the past" Burton Malkiel - WSJ December 31st
"base case is for a "blah" year, with risks skewed for something worse" John Authers - FT January 2nd.
"not a lot to get enthusiastic about, and a long list to be worried about". Margie Patel - WSJ January 2nd.

I would assert that the Wall St. Journal's use of the term "bull market" in the context of this past year's performance and the prevailing opinion for 2016 was a poor one.

Much of what happened in 2015 can be traced to significantly lower energy prices. The falling price of oil affected its own sector as well as the broad market, as energy companies within the S&P 500 lost nearly ¼ of their value. (NY Times January 1st). Global demand for oil grew in 2015 but not nearly fast enough to keep pace with supply. Oil reserves surged as the U.S. supplanted Saudi Arabia and Russia as the world's largest producer in 2015. Iraq's production came back on line and Iran is expected to flood the market with its oil once sanctions are lifted. A barrel of oil has fallen to $36, its lowest level since 2004, continuing a record decline from over $100 in June 2014. (NY Times January 1st) As prices decrease, producers are supposed to cut back (Economics 101 – Any University) but no one, especially OPEC, wants to cede market share.

Another important event was the Federal Reserve Bank's decision to raise interest rates for the first time since the financial crisis in 2008, a move it described as a vote of confidence in the U.S. economy. The widely anticipated announcement, made on December 18th, signals the beginning of the end of the central bank's stimulus program. Despite the Fed's aggressive efforts to spur the economy, which included a quantitative easing program of buying Treasury securities, the experiment has yielded mix results, delivering neither the vigorous expansion intended nor the disasters its detractors feared. Fed officials emphasized that they will hike rates gradually, and only if growth continues, predicting that short term rates will rise by 1% a year for the next 3 years.

A view of the current situation in the global capital markets does not lend itself to predicting a bright year ahead, with pockets of weakness everywhere, shrinking corporate profits and a rising interest rate environment. Neither I nor anyone else, however, knows what will happen in 2016. The best way to proceed, as always, is to invest when assets are trading at reasonable prices, diversify, re-balance, and maintain a long term perspective.

I invite and encourage clients to contact me with your questions and/or concerns and am available to meet at your convenience.
