An Inauspicious Start

At the risk of being obvious, 2015 was marked by volatility. We saw new highs and also double digit declines on the major indices. When it was all said and done, US Equities finished with a return of -2.5% with contributions as follows: S&P 500 returning ~1%, DJIA returning -2.25% and NASDAQ returning 5.7% …International Equities had an aggregate return of -9.5% with contributions as follows: Emerging market -18% and Developed International -3.5%. The biggest loser was the Goldman commodity index with a return of -34%.

Volatility is a normal characteristic for the capital markets. We expect it and prepare for it. One of the hallmarks of our practice is managing cash flow. We spend a great deal of time investigating both our clients’ capacity to save in a given year or their portfolio income needs. Investors in the accumulation phase of their financial life benefit by deploying resources and leaning in to embrace the opportunity that down days afford in buying securities at lower prices. Investors in the harvesting phase of their financial lives must apply the opposite discipline. Establishing annual cash flow needs, maintaining cash reserves and raising cash opportunistically are critical to financial success in retirement, particularly during times of volatility. Reacting to declines with fear and extracting money during market turmoil is destructive to portfolios growth and income needs. For these reasons, we approach all portfolio construction and management through the cash flow lens.

The best that can be said about the performance of the capital markets in 2015 is resiliency. Earnings for the S&P 500 were lowered 5% from the start of the year, due to the ~50% decline in the price of oil and evaporation of profits associated with a sector that represents 8% of the S&P 500. Our forecast last year called for energy to be a major theme and risk and it bore out to be true…Who would have believed that last year when we wrote about the price of oil dropping 50% that it would be cut in half again…Crude closed 2015 at $37 per barrel. The price of oil will be a major theme for 2016 as well.

Head winds for 2016 are plentiful, including: rising interest rates, low domestic growth, slowing growth in China coupled with greater transparency, geo-political unrest in the Middle East and commodity price deflation. Despite the dour tone, there are always pockets of opportunity in the capital markets and 2016 is no different.

Value oriented, dividend yielding securities in all asset class size are a focal point in 2016. Expectations for earnings growth are low, making dividends the primary source of returns. Fixed income markets (bonds) will continue to be a wild card. They are no longer a safe place to hide or a source of stability for investors. Regardless, they remain an appropriate part of diversified portfolios, but their role is different than the last 3 decades. Alternative fixed income remains a key to our overall strategy. While we remain vigilant in assessing
the role of REITs and preferred securities, they continue to offer value and returns. Additional asset classes and sectors that we see as opportunities in 2016 include reinvestment into energy. Managed futures are a possible add both for returns and to potentially mitigate risk and volatility.

Most importantly in this yearend review and New Year forecast, we want to offer context to think about your portfolio against the back drop of 2015 and an inauspicious start to 2016. We manage your finances with three tenets in mind: Secular, Cyclical and Technical portfolio construction and management. The Secular tenet drives the long term mandate of your needs: 10-30 years. Are you accumulating or harvesting over most of that time? Are you 30, 50, 70 or somewhere further out or in-between? We take this into consideration first in building a strategy for you. We overlay a Cyclical band which is 3-10 years. It accounts for where we are in the business cycle: expansion, contraction, recession, recovery. Finally, we employ a technical filter: 1 year or less. This drives whether we are on offense or defense in deploying or extracting money from the capital markets. It is as much art as science. Nonetheless, you can feel confident that we are vigilant on all three fronts every day!

It is our opinion that we remain in an economic expansionary period, but a mature place in the business cycle. We feel that positive returns will be lower and also that the market will be more volatile. Bull markets have been known to last 10 or more years, with this current “bull run” having begun in 2009. We endured two down years of performance over that time: 2011 and 2015. The economic back drop is as mixed as it always is: low unemployment, a stable and growing housing market but rising interest rates and an unstable energy market are just a few of the cross currents. We believe in the resiliency of the capital markets and the US economy in particular. So, we approach this New Year with a realistic expectation that we will be able to grow your portfolios and provide the income that you need this year and beyond.

We remain incredibly grateful for your trust, confidence and patronage and look forward to meeting with all of you this year to catch-up on your families, plan for your future and discuss your challenges and opportunities. Happy New Year!