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Fourth Quarter 2015 Market Summary

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Fourth Quarter 2015 Market Summary

Although equity returns during the fourth quarter of 2015 were strong, the year finished relatively flat to negative. U.S. large caps, represented by the S&P 500, ended up just over 1% on the year while most other U.S. equity and global equity markets were down anywhere from 2% to 15%. Overall, equities posted their worst return since 2011, a similar period with global growth concerns and macroeconomic risks.

Equity market leadership during 2015 was narrow as only a few sectors and more specifically, a few stocks, were responsible for the 1% return in the S&P 500. Nine of the top ten contributors to the S&P 500's performance were growth oriented companies, which helped the S&P 500 Growth Index strongly outperform the S&P 500 Value Index by 8%. Additionally, larger company stocks strongly outperformed smaller company stocks during the year.

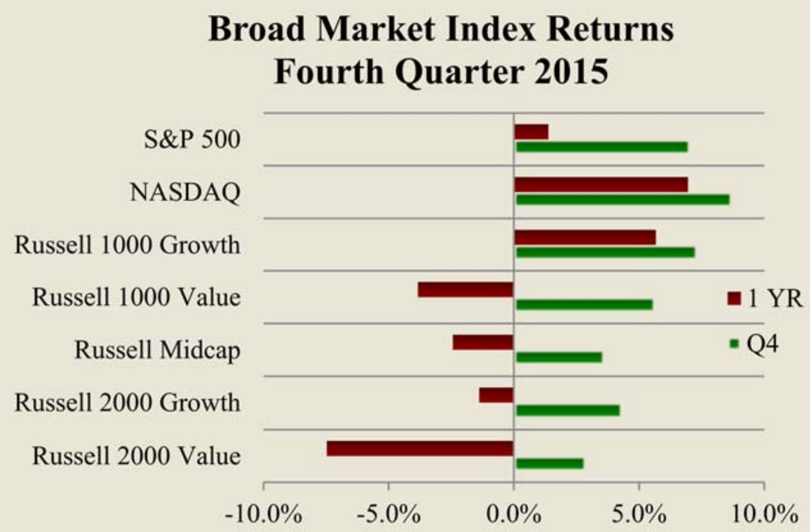
International equities were some of the worst performing stocks during the year as the markets digested weak economic data in Europe, China's slowing economy, lower commodity prices and weak currencies. Emerging market equities were hit especially hard due to the appreciation of the U.S. dollar and the negative impact on commodity prices as a result of oversupply and weaker global growth.

For the first time since 2006, the Federal Reserve increased the fed funds rate in December by 25bps. The rate hike did not have a large impact on the fixed income market in the fourth quarter. Short to intermediate term Treasury rates increased marginally. However, longer term interest rates remained unchanged due to economic concerns around the world. Credit spreads widened in the second half of the year leading to negative returns in investment grade corporates and high yield bonds.

While long-term equity returns have averaged 9 – 10%, as measured by the S&P 500 from 1965 – 2015, it is unrealistic for investors to anchor their annual expectations on this average. Equity markets are volatile and unavoidably go through periods of higher and lower returns. For instance, from 2000 – 2009 the S&P 500 returned on average negative 0.95%. On the other hand, from 2009 – 2014, the S&P 500 returned on average 17.2%. Since we know equity markets can experience very wide deviations in annual returns, most investors are not willing to accept the level of risk associated with an all equity portfolio. Therefore, an allocation between equities and fixed income instruments is typically utilized to assist in the management of risk. However, even fixed income instrument returns in 2015 were well below their longer-term average.

A diversified portfolio of approximately 40% fixed income instruments and 60% stocks has historically averaged an 8 – 9% annual return with almost 40% less volatility than an all-equity portfolio. However, with both the equity and fixed income market returns for 2015 being so far below their historical average, diversified portfolios inevitably fell below their historical average. Outside of recessions, diversified portfolios have historically had few years with returns as low as in 2015.

Over the next year, portfolio returns will be highly influenced by which direction the global economy goes in 2016. Fixed income markets are already pricing in a large slowdown in economic growth as credit spreads, a measure of perceived credit risk, are at prior recession levels. This volatility, largely triggered by deflationary commodity prices and concerns in China, has moved into the equity markets as we have started the year. Actually, the S&P 500 just finished the worst first trading week of a new year in history. While last Friday, the U.S. payroll report showed 292,000 jobs were created in December, well ahead of expectations. We believe these types of mixed signals will continue into the year without any clear direction one way or the other, resulting in likely increased market volatility



HIGHLIGHTS

MACROECONOMICS

- The Bureau of Economic Analysis released the third estimate of third quarter 2015 real GDP, an annual rate increase of 2.0% from the preceding quarter. While unimpressive, GDP continues to show slow growth in the economy.
- The University of Michigan Consumer Sentiment Index final reading for December was 92.6, which was an increase from November and the previous quarter. Consumer sentiment remains high despite flattening out during 2015.
- The ISM Manufacturing Index decreased during the quarter from 50.2 in September to 48.2 in December. The ISM Index has trended down since the end of 2014 as manufacturing has struggled. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- In December, the Conference Board Leading Economic Index decreased 0.2% month-over-month to 123.7. The Index has been increasing gradually over the past year showing steady slow growth in the economy.
- The price of WTI Crude Oil was $37.13 at the end of December, which is 17.6% lower than $45.06 at the end of September. The price of Brent Crude Oil decreased 22.6% in the quarter to $36.61. The price of oil has been volatile as the supply and demand dynamics are being affected by a weaker than expected global economy and a market share battle among U.S. shale companies and OPEC members.
- In December, headline CPI increased 0.7% year-over-year, up from an increase of 0.2% in September. Core CPI, which does not include food and energy, had a 2.1% increase. Inflation levels have remained low over the past year and have been less than historical averages and the Fed's 2% inflation target.

HOUSING

- Preliminary existing home sales decreased in December with an annualized rate of 5.46 million units from 5.55 million units in September. However, the December annualized rate is 7.7% higher than the 5.07 million units in December 2014. Home sales have been strong throughout 2015.
- Median existing home sale prices decrease during the quarter. However, the preliminary prices for December were 7.6% higher than the levels of one year ago and have been trending up since the beginning of 2012.
- New home sales decreased during the quarter with a seasonally adjusted annual rate of 490k homes sold in November versus 507k in August. Home sales have rebounded from the lows of May 2010, when 280k new homes were sold. The past few months' new home sales growth have accelerated on a year-over-year basis.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose 5.6% year-over-year in October.

EMPLOYMENT

- The labor market improved during December as nonfarm payrolls added 292,000 jobs in the month which was much higher than expectations. Nonfarm payrolls rebounded strongly in the fourth quarter, averaging 284,000 jobs added per month versus an average of 174,000 jobs per month in the third quarter.
- The unemployment rate fell to 5.0% from 5.1% during the quarter.
- Initial Jobless Claims have been decreasing since 2009 and dipped to lows last seen in 1999.

DOMESTIC CORPORATIONS

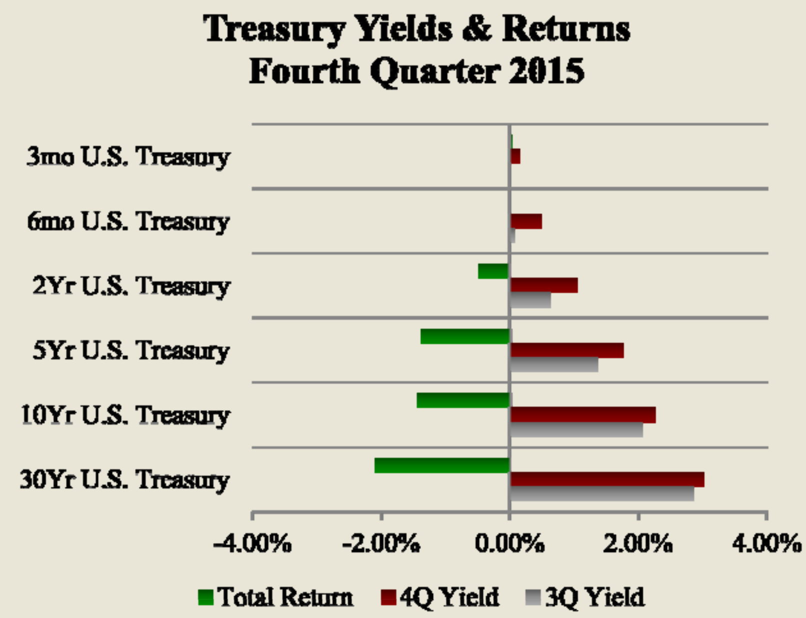
- Corporate operating earnings rebounded in the fourth quarter as the energy sector posted positive earnings following three negative quarters. Lower oil prices and weaker foreign currencies will continue to affect earnings over the coming year. Operating margins have retreated from highs but remain well above historical averages.
- Forward and trailing P/E multiples are near or above historical averages.
- The U.S. dollar reaccelerated its appreciation vs. major currencies after remaining flat for much of the year. Multinationals have seen their earnings pressured due to their international exposures.
- The price of oil has continued to decline over the past year as a new supply/demand equilibrium is trying to be established. The price decline has significantly hurt energy companies as many companies have seen their market capitalization reduced by over 75%. Lower prices should help other sectors that use oil as an input; however, we have not seen large benefits flow through yet.

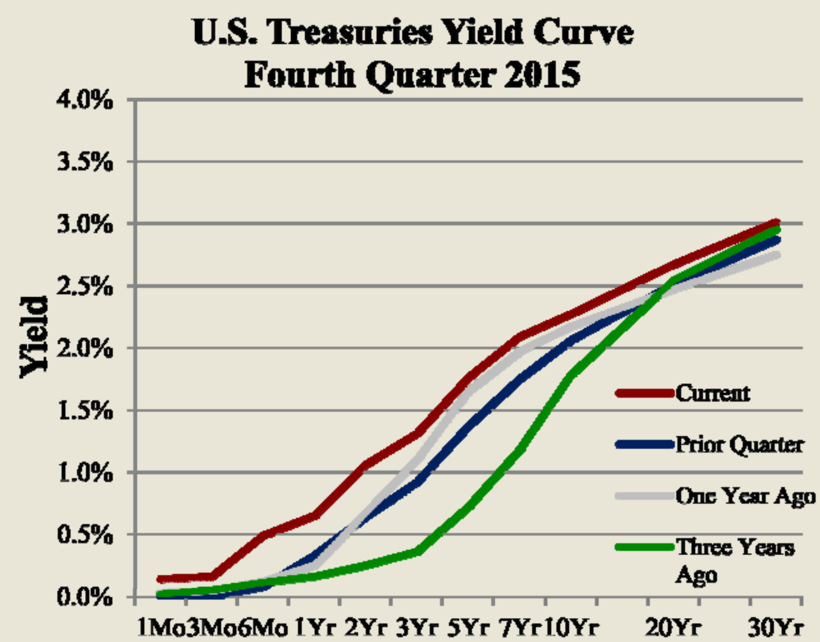
FED POLICY

- In December, the Federal Open Market Committee (FOMC) announced they would raise the federal funds rate by 25bps to 0.25% - 0.50%. This was the first increase in the fed funds rate since 2006. In their statement, the Fed noted the economy is expanding moderately and they expect to gradually increase the federal funds rate.
- The Fed is forecasting they expect to raise rates four times during 2016. However, many investors feel the economic data currently only justifies one or two rate hikes during the year. Investors will be looking for a pick up in the manufacturing sector while maintaining relatively good consumer spending.

FIXED INCOME

- The yields on longer-term Treasury securities increased quarter-over-quarter; however, yields on shorter-term Treasury securities increased even more causing the yield curve to flatten.
- On a historical basis, the yield curve is relatively steep due to the Fed holding down short term rates. A steep curve indicates market participants are not concerned about a recession over the next year. However, with the Fed beginning to raise the fed funds rate, the short end of the yield curve will likely increase more than the long end of the curve, causing further flattening. Short term interest rates are controlled or heavily influenced by central banks where as long term interest rates are controlled by market forces and economic growth.



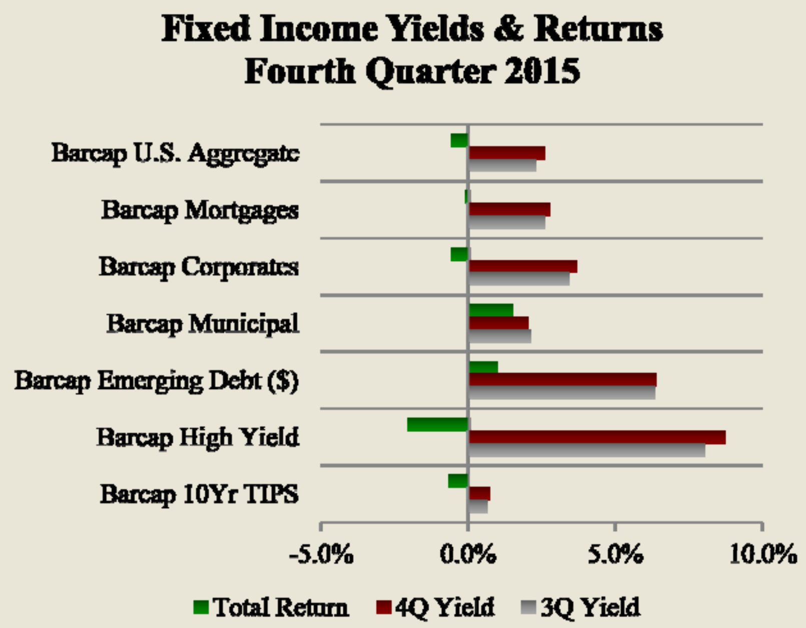


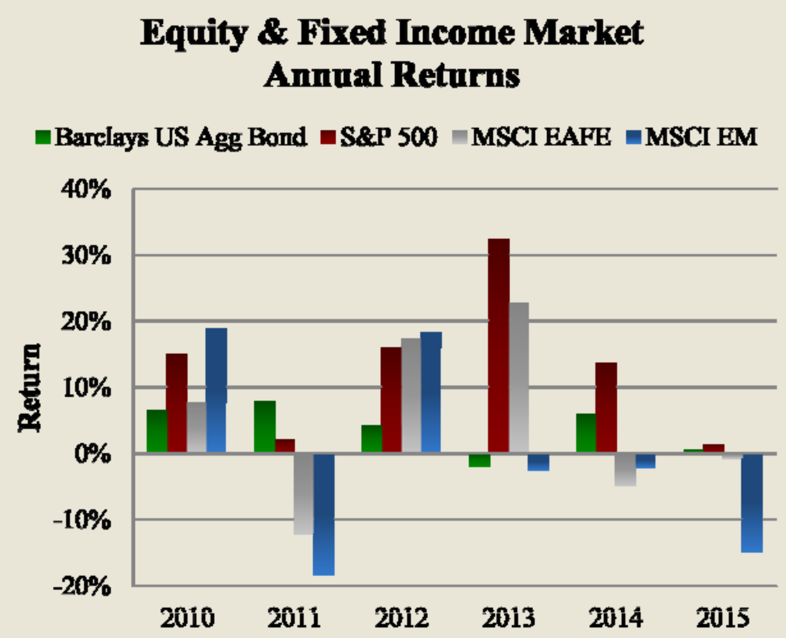
FIXED INCOME (continued)

- Yields in more credit sensitive fixed income sectors increased during the quarter as spreads widened. Returns were mixed across sectors with high yield continuing to post negative returns while municipals was the best performing sector. The Barclays U.S. Aggregate was down half a percent as interest rates increased and credit spreads widened. For the year, fixed income performed well compared to equities.
- High yield spreads have widened out to levels last seen in 2011, which was a period where economic growth slowed and there were concerns over a double dip recession.
- Fixed income returns, going forward, are expected to be lower than historical averages as interest rates are starting at a very low level. Historically, future ten year fixed income annualized returns have been about equal to the 10 year Treasury yield at the start of the period.

EQUITIES

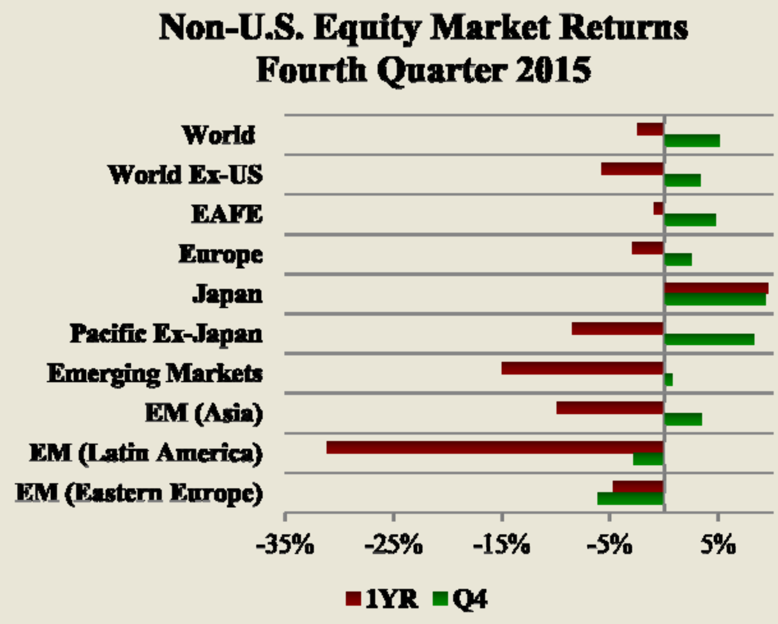
- Volatility in the equity markets increased during 2015 after being subdued over the past couple years. There was narrow market leadership in U.S. equities with only large cap growth companies posting positive returns. These positive returns were also concentrated in a few sectors, specifically health care and technology.
- Global growth is being questioned which is fueling the volatility. Europe is continuing quantitative easing to support their economy while China's government is intervening in their markets to combat slowing growth. However, one of the largest impacts on international and emerging market equity returns has been the strength of the U.S. dollar.
- After multiple very strong years for the equity markets, returns are expected to be lower as earnings growth remains sluggish and valuations are slightly higher than average. Volatility should continue as 2016 unfolds.





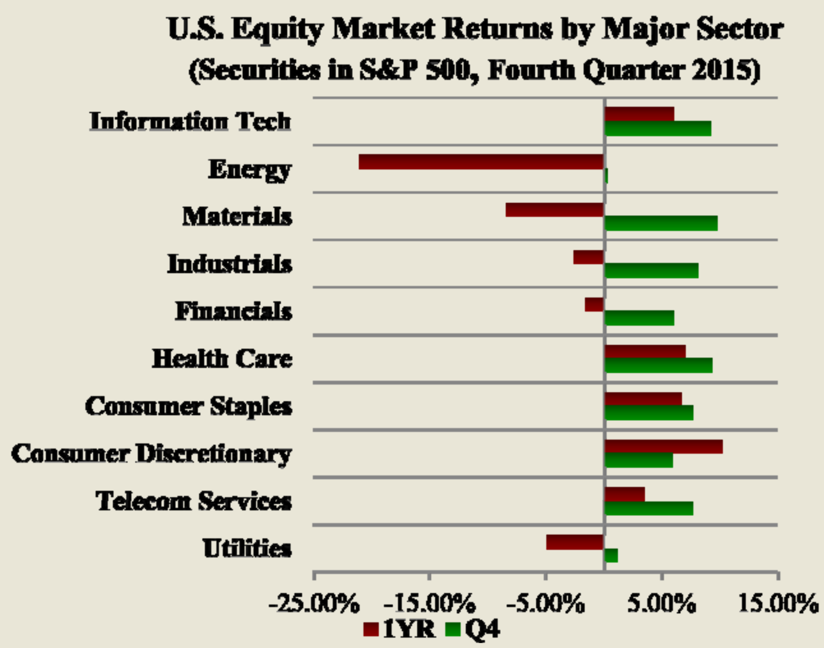
INTERNATIONAL EQUITIES (continued)

- Developed international stocks performed slightly worse than U.S. domestic equities. The MSCI EAFE index of international markets stocks increased 4.7% during the quarter. On a year-over-year basis, the EAFE is down 0.8%.
- During the quarter, emerging market stocks performed worse than developed markets and are down significantly on a one year basis. The MSCI Emerging Markets Index increased only 0.7% in the quarter and has a negative 14.9% return over the past year. Returns were greatly impacted by emerging market currency devaluations.
- Valuations are lower in developed international and emerging market equities than in the U.S.; however, many regions are trying to recover from economic slowdowns or are going through structural changes. Additionally, currencies, specifically the Euro and Yen, have depreciated considerably versus the U.S. dollar which has led to lower returns for U.S. investors in international equities.



DOMESTIC EQUITIES (continued)

- Domestic equities rebounded after a negative third quarter.
- The Russell 1000 Index of large capitalization stocks posted a total return of 6.5% during the quarter. On a year-over-year basis, the Russell 1000 Index has increased 0.9%.
- Small capitalization stocks, as represented by the Russell 2000 Index, posted a total return of 3.6% during the quarter. On a year-over-year basis, the index has declined 4.4%.
- Trends over the past year continued through the fourth quarter, energy continues to lag while technology and health care performed well. Sectors that are tied to global growth and manufacturing struggled during the year. Energy, materials, and industrials had negative returns. Despite struggles in the manufacturing segment of the economy, the consumer segment has held up relatively well.



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