January 5, 2016

The year in review: A flat finish doesn't tell the whole story

The domestic equity markets seemed to be telling investors a story about resiliency in 2015. Despite headline news, geopolitical and global economic concerns – particularly among China and emerging markets – as well as a challenging domestic market environment, the benchmark S&P 500 basically ended the year right where it started. The Dow Jones Industrial Avenue and the international MSCI EAFE lost a bit more ground. Only the NASDAQ held on to any gains since last January.

A look at the quarter-end numbers tells another part of the story, reflecting the impressive October rebound after a harrowing August and September. In fact, the three major domestic stock indices as well as the EAFE were up at least 4% (the NASDAQ, again, came out on top with an 8.4% gain) for the quarter ending Dec. 31. So, although a lot happened this year, there was little to show for it in terms of absolute stock market performance.

	12/31/14 Close	12/31/15 Close	Change	Gain/Loss
DJIA	17,823.07	17,425.03	-398.04	-2.23%
NASDAQ	4,736.05	5,007.41	271.36	5.73%
S&P 500	2,058.90	2,043.94	-14.96	-0.73%
MSCI EAFE	1,774.89	1,716.28	-58.61	-3.30%

Performance reflects price returns as of 4:15 p.m. EDT, Dec. 31, 2015.

It is interesting to note that four stocks, Facebook, Amazon, Netflix and Google were the primary drivers for the indexes. These four companies make up 20% of the NASDAQ and 5.5% of the S&P 500. They contributed +3.5% of the S&P's performance this year.

The further you get from a few Large Cap Stocks, the larger the negative numbers.

- Mid Cap Stocks were negative by 6.5%
- Small Cap Stocks were negative by 7.7%
- Micro Cap Stocks were negative by 11.3%

(Above Stats courtesy of FINVIZ.com & ZACKS)

But market performance is only part of the story. Over the past 12 months, we also saw job market improvements, low inflation, and declining oil prices – all of which spurred consumer spending.

Domestic demand was strong this year, but the combination of slowing global economies and a strong U.S. dollar may weigh on future exports, according to Raymond James Chief Economist Scott Brown.

Perhaps counterintuitively, the Federal Reserve's "will they, won't they" stance on raising the fed funds target rate rattled the equity markets more than the bond markets, which may have already priced in the inevitable rate increase. We did see the first tightening (25 basis points) at the December meeting, and further rate hikes may present a potential headwind in 2016. The Federal Reserve is expected to raise short-term interest rates gradually in 2016. Scott notes that officials are signaling an expectation of four rate hikes over the course of the year, one per quarter, but the central bank may move more slowly if conditions warrant.

Chief Investment Strategist, Jeff Saut, believes the gradual pace shouldn't greatly impact the economy going forward, and he has noted that the markets should accommodate the change, as well. Historically, stock markets peak on average 30 months after the first rate hike, and that is consistent with the belief that we're still in a secular bull market with several years left to run.

As we head into 2016, potential tailwinds include a healthier labor market, low interest rates, continued increases in consumer spending and a housing expansion. We'll soon know more as the new year brings fresh data to the picture, including the monthly jobs reports and the official Fed meeting minutes. Manufacturing numbers, which come in just after year-end, fell short of expectations. Details of the report showed mixed conditions (depending on whether one is a producer or consumer of raw material), but mild softness overall, Scott noted. It's important to remember that the overall economy can continue to expand even if the factory sector is in a mild recession. However, the report only added to anxiety already present in the domestic markets after the Shanghai Composite Index fell enough to halt trading for the day on China's stock market.

As always, we'll be sure to keep an eye out for changes in factors that could influence the markets, particularly paying attention to Federal Reserve policy, the strength of the U.S. dollar, earnings growth, global economic growth and geopolitical changes. More important, we'll be sure to let you know what impact, if any, these factor could have on your financial plan.

In the meanwhile, please contact me if you have any questions, I would look forward to hearing from you.

Sincerely,

Larry Cavalena
Registered Principal

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