Market Commentary - January 2016

CLEARVIEW
WEALTH SOLUTIONS

2015 Recap – Volatility but No Progress

Although the stock market averages were flat last year (S&P 500 index down 0.7%, Dow index down 2.2%), most stocks were down. For example, through December 18, 65% of Russel 3000 stocks (an index that includes both large and small cap stocks) were down at least 15% from their 2015 highs. The saying went that unless you were in the FANG stocks (Facebook, Amazon, Netflix, and Google), it was hard to make money. Maybe the best that could be said for 2015 was that it was a “time correction,” that is, a period where the fundamentals (mostly earnings) catch up to justify current valuations. Here is a recap of why 2015 finished where it started:

- Corporate earnings growth was slower than expected. In fact S&P 500 profits were down (including energy stocks), though up about 5% ex-energy stocks.
- Investors were concerned about the Fed's transition to tighter monetary policy. Questions such as when, how often, and by how much kept investors on edge.
- Sluggish U.S. economic growth continued. Annual 2% GDP growth seems to be the new normal (see our June 2015 Market Commentary for further discussion).
- Slowing global economic growth, including China, spooked the markets in late summer.
- Late year concerns about the junk bond market sparked fears about the broader U.S. bond market and the possibility that it is signaling the U.S. economy may be slowing.

2016: Clear as Mud

What will have to happen in 2016 for investors to have a better year? We think there are four key areas to watch:

1. **U.S. corporate earnings must re-accelerate with and without energy stocks.** Earnings growth is estimated at 8.5% for the S&P 500 (including energy stocks) which we think is too high because we expect low oil prices to continue. Five percent growth in earnings is a more reasonable forecast in our view.
2. **Global economic growth must revive.** Weakness abroad has never pushed the U.S. into recession but global strength would greatly help our economy by boosting exports. China is still a wildcard. We are not optimistic that global growth will accelerate enough to make a real difference to the U.S.
3. **After appreciating 9.3% in 2015, the U.S. dollar needs to pull back.** A lower U.S. dollar will help drive our exports (partially offsetting the weak global economy) and allow companies to translate foreign sales and earnings into more dollars. We forecast a weaker dollar next year mostly in the second half.
4. **The Federal Reserve must not move too quickly or too harshly.** The consensus is for the Fed is to raise rates in increments of .25% three or four times next year. Anything more would likely spook investors. We think the Fed will move less than the consensus because of continued sluggishness in GDP growth and core inflation still running just over 1%. A slower moving Fed would help the dollar weaken.

Our Conclusions:

- It is getting very late in this bull market (8^{th} inning? 9^{th} inning?). Risks are rising. As a conservative core equity manager, it is prudent to become more defensive which we have been for a while. The same stocks that lead late in long bull markets do best in early bear phases. This is where our focus will continue to be.
- As explained above, our outlook can be summarized as follows along with its likely impact on stock prices:

Our View	Impact
Lower than expected earnings growth	Negative
Slower global GDP growth	Negative
Lower U.S. Dollar	Positive
Slower rate rises by Fed	Positive

- We continue to expect 2016 equity rates of return in line with earnings growth of 5%. This assumes no P/E expansion or contraction. Upside to that forecast could result from stronger foreign economies or a weaker dollar, or both.

Updates on Clearview's Three Equity Strategies:

- CORE: Our core equity strategy is currently overweighted in financial, health care and consumer staple stocks. Financials should benefit from higher interest rates and health care and consumer staples are traditionally more defensive areas. We are underweighted in cyclical areas including technology, industrials, and energy.

  The portfolio's current beta is about 0.90. (Beta is a metric that measures potential volatility risk in properly diversified equity portfolios.) A beta of one implies average, or market risk. Our current measure, well below one, validates our defensive risk posture.

- DIVIDEND GROWTH: Dividend Growth is a more conservative strategy than Core and is meant to generate above average dividend yields along with robust dividend growth. Currently about 50% of the portfolio is in health care and consumer staple stocks. The current beta is a very conservative 0.80, or 20% less than market beta of one.

- FOCUS 20: Although this equity strategy is not as conservative as the other two, the current focus is also on large and mega cap stocks (usually late cycle market leaders). The portfolio objective is to purchase growth stocks with consistent low to mid-teens growth in earnings at reasonable prices. The current portfolio beta is one.

Fixed Income

As 2016 begins, fixed income investors are reassessing their holdings. We believe this to be a healthy process as both the credit and economic cycles are growing mature. Thus far, most of the damage has been confined to the credit challenged areas of the market such as domestic high yield bonds (especially the bonds of commodities and materials companies) which returned negative 4.5% in 2015. According to *Bloomberg Businessweek*, the yield on CCC high yield bonds (the worst of the worst) has doubled to 16% as of mid-December. Investment grade corporate bonds were challenged as well returning negative 2.7% for the year while treasuries were up 0.67%.

Emerging market sovereign debt and the associated corporate bonds within these markets have also come under pressure. **Bear in mind that about half of the worldwide debt issuance outstanding is now non-investment grade.** The risks vary by country and company and are difficult to assess. These bonds hold greater risk than we would consider appropriate for most investors–especially as emerging markets are now in a downturn.

We have always avoided high risk bonds and will continue to do so in core portfolios. Some purchases in 2016 may include U.S. Treasury notes which should do well if there is a further flight to quality.

Find Out More at Clearviewws.com