

Wiggn Financial Services

Markets in Review

As we look back on the financial markets in 2015, what really stands out is how poor returns were across the globe and across asset classes (stocks, bonds, commodities, etc.). Among the major global stock markets, the United States was the best performer, but that's faint praise given the S&P 500's 1.4% return. What's more, it was a market in which a handful of large tech/Internet companies (e.g., Facebook, Amazon.com, Netflix, and Google) generated huge gains and helped propel the index into positive territory, while the equal-weighted S&P 500 index actually *fell* 2.2% for the year.

One striking feature of last year's investment environment was the difference in the direction of the U.S. economy and U.S. monetary policy versus other major global economies. In December, the U.S. Federal Reserve was sufficiently comfortable with the outlook for economic growth and the potential for inflation to eventually normalize that it made its first increase in rates in nearly a decade. Outside the United States, regaining more normal economic growth and inflation has remained more challenging in the face of downward pressures such as sharply lower commodity prices (most notably oil), Middle East tensions, and China's slower economic growth. Year-end foreign stock returns reflect this bifurcation, with developed international stocks down 0.4% and emerging-markets stocks falling 15.8%. As in 2014, the strength of the dollar exacerbated foreign markets' underperformance for dollar-based investors, detracting 9% from emerging-markets stocks and 6% from developed international stocks compared to their local-currency returns.

The worst-performing areas of the markets were commodity-related asset classes. Commodity indexes were crushed, down on the order of 25%–30% as oil prices hit an 11-year low in December and fell 30% for the year, after plunging 50% in 2014. Energy MLPs, an increasingly popular vehicle for yield seekers (and yield chasers), dropped 35%–40%, wiping out the previous four years' worth of gains.

Fixed-income offered little respite, with the core bond index gaining just 0.3%. High-yield bonds fared worse, down close to 5%, while floating-rate loans lost 0.7%. Investment-grade municipal bonds were a *relative* bright spot, with the national muni bond index up nearly 3% on the year.

Overall, 2015 was a challenging year for the financial markets in general. Similar to the past few years, the major headwind to our performance was our allocation away from U.S. stocks in favor of European stocks with an additional allocation to emerging markets although we tempered the percentage due to our perceived risk levels of our clients.

Portfolio Review and Positioning

Given the challenges of the past year, we think it is particularly important to reiterate our positive outlook for our portfolio positions and review how we arrive at our assessments.

Our positions in foreign stocks are not based on a short-term view of the market, or a prediction that a drop in U.S. stocks is imminent, or even that U.S. stocks will necessarily trail non-U.S. stocks in 2016 (although it is very tempting to say they are due!). Financial market history is a history of cycles (or like

the swings of a pendulum), moving from one extreme to another. Market history teaches us that undervalued assets can fall further, and overvalued markets can overshoot even further on the upside. We need only look back to the tech bubble to see one recent example of this. It is simply the reality that comes with being a long-term equity investor.

Our investment philosophy is based on the belief that fundamentals ultimately drive investment returns. This gets down to the economics of the investment. Specifically, whether we're evaluating stocks, bonds, real estate, or another asset class, the value of an investment is generally determined by the cash flows the investment or investment market generates over time. This type of valuation, unfortunately, is a very poor short-term market indicator. But over the longer term and over full market cycles (five to 10-plus years), history has shown that valuation is a powerful driver of returns. Buying undervalued assets pays off over time, but you need to withstand the discomfort that typically accompanies it as you wait for markets to turn in your favor.

The U.S. equity market has had a very strong run over the past few years and by most valuation measures is stretched. After six years of generally rising stock prices, investors may be complacent about the potential risk. Those risks may or may not be imminent, but we believe the reversal of this current cycle may not be long in coming given the relative attractiveness of foreign stock market valuations and the potential for foreign company earnings to improve from currently depressed levels.

We are confident we will be rewarded (with outsize returns) for our current allocations to European and emerging-markets stocks. But we also know that we don't know precisely *when* those markets will turn around. As the old saying goes, "They don't ring a bell at the bottom of the market" (or the top for that matter). It requires patience—another core element of our investment philosophy—to hold onto (and potentially add more to) these longer-term return generators during the periods when they seem only to be *downside-risk* generators.

On the bond side, with interest rates having begun what the Fed has said will be a gradual upward climb, our conviction in our diverse fixed-income lineup is stronger than ever. Our investments in flexible and absolute-return-oriented bond funds, and floating-rate loan funds are designed to generate higher returns and better manage their interest-rate sensitivity versus the core bond index in a rising rate environment. And while core bonds may still mitigate some of the shorter-term downside risk from stocks in our portfolios, the degree to which they can do so is more limited in the current market cycle. This past year was a good example of this, with core bonds barely positive while global stocks were negative.

Finally, given our subpar outlook for U.S. stocks and bonds, we continue to find value in owning alternative strategies that can generate attractive long-term returns and provide powerful portfolio diversification benefits.

Looking Ahead

We believe our portfolios are well positioned to generate solid returns over our five-year horizon, but we think it is prudent to be prepared for potentially increased market volatility and downside risk (as well as positive returns) over the shorter-term. We may even get the opportunity to add to our undervalued positions or establish some others before this market cycle turns. In other words, we believe the key to successful investing ahead is to maintain the healthy patience, perspective, and discipline necessary for long-term investment and financial success.

We always encourage each of our clients to schedule at least one meeting a year. It may be particularly important this year given the level of volatility we are experiencing in the markets. These meetings are necessary to insure that we understand each other. Based on our many past conversations, we believe we understand your goals and risk level; however, things change, and we want to be sure our understanding is current. Please, call us to schedule an appointment.

As always, we appreciate your confidence and welcome questions about your individual situation.

Best regards,

Debbie Wiggan CFP, RLP