Making Sense of Finance

Karagosian Financial Services | 1/20/2016 | Volume 19, Issue 1

Fourth Quarter And Full-Year Review

STOCK MARKET

The U.S. market rebounded in the fourth quarter from its dismal third quarter performance, although finishing out the year with a whimper and starting the new year dreadfully. After a volatile 2015, and a satisfying gain last quarter of 6.5%, the S & P 500 finished the year close to where it started with a decline of 0.7% for the year. The two other major U.S. stock indices acted similarly last quarter with the Dow Jones Industrial Average gaining 7.0% and the Nasdaq Composite increasing 8.4%; however the Dow finished the year in negative territory but the Nasdaq actually posted a palatable gain of almost 6% in 2015. This somewhat large divergence in performance of these indices can be traced to the fact that ten of the largest stocks in the Nasdaq had an average gain of 42% last year, Alphabet and Microsoft were among that group.

If you believe the movement in stocks is becoming more volatile, you are not mistaken. Chicago Board Options Exchange Volatility Index (otherwise known as the VIX) is a weighted blend of prices for options on the S & P 500 index. This is just another means for some investors to make money by either buying or selling volatility just as you would a stock. In the past 11 years exchange traded funds and derivative products have been created based on the VIX so that not only institutions but retail investors can participate in market movement. The VIX has nothing to do with the underlying fundamentals of the stocks but is only based on movement. Someone wins and loses every day betting on the VIX but it takes a steadfast investor to ignore the movement and to concentrate on the longer term potential of an investment.

Foreign markets in developed countries rebounded 4.3% in the fourth quarter as measured by the MSCI EAFE U.S. dollar based index. The increase in the last quarter was primarily due to strengths in the Japanese and Australian markets. The EAFE, however, also closed with a loss on the year of 3.3%. However, the MSCI Emerging Market index did much worse. After a small gain in the fourth quarter, the index still lost nearly 17% in 2015. Slowing growth in China affected the emerging market countries that are large exporters to China. Also, the devaluation in the Chinese yuan caused weakness in other emerging market currencies.

All sizes of market caps participated in the fourth quarter rally, but in general the larger stocks did better. For the second consecutive year large caps

Making Sense of Finance

Everyone and their neighbors have an opinion. At Karagosian Financial Services, we have a combined 40 years of investment experience. We have seen the markets at their highest highs and lowest lows. Through this newsletter we attempt to convey our opinions on current events in the investment world and their likely outcomes. Forecasting is inherently difficult and our advice is geared toward making sensible and prudent choices based on logic and experience, and not based on emotion.

Contributors:

Seaver T. Wang

Christine Terry

315 Fifth Avenue 704B

New York, NY 10016

www.toinvest.com

Representatives are registered through, and securities are sold through Nationwide Planning, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Insurance sold through licensed Nationwide Planning, Inc. Nationwide Planning, Inc. and Karagosian Financial Services are non-affiliated entities.

outperformed small cap stocks as measured by the Russell 2000 index. Although rising over 3% in the fourth quarter, it declined for all of 2015 by over 4%. Healthcare, technology and consumer staples were among the best performing stock sectors last quarter, with energy and financials showing slight declines. Energy stocks, while not gaining much ground last quarter, at least had much smaller losses than in the third quarter and may be bouncing along the bottom. However, recently oil dropped below $30 per barrel for the first time in 12 years. More so than stocks, commodities were not the place to be in 2015.

BOND MARKET

The long anticipated Fed Fund target rate increase happened last month. The nominal increase of 0.25 percent in this rate barely budged the Treasury market that day since most investors were waiting for this to happen for a long time and bond prices already reflected the move. In the fourth quarter, interest rates increased across the board on all Treasury maturities. However it was the short end of the yield curve that experienced the largest increase in 2015 as the three month Treasury bill started the year with a yield of .03% and ended the year at a still very low .14%. The 10 Year Treasury, which is used as a gauge for the direction and magnitude of mortgage rates, rose slightly on the year and ended at 2.27% yield. Most bonds declined last quarter except for municipal bonds which had slightly positive returns for the quarter and the year. High yield (below investment grade) bonds performed the worst as yields increased for the most part due to widening credit spreads affected by worries of defaults in the energy sector.

The Barclays U.S. Aggregate Bond index which is a blend of many types of domestic bonds had a small loss in the quarter and gained less than 1% last year. In general, 2015 was one of the worst years for asset allocation because it was difficult to make money in any major investment class, including bonds. Cash had only a very small return, Treasuries and most other bonds declined in value. According to a research study by Bianco Research LLC and Bloomberg, 2015 had the lowest return for asset allocators since 1937. The best return among the large asset classes as represented by the stocks (S & P 500), bonds (30 Year Treasuries), cash (three month Treasury bills) and commodities (CRB index) was the 1.38% total return (includes dividends) by the S & P 500.

MARKET OUTLOOK

As we write this issue of our quarterly newsletter, signs indicate a self-fulfilling prophecy. News articles continue to make comparisons between 2008 and our current situation, but we see little similarity except for the fact that markets have declined. There is no mortgage and real estate bubble evident and no credit crunch. Let us look at the current situation. The U.S. economy is growing (3.9% in 2Q and 2% in 3Q) and at a healthy enough rate that the Federal Reserve increased interest rates to 0.25%, up from 0%. The cost to borrow money is still the lowest it's been in generations. Companies in the S&P 500 are in the best financial shape they have been in decades with over $1.4 trillion in cash, as of September 2015, and unemployment continues to decline; currently at about 5%. Yet, the Dow Jones Industrial Average is down nearly 2,500 points from its highs attained just a few months ago. Don't forget that oil is at its lowest in over a decade, hovering a little under $30 a barrel, which is great for consumers overall, although bad for oil exploration companies. In the short term, could oil decline further? Sure, but we think we are reaching trough levels. Consumption of oil remains high, but producers, primarily Saudi Arabia, have chosen to pump more oil that is depressing prices in order to increase their market share and we think this is unsustainable over the long term.

I SENSE AN OPPORTUNITY! The markets will do what they will do in the short term (the present to a couple of years out). The simple mantra of Buy Low, Sell High still holds true. Remember, we are investors not traders so these large swings should not sway anyone from their original game plan. Extreme down cycles are also often followed by extreme up cycles with little substance behind it. These swings in asset prices are about emotion and fear, not about profit margins and economics. Do you remember the late 1990s when oil sold for less than $10 a barrel? The economy was booming and it was considered a nonfactor yet a low oil price is cited as another reason the stock market is doing poorly. Would you rather have oil trading at $150 a barrel? Somehow, I doubt that it would be viewed as a positive for the economy. It is perfectly normal to be more fearful during declining markets and more confident in rising ones, but recall, that none of our portfolios were ever created to avoid declines, but rather built to help weather them.

Representatives are registered through, and securities are sold through Nationwide Planning, Inc., Member FINRA/SIPC, located at 115 West Century Road, Suite 360, Paramus, NJ 07652. Investment advisory services are offered through Karagosian Financial Services. Insurance sold through licensed Nationwide Planning, Inc. Nationwide Planning, Inc. and Karagosian Financial Services are non-affiliated entities.