RBC Wealth Management

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4th Quarter 2015 Market Commentary

A volatile year ends with a whimper
The Dow Jones Industrial Average is made up of 30 large, well-known companies. It is the best known and oldest of the many yardsticks that measure stock market performance. While not necessarily a household name, the S&P 500 Index—as its name implies—is made up of 500 larger U.S. companies. It captures about 80% of the entire market capitalization (S&P Dow Jones Indices), and is the most often quoted measure of market performance among analysts.

While the S&P 500 made significant advances in 2013 and 2014, this past year action in stocks felt more like 2011, when overseas tremors reached our shores. While 2015's ride was not as volatile as that of 2011, the S&P 500 did experience its first 10%+ decline in four years (St. Louis Federal Reserve). In both years, the benchmark index ended the year pretty much where it started.

Much of the pain in the equity markets was felt in the mining and energy sectors. In general large companies (large caps) out performed small companies (small caps), and U.S. stocks generally topped international stocks.

Meanwhile, longer-term Treasuries yields continue to hold near historic lows, which signaled there's still plenty of interest in the most creditworthy bonds. We did, however, see modest backup in bond yields among investment grade issues (as measured by the BofA Merrill Lynch US Corporate Master Effective Yield—St. Louis Federal Reserve) and bigger problems in high-yield bonds, sometimes called junk bonds.
Expectations of an eventual Fed rate hike probably influenced yields in investment grade issues. But the sharp increase in junk bond yields, especially those with the lowest credit ratings--what we sometimes call the junkiest of the junk--were tied mostly to problems in the energy and mining sectors.

Table 1: Key Index Returns

	MTD %	2015 %	3-year* %
Dow Jones Industrial Average	-1.66	-2.23	+9.97
NASDAQ Composite	-1.98	+5.73	+18.37
S&P 500 Index	-1.75	-0.73	+12.74
Russell 2000 Index	-5.19	-5.71	+10.18
MSCI World ex-USA**	-1.88	-5.44	+1.27
MSCI Emerging Markets**	-2.48	-16.96	-9.04

Source: Wall Street Journal, MSCI.com
MTD returns: Nov. 30, 2015–Dec. 31, 2015
2015 returns: Dec. 31, 2014–Dec. 31, 2015
*Annualized
**USD

Emotional vs. disciplined investing
We'll touch on some of the issues affecting high-yield shortly, but last year's lackluster performance in key stock and fixed income sectors is a perfect segue into why long-term goals and sticking with a carefully crafted investment plan have historically been the best way of managing risk and reaching your financial goals.

Your personal situation, goals, and risk tolerance influence your asset allocation. If your personal situation has changed, we may want to make a mid-course adjustment to your investment portfolio.
But for many investors, the plan that was designed specifically for you remains the best long-term roadmap. Let me explain by highlighting a study published last year by DALBAR, one of the nation's leading financial research firms and one with a 40-year track record.

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The study found that over a 20-year period ending December 31, 2014, the average equity stock fund investor posted an average annual return of 5.19%, which compares unfavorably to the average annual return for the S&P 500 Index of 9.85%. Going back 30-years, DALBAR paints an even gloomier picture, with the average equity stock fund investor earning 3.79% annually versus the S&P 500's average annual gain of 11.06%. As the study underscores, "Investor underperformance is present in all investment classes, therefore proving (the word it used in the study) that the failure is not primarily one of poor asset allocation." But the study concluded that the largest contributor came under what it called "voluntary investor behavior," which generally represents "panic selling, excessively exuberant buying, and attempts at market timing."

Prudential took the study one step further and analyzed equity cash inflows and outflows over the last 20 years ending December 31, 2014. Not surprisingly, investor interest was the highest when shares peaked in 2000 and outflows were largest when prices approached the bottoms in 2002 and 2009.
It's what happens when emotions get in the way of a disciplined approach. We certainly understand that there can be a temptation to sell when stocks are in downdraft, as we briefly saw last year, however this flies in the face of the simplest of market adages, "buy low, sell high." Selling out at market lows and waiting to buy back in once the market has "turned around" more often than not will negatively impact long-term client investment goals by trying to "time the market."

China and a look ahead
Last year, international events played a role in hampering sentiment at home. A slowing economy in China provided just the right excuse for late summer's correction. China's rocky transformation from an industrial-based, infrastructure-driven economy to one that is more balanced remains a headwind to sentiment. But keep in mind that U.S. exports to China account for less than 1% of the total U.S. economy (U.S. Bureau of Economic Analysis). Hence, it's hard to imagine a scenario where weakness in China pulls the U.S. into a recession.

As we enter the New Year, two stiff headwinds remain–oil and a stronger dollar that is contributing to weakness in exports. Many of us are being treated to the lowest gasoline prices in years ($1.85 at the Casey's on Hickman in Clive!). But consumers are benefiting at the expense of producers, and not just the big oil companies.
Sharp cutbacks in capital spending in the energy sector, coupled with layoffs, are hampering manufacturing. Yes, low oil and commodity prices help keep inflation in check, but again, that's creating big problems in the energy and mining sectors.

Junk gets junkier
The well-documented problems in energy and mining have spilled over into high-yield bonds. Moreover, the riskiest bonds, or those which sport the lowest ratings, have seen the largest jump in bond yields.
If oil and the commodity sector begin to bottom and the economy continues to expand at a modest pace, historical analysis suggests that much of the damage in junk bonds is probably behind us. However, a lack of liquidity in the sector, the outside potential for a broader economic slowdown, and continued problems in mining and energy may generate additional uncertainty.

Seeking clarity in earnings
Finally, let's end on a more upbeat note. Corporate earnings are probably the most important variable in determining the direction of stocks over the medium and long term. Yes, other factors can create volatility shorter term, but profits are the lifeblood of stocks. According to Thomson Reuters, earnings for S&P 500 firms collectively fell by 0.8% in Q3 and are forecast to decline 3.7% in Q4. Much of the weakness can be pinned on a steep drop in earnings among energy companies. Pull out the energy sector and Q3 profits would have been about seven percentage points higher, according to FactSet Research.

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Bottom line

We always stress the importance of being comfortable with your portfolio. As we've talked about in our meetings, one of our goals is to help you accumulate wealth without taking on undue risk. Stick to the plan. Markets rise and market fall, but unless there have been changes in your circumstances or you've hit milestones in your life such as retirement, stay with the plan. By itself, a long run in stocks isn't a good reason to bail out of the market. But you must be comfortable with the level of risk you're taking as we set out to meet your objectives. If you are not, let's talk and recalibrate.

Let's end with this comment from Warren Buffett. "Someone is sitting in the shade today because someone planted a tree a long time ago." For many, we have already planted that tree, so I encourage you to stay with the plan that nurtures and grows your tree. He has also said, "To gain higher returns available in the stock market, you have to ride the roller coaster." Thus, enduring periods of downward volatility is one of the tradeoffs in earning potentially higher returns.

Team Member Profile: Dana Weir

Dana has been with the Abrahamson Investment Group since 2007, and joined RBC Wealth Management in 1992 after graduating from the American Institute of Business in Des Moines. Dana assists Kirk with a multitude of branch management duties and continues to expand her role within the team by providing administrative operations and client service support. Her exemplary work performance earned her the 2012 RBC Wealth Management Award of Excellence, which recognizes individuals firm-wide who make exceptional contributions to their position.

Dana, and her husband, Chad, met in grade school and are now enjoying their 20th year of marriage. Originally from Algona, Iowa, the Weirs now reside in Ankeny and have two college-aged children, Cody and Alesha. Cody is currently attending the Des Moines Area Community College and Alesha is at the University of Northern Iowa. Like Kirk and Dianna, the Weirs have come to embrace their role as empty nesters!

On the weekends, you'll find Dana and Chad enjoying the outdoors. Both enjoy camping, boating and cycling, which they began close to 9 years ago. They've since become avid cyclists with six RAGBRAI trips under their belts and enjoy weekend biking and camping trips with their cycling group, the Tall Dog Bike Club.

We hope you've found this review to be educational and helpful. We emphasize that it is our job to assist you! If you have any questions or would like to discuss any matters, please feel free to give us a call at your convenience.

As we enter 2016, we would like to say once again that we are honored and humbled that you have given us the opportunity to serve as your financial advisors.

-The Abrahamson Investment Group
Kirk, Mike, Dana & Colby