January 25, 2016

Q4 2015 Commentary: Be not afraid to buy low…

After noting last quarter how we had finally experienced a ten percent market correction after four years, we have again seen the stock market fall by more than 10% as we began 2016. In fact, this is the worst start to the year ever for the stock market. A return to more "normal" market volatility after four exceptionally calm years may be disconcerting to some, but it does provide the disciplined investor a greater opportunity to buy stocks at attractive prices. In the August period, we were able to put cash into the market at some of the best prices of the year. We are using the current period to rebalance portfolios and again add to the stock portfolio. This is the time to position portfolios, not for the next month, but for the better environment we expect in the next year.

The S&P 500 was actually lower at the end of the year than it was at the outset. Dividends pushed the year's total return into positive territory to 1.4%. In the 4th quarter the stock market recovered much of the losses experienced in the summer. Like the stock market, the bond market had an up and down year. The Barclay's US Aggregate Bond index total return in 2015 was 0.5%. The low interest rate environment is a large reason for the meager return. However, fears of the Federal Reserve raising rates had a negative impact and the high yield bond sector, which has a large representation of energy companies in it, was the weakest sector of the bond market due to the rising threat of borrowers defaulting on their bonds.

A significant number of stocks did not do well in 2015 and they were not just oil stocks. Much of the year can be characterized by rolling bear markets within rotating sectors of the market. Energy stocks collapsed during the year along with oil prices. The end of the year was marked by significant underperformance by retail stocks. Entertainment, drug, biotech and other industries had significant corrections at various times of the year. In the plainest terms, it was a difficult year for anyone to make money in the financial markets. In early January, Oscar Shafer pointed out in the Barron's Roundtable, 70% of the Russell 2000 index of small US stocks, 49% of the S&P 500 stocks and 68% of Nasdaq stocks were trading more than 20% off their 52 week high price. Since that time the indices have continued lower.

Our private real estate backed loans continue to do well. All loans outstanding performed as expected and all loans yield at least 8.25%. We have been able to expand the number of these loans we can offer although the timing of availability is still irregular.

We would reiterate what we have expressed for the past year. The investment environment is not as bad as most recent bad news might indicate nor is it as good as any good news might suggest. We have been and will remain in a moderate growth economy. Slowing economic growth outside the US and the strengthening dollar have stalled earnings growth. After a very good three year period in the stock market, a pause is not unexpected. We will move past the negative impact from last year's stronger dollar. Interest rates will remain low and with monetary authorities in Japan, China, Europe and elsewhere around the world providing stimulus to their economies, we can expect global growth prospects to improve in 2016. It all adds up to a resumption of earnings growth and a better stock market from current levels.