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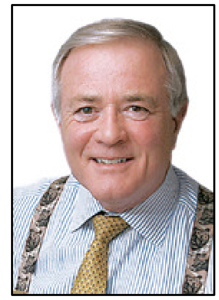

William Rutherford

Markets end 2015 flat, face more resistance

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2015 offered very little return to investors no matter what asset class they chose to invest in. After reaching an all-time high on May 21, 2015, the equity markets plunged in August as China devalued its currency in a surprise move and commodities' prices fell. Investors became very concerned over weakness in the Chinese economy. Oil prices were down 30 to 35 percent on the year.

In September, Hillary Clinton tweeted that she would crack down on high drug prices if she were elected president and pared $162.4 billion off of the NASDAQ biotech index ETF (NBI). The drug sector, one of the best performing ones of 2015, became a political football, and fell dramatically when the prospect of "Hillarycare" triggered a rout.

The S&P broad market index closed the year down 0.7 percent – hardly the returns that investors have come to expect, and not enough to keep up with even subdued inflation. The consumer discretionary sector in which we are overweighed led the S&P, up 8.4 percent.

The Dow Jones industrials lost 2.2 percent, with 1 percent of that loss coming on New Year's Eve. The NASDAQ was the best performer – up 5.7 percent, with Netflix (up 134 percent) and Amazon (up 118 percent) leading the way.

It didn't matter in what sector one invested; the results were about the same. Six of the 10 sectors in the S&P were down on the year. High-yield bonds were hit hard. Even Warren Buffett was down 11.5 percent on the year. The markets are up 63 percent in the past five years, but 2015 was certainly a year to remind investors that investing is risky.

With the Fed telegraphing its desire to raise interest rates, the dollar put on a show. The dollar rose about 9 percent year over year against a basket of securities, with its gain against the euro at over 10 percent. The dollar has strengthened nearly 25 percent against the euro in the past 18 months, and might yet reach parity with it. The strong dollar has been blamed for the crimping of U.S. exports and continued deflationary risk for the U.S. A strong dollar could be a key risk for markets in 2016.

The U.S. Federal Reserve made its widely expected move to the upside in interest rates on Dec. 16, adding downward pressure to commodity prices and strengthening the dollar. It can be expected that a higher dollar will make export sales more difficult for the U.S., at a time when the industrial sector is already in a recession. The Fed made its move against a backdrop of a soft global economy. Normally the Fed's job is to take the punch bowl away before the party gets out of hand. However, it appears that the party was already over.

With the Fed raising interest rates at the same time the rest of the world central banks are cutting rates, we are set for an unprecedented scenario, as the central banks usually act in concert. Fed Chairwoman Janet Yellen opined that the increase in interest rates was a reflection of the strengthening U.S. economy, though few believed her. After the Fed announcement, the market rallied for a day and then plunged to finish the year – not a strong affirmation of Fed policies.

The Chicago Purchasing Managers Index fell, and unemployment claims rose. Inflation remained nearly nonexistent. Commodities and industrials are still moribund. Only auto sales looked truly robust. The economy seems headed for its 11th straight year of annual growth below 3 percent.

Emerging markets could suffer from a rising dollar. Emerging market debt is currently $23.7 trillion – up more than 500 percent in the last decade. It represents yet another risk to the global economy since the debt has to be repaid in surging dollars.

Profits are the driver of markets, but 2015 was a year in which profits were flat; 2016 looks to follow suit. Investors should expect significantly smaller future returns on their investments.   Markets could favor stock pickers over asset allocators.

The market was down sharply on the first day of the year because of China fears and a generally weak U.S. economy. How the market starts the year is generally a good predictor of how it will finish the year. I expect 2017 to be a down year as well.

In spite of all the worries, one should remain fully invested in a diversified portfolio of growing equities. Growing companies still exist, even if the economy is soft. Trying to time the markets seldom works, because market timers usually miss the big and often short upside moves.

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