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CELEBRATING 17 YEARS OF SERVICE TO OUR CLIENTS 1998 2015

the Lonely Bull

January 2016 | *a market **perspective** by Riverplace Capital* | Number 70

2015 YEAR IN REVIEW

The pause that refreshes; maybe.

At any rate, 2015 was a difficult year. Even though the indices gave the appearance of near neutral returns, **the reality was that a few highly valued large growth stocks were responsible for holding up the averages.** In fact, between 10-12 stocks were responsible for most of the positive returns. This is incredibly narrow and indicates that momentum and speculation carried the day.

Healthy markets have broad participation with many stocks in a variety of sectors contributing.

One of the worst attributes about the market this past year was how choppy it was. Several days higher were followed by several lower. Sometimes the changes were dramatic. Just when it appeared that stocks were getting into gear based upon good fundamentals, investor focus would change to some geopolitical event and sell off out of caution. It was a very frustrating time.

Bonds also had a tough year. The Federal Reserve played cat and mouse all year long before implementing the first rate rise in years. When they finally moved in December, it was a relief. The prospect of increasing interest rates put a damper on returns. Some sectors of bonds, like high yield, took big hits as credit quality came under increasing question. Part of the reason is that many of these bonds were issued by resource companies. Almost all resources, especially oil and gas, have had dreadful declines this year.

One characteristic of 2015 is that it was a bear market year for almost all commodities. This bear market actually started in August 2011 with the start of the European debt crisis. This deflationary event was followed by a collapse in emerging markets; another major deflationary force. The broad CRB index was down over 20%, led down by metals and oil. This is a huge move.

So if stocks didn't do well, bonds did poorly, and commodities tanked, then what does the future hold. Will we get more of the same in 2016? Or will there be a change in trends in the New Year?

> "The individual investor should act consistently as an investor and not as a speculator."
> – Ben Graham

TALK WITH US

There is a lot of misunderstanding about interest rates and stock values. The standard interpretation is that higher rates are bad for stock values. That is true at higher rates, because bonds are always an alternative to equity investing. However, when interest rates are well below normal, there is hardly a discernable effect.

In fact, rising rates can be taken as a sign of a healthy economy. This increases confidence in earnings expectations which leads to higher valuations, not lower ones. As long as interest rates do not rise beyond what is considered normal or reasonable for a given level of economic activity.

Stock markets have a history of rising once interest rates begin to rise after a downturn and lowering of rates. So precedence is also on the side of higher values. This is no guarantee, but certainly flies into the face of the perpetual hand wringers predicting dire conditions for stocks this year.

Interest rates only really come into play in dampening stock values when they are used as an instrument of Federal Reserve policy to slow down the economy or to put pressure on inflationary conditions.

That is not our current situation; not even close.

So don't be confused by those spouting conventional wisdom. Higher interest rates at this point are good for stocks; **Talk with Us.** ◆

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FORECAST

ECONOMY

One irony of this past year is that the stock market slowed and backed off, just as the economic growth became increasingly sustainable. In fact, except for the resource sectors and some of manufacturing, other parts of our domestic business scene gathered increasing strength. GDP growth this coming year is likely to show some acceleration. **The consumer, with lower energy prices and higher employment, is in especially good shape.**

Even though interest rates will be rising, they are not at levels that should put a drag on growth. In fact, rising rates may prompt delayed purchases or projects to be started before rates advance too much; we shall see.

We anticipate GDP growth to start at a run rate of 2½% and gradually accelerate to over 3%. This seems modest, but it is a significant increase from the recent 2% rate. Unfortunately, this growth will not be enough to lift all sectors. The resource sectors will likely remain in the doldrums. Emerging market economies need to recover to help change dynamics for commodities. This will happen, but the timing is unpredictable. ◆

EQUITIES

Stock market predictions are notoriously wrong. In fact, it seems the more there is an expectation, the more likely something else may happen. So with that understanding, **we will say that conditions are still favorable for decent returns.** Stock valuations are not, as a whole, expensive. Economic growth should drive an increase in earnings, government fiscal policy is still stimulative, and interest rates are not likely to rise to levels that cut off growth.

Rather than sectors, performance should come to those stocks that show good growth. In an economy that is not likely to be strong enough to lift all boats, it will be important to have the right ones. Just a few companies had good performance this past year. It is unlikely that they will have another year of exceptional results. Performance has produced popularity and momentum, which cannot be indefinitely sustained. These names have simply gotten too expensive.

We have to look for good results in new areas and with other companies. All our expectations will not be met, but we work hard to give the best opportunity possible commensurate with reasonable risk. We at Riverplace Capital invest our own funds alongside yours. ◆

FIXED INCOME

We have been waiting for the Federal Reserve to begin normalizing rates for some time now. We are glad that they have finally started. It will take for some time for rates to approach normal levels for an economy growing as well as ours. We do not foresee, at this time, any reason to go beyond normal.

There is little inflation in sight, and growth is a long way from getting out of control. In other words, we have continuation of favorable conditions for investors.

So when do we begin buying bonds again? We need a couple more interest rate rises, and then we believe intermediate rates ought to adjust up to investable levels. In the meantime we are searching for opportunities. ◆

INVESTMENT STRATEGY

EQUITIES

We plan to maintain some cash reserves this coming year, simply to take advantage of volatility. Volatile markets are likely to be with us for some time yet. In the U.S. we have an election cycle, geopolitical conditions are in some ways beyond understanding, and world events can loom large. At the same time, many companies are doing well and creating more value every day. We try to keep our focus on these factors. They are in the end the most important. ◆

FIXED INCOME

This year we expect to begin rebuilding bond portfolios. However, it may take some time to get back to allocation levels we would like. The pace of portfolio rebuilding will all depend on how soon the Federal Reserve approaches normalized rate levels. ◆

WEALTH MANAGEMENT

We continue to monitor our allocation decisions for these portfolios. Until we see exactly how various sectors respond during the New Year, we will keep current allocations. These portfolios were set to not take much allocation risk, but to set a wide net for returns. After the correction this past fall, we thought that there might be a shift from growth to value sectors. However, the shift didn't happen, so we maintained our weightings. We will continue to evaluate the allocations, but only make changes when markets dictate change is needed. ◆

MAJOR INDICES

as of 12/31/2015

Large Cap Stocks (S&P 500)	-0.7%
Dow Jones Industrial Average	-2.2%
Mid Cap Stocks (S&P 400)	-3.7%
NASDAQ Composite	5.7%
Small Cap Stocks (Russell 2000)	-5.7%
MSCI EAFE	-3.3%
Barclay Aggregated Credit Index	-0.8%
Inflation	.5%
CRB Commodity Index	-23.4%

Equity indices are twelve-month returns excluding dividends.

NOTICES

Check out our web site. www.riverplacecapital.com It offers a lot more information for you including a blog with weekly insights. We look forward to your feedback.

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Riverplace Capital offers our clients free financial planning. We believe strongly in the value of planning as it helps document goals and objectives, and provides a benchmark to measure progress. **Planning helps us provide better, more targeted financial service to you.** If you would like a financial plan, contact your portfolio manager at (800) 391-1212.

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