Market Commentary

The S&P 500 was one of the best performing major stock indexes in 2015, gaining 7.0% in the fourth quarter, to finish the year up 1.3% (including dividends). Despite gains of 3.2% in the fourth quarter for both small company and international stocks, both asset classes continued to underperform larger company stocks and finished the year down 3.6% and 5.7%, respectively. In addition, falling commodity prices and a strong U.S. dollar negatively impacted emerging markets stocks which declined by 0.7% and 15.8% for the quarter and year, respectively. Interest rates increased slightly this quarter, pushing investment grade bond prices down by 0.6%, but this asset class still finished the year in positive territory with a gain of 0.6%.

Federal Reserve Raises Fed Funds Rate by .25%

At its December meeting, the Federal Open Market Committee decided to increase the federal funds rate by 0.25% to a range of 0.25%-0.50% (the actual rate changes on a daily basis within the range set by the Fed). The committee emphasized that future increases would occur at a gradual pace, thereby appeasing stock and bond investors, who fear rapid interest rate increases will impede returns. Based on the Fed's comments, the market (as measured by the Bloomberg Euro Dollar Synthetic Rate Forecast Analysis) anticipates the federal funds rate will be 1.25% at the end of 2016 and 1.75% at the end of 2017.

The Fed will closely monitor employment and inflation as key factors in determining the optimal path of interest rates. Currently, subdued inflation is giving the Fed significant leeway on the speed of tightening, but if inflation accelerates, more aggressive rate increases may be needed. The rate at which the Fed increases rates is very important for businesses and consumers alike since many loans are based on the Prime Rate, which is dictated by the Fed funds rate. Historically, gradual rate increases have been advantageous for stocks and far superior to a rapid ascent. Since 1946, twelve rate tightening cycles have occurred with five considered gradual and seven considered rapid. During gradual cycles, stocks increased by an average of 10.8% during the year following the initial rate hike while they decreased by 2.8% in the year following the initiation of a rapid tightening cycle.

Oil Continues Slide, Causing Energy Sector to Falter

OPEC failed to agree on any oil production limits at its December 4th meeting, fortifying its decision to protect market share instead of prices. This news accelerated falling oil prices and contributed to a 30% price decline in 2015, which followed a 46% decline in 2014. Declining prices have produced stress throughout the energy supply chain including private oil drillers, shippers, and oil producing countries including Venezuela and Russia. While lower oil prices are helpful for many sectors including airlines, hospitality, and retail, lower prices also increase the risk that highly indebted oil companies default on their high yield debt. If supply continues to outpace demand in 2016, as many experts believe, low oil prices could persist for the foreseeable future. Investors are closely watching oil prices due to concerns that further declines may drive bankruptcies and layoffs at oil companies which could have a negative ripple effect throughout the economy.

Comparative Returns

	Q4 2015 Returns	Annualized Performance			
		1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks(1)	7.0%	1.3%	15.0%	12.5%	7.3%
Small Cap U.S. Stocks(2)	3.2%	-3.6%	12.6%	10.5%	8.0%
International Stocks(3)	3.2%	-5.7%	1.5%	1.1%	2.9%
Real Estate(4)	7.0%	2.4%	11.0%	11.8%	7.6%
U.S. Bonds(5)	-0.6%	0.6%	1.4%	3.3%	4.5%

1. *Measured by the S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy.*
2. *Measured by the MSCI U.S. Small Cap Index.*
3. *Measured by the MSCI ACWI ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets.*
4. *Measured by the MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks.*
5. *Measured by the Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market.*

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