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Economic & Market Summary
January 2016

The U.S. economy continued to expand in 2015, with GDP growth of 2.2% over the last 12 months. The mix of growth remains tied to consumption, but housing and business investment were contributors. Unsurprisingly, exports detracted from growth. The unemployment rate of 5% may lead to upward wage pressure, a factor missing from this economic recovery. Full employment should be viewed positively because the U.S. economy relies on consumption as its primary growth engine. Additionally, the rapid decline in commodity prices has yet to fully affect consumption but should be a positive catalyst in 2016. Interest rate increases in 2016 may encourage business and housing investment as the window of cheap financing begins to close. Overall, we anticipate 2016 GDP growth in the 2.5% range, consistent with a slow, but long duration economic recovery.

On the international front, growth has been weaker than anticipated as China struggles to achieve upper-single digit growth while transitioning to a more consumption-based economy. This economic slowdown has had significant repercussions for other emerging economies that supply China with raw materials. While commodity prices have declined substantially, lower prices result in higher demand, a point which seems lost on many investors. Finally, the lagged effect of monetary stimulus should provide additional support to international economic growth.

The Federal Reserve raised interest rates (by 0.25%) for the first time in this recovery, in response to strengthening employment conditions and inflation nearing the 2% target. Expectations are for 2-4 additional quarter-point rate increases in 2016. Though the Fed seeks consensus among Board members on policy decisions, the four new voting members on the Board in 2016 all tend to favor higher interest rates. Another variable is the 2016 presidential election. While the Fed theoretically operates separately from the Federal government, policy has tended to remain more accommodative during fall election years. Bond market reaction has been fairly well-contained so far, although we are observing stress in the high-yield sector. Our strategy continues to emphasize high credit quality and short maturities, especially at this early stage of the interest rate cycle.

The S&P 500 realized a 2015 total return of 1.4%, reflecting dividend income offset by a slight decline in prices. Growth stocks posted very strong performance in 2015 as investors bid up P/E multiples in a world where growth is scarce. Value stocks were weak and appear to offer a more compelling investment proposition. On a reported basis, S&P 500 earnings declined approximately 6% year-over-year due primarily to weak results from energy and commodity-oriented companies and a stronger U.S. dollar. Outside of energy and commodities, operating earnings grew at a mid-single digit pace. The 2016 earnings estimate of ~$120 appears to imply stabilization in commodities and the dollar, a view we believe is reasonable. Longer term, with a dividend yield of 2.1%, a P/E of 17x, and mid-single digit profit growth, the case for owning equities broadly looks reasonably attractive. We expect volatility incurred in the equity markets last year to continue into 2016, again offering meaningful opportunities to build positions.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address above.