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summaries

SIGMA INVESTMENT COUNSELORS

the official newsletter of sigma investment counselors

December 2015

Ode to 2015

As we reflect and are grateful for this past year.
We are hard pressed to believe 2015 is about to disappear!

We are thankful US equity markets have managed to stay afloat and remain in good stead,
And we are hopeful for the 2016 market journey that lies up ahead.
This year tech stocks like Apple, Amazon, Google and Facebook filled investors with glee.
Many hope they find those shares wrapped for them under the Christmas tree.

We are thankful US government interest rates remain positive you see,
Because in Europe government interest rates are negative, how can that be?
The bond market continues to give fixed income investors fits.
The Fed continues to punish savers; investing in bonds remains the pits.

We are thankful that China continues to grow, albeit at a mere 7%.
Were the US to have such growth it would be heaven sent!
Despite a lackluster economy here in the US,
Dollar strength has contributed to the oil market mess.

We are thankful we can elect Congressional representatives though sometimes we wonder why.
Watching their antics we've decided to laugh so we don't cry.
We are hopeful our leaders will find their way out of the paper bag, yet we fret.
We want them to keep our homeland safe and get rid of our $18 trillion debt!

We are thankful we live in a free country where elections are democratic,
Even if some of the candidates seem a bit erratic.
2016 will be filled with lots of promises from candidates pursuing the DC house that is white.
Watching the activities until November 4th of 2016 should prove to be quite an interesting sight!

We are thankful that each year we at Sigma can work together as a team.
Bringing on new members like Patrice, Sara, Ceiaria and Amanda seems like a dream.
We miss our friend Dave; he will live in our hearts forever.
His memory is one that we always will treasure.

We are thankful at Sigma for each colleague, client and friend
For without them we know Sigma would end.

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Each of us at Sigma know we are privileged to serve as our clients' trusted advisor and we are fortunate to have the opportunity to earn your continued trust in our organization on a daily basis. 2015 proved to be a year of many blessing at Sigma. Among them are the additions of Patrice, Sarah and Ceiaria to our operational dream team and Amanda to our investment process. This year also left us with sorrow as Dave Bergman is no longer with us. Dave was a trusted colleague and friend. For over 24 years he provided wise counsel to clients and challenged us to always find ways to better serve our clients. Dave spent his free time committed to giving back to the community, providing coaching and guidance to aspiring ball players and tirelessly giving his time and energy to many charities. He always had a grin on his face and a special presence that will always be with us.

Year End Outlook

Looking in the rear view mirror when driving is not the primary focus for a driver, but it does provide useful information for a safe journey. The same can be said for investing. Accessing what lies ahead is the key. Yet, an analysis of what influenced investors and impacted markets in the past can provide insightful information. To that end here are some thoughts about market activity in 2015 and our outlook for 2016.

Thoughts on Interest Rates and Bonds -

An overarching investment theme this past year has been the behavior of major central banks around the globe. Based on history, a "normal" long term rate environment is considered to be in the range of 4-6%. Quantifying a normalized rate level at this time is not particularly important. Whether one's reference point is a 70 year chart of US rates, or a 300+ year chart of Bank of England rates, they all tell the same story; rates remain at all time lows. The crux of the issue for the US Central Bank (Federal Reserve) has been whether the US economy has gained enough strength to withstand a rate increase. And furthermore can it stand several increases in rates back towards a "normalized" level? A year ago, consensus was for a rate hike by May. We expressed concern over the economy and did not expect a rate hike before September. To date the Fed has not raised rates. The Fed meets again in mid-December and we expect at that time they will raise the overnight lending rate (the rate the Fed charges banks to borrow from it) from 0.0% to .25%.

Given the low level (0%) from which the Fed is starting and the tepid economic recovery, we expect the Fed will be cautious and measured. We do not expect rates will increase in lock step across the yield curve. As long as inflation expectations remain low we believe rates at the shorter end of the curve will rise disproportionately relative to longer term bonds. The benefit to a rise in rates is savers will again be rewarded for their behavior as they will earn more interest from their investments. But rising interest rates also means falling bond prices. A prolonged period of rising rates and declining bond prices will be a new experience for investors who benefitted from a thirty year period of declining interest rates and rising bond prices. Over the past few years investors have had to adjust their yield expectations. It will now be time for investors holding bonds to recalibrate their bond return expectations as rising levels of interest will be offset by declines in bond prices.

While the US central bank prepares to gently apply the accelerator, other central banks around the world are applying the brakes. In Europe and Japan, Central Banks are lowering rates in an attempt to stimulate their economies and China recently devalued its currency. What is particularly unique about the activity in Europe is interest rates are actually negative in several European countries. Negative interest rates are a bizarre concept. For example, it makes no sense that when investors buy a government bond for safe keeping their return of principal will be less than they invested. This is uncharted territory. The consequences of a negative rate environment are not known. What we do know is lowering interest rates makes a currency less attractive to global investors. The currency becomes weaker relative to other currencies around the globe. In this instance, global investors seeking yield from government securities flock to the dollar. This has put upward pressure on the dollar versus most other currencies. Barring a situation which creates a flight to quality, we think much of the move in the dollar is behind us and that 2016 will bring stabilization. With central bank activities impacting bond markets, we also think currency markets will become an important venue to help interpret global investor sentiment.

Thoughts on Commodity Prices –

Commodity markets such as oil and copper are priced in dollars so a strong dollar impacts their prices too. While the price of commodities has been driven down due to over capacity and over supply, the dollar's rise puts more downward pressure on oil, copper and other dollar denominated commodities. As we move into 2016, the combination of reduced production levels and a reduction in excess supply should tighten supply. We think global demand growth will remain lack luster. Combined with our expectation that most of the rise in the dollar is behind us, we expect commodity prices will improve but remain at the lower end of their price ranges.

Thoughts on Emerging Markets -

The strong dollar also impacts developing market economies. For many emerging market countries, commodities are their primary export. As the dollar strengthens their currency values decline and they receive less revenue in local currencies for the same volume of product sold. As their revenues decline, so go the equities in those markets, hence the continued under performance of emerging markets in 2015. Valuations in many emerging markets appear to be compelling. If the dollar stabilizes, a combination of compelling valuations and a reversion to the mean should produce better returns for emerging markets in 2016.

A strong dollar also makes US products more expensive relative to products from other countries, creating difficulties for US multinational companies exporting goods made here. The opposite also is true. Prices of goods produced overseas become more competitive here in the US.

Thoughts on US Equities -

Equities remain the asset of choice. That said, after several years of strong performance US equity market looks close to fair value. At the time of this writing the S&P is up just over 200% since the bear market bottom in March of 2009. Valuations are less compelling relative to other developed market equities. While the health of US companies remains strong (ex the energy industry) some of the metrics we track for US equity markets have deteriorated. Revenue growth for US companies has declined from an almost 8% growth rate in July of this year to about 2% by the end of November. Earnings growth is also tepid. We track the number of earnings upgrades vs downgrades on a monthly basis. In every month this year except for one, the number of downgrades has exceeded the number of upgrades. In November it was about 2 to 1 in favor of downgrades. While we hope our return expectations will be surpassed, we caution US market investors not to extrapolate the double digit market returns of the last several years.

On behalf of my colleagues at Sigma we wish our clients and friends, a wonderful holiday season and a prosperous New Year filled with Health and Happiness!

Denise M. Farkas, CFA®
Chief Investment Officer

Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives