Market Review and Outlook—January 6, 2016

So how did 2015 measure up? Not very well. The chart below shows that municipal bonds did fine, but other bonds lost a little. All four major stock categories lost money in 2015, and while real estate and technology made money, natural resource stocks fell over 20%. A typical investor lost about 2% in 2015.

Can we blame this all on oil? Oil explains a lot. While energy stocks make up less than 7% of the S&P, they went from providing 12% of the quarterly earnings for the S&P to posting a loss. That swing came to $5 of earnings, or almost 20% of the S&P's quarterly earnings. Thus this smallish sector of the US stock market sucked 20% out of the US stock market's earnings.

The average natural resource stock fund has lost money for the past decade. At Mallard, we typically add to positions that have fallen, hoping to pick up bargains. In 2015, however, we cut back on energy, due to our concerns that the energy market is undergoing a sea change. We find it likely that "it is different this time," and the 3– and 5-year losses suffered by natural resource stock investors are unlikely to bounce back sharply.

Bonds didn't help much. Corporate bonds lost a little in 2015. Bonds pay some interest—in 2015, the stock price fell a little more than the interest earned by investors. Most opportunity bonds (high-yield, multi-sector) also lost money; like stocks they are also economically-sensitive. Municipal bonds did well, both quality and opportunity. We didn't expect much from bonds in 2015, and they indeed provided little for investors.

2015 brought challenges. Not only did oil prices plummet, and China slowed down, but the US dollar soared. All three changes worried stock investors, and helped to drive stock prices down in 2015. While the year had many bright spots, on the whole, the oil/China/dollar triple-crown combined to sour investors on stocks.

One bright area was growth stocks in general, and with technology and health stocks in particular (up over 5% and 8%, respectively, in 2015). Just as the US economy in the dot-com crash of 2000 wasn't bad if you backed out technology, the US economy in 2015 was pretty good, if you backed out energy.

2015 was a 'breather year,' with weak results following a fine 2014. Economic news was moderate (neither great nor awful) in 2015. Investors were unimpressed. While this hampered 2015 results, it led to stock prices which are reasonable. Hopefully this will all lead to a better year in 2016.

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
Fidelity Cash Reserves	+0.00%	+0.01%	+0.01%	+0.01%	+1.32%
Intermediate Term Bond	-0.60%	-0.26%	+1.16%	+3.22%	+4.18%
Intermediate Muni Bond	+1.38%	+2.50%	+2.38%	+4.54%	+3.85%
Large-Cap Stock	+5.56%	-1.07%	+13.22%	+10.75%	+6.44%
Mid-Cap Stock	+2.37%	-4.75%	+11.44%	+9.08%	+6.50%
Small-Cap Stock	+2.68%	-5.38%	+10.34%	+8.22%	+6.27%
Foreign Large-Cap Stock	+3.58%	-1.59%	+3.67%	+2.60%	+2.79%
Real Estate	+6.59%	+2.41%	+10.14%	+11.10%	+6.61%
Natural Resources	-1.11%	-22.16%	-8.58%	-6.82%	-0.34%
Technology	+9.28%	+5.21%	+17.00%	+10.68%	+8.35%
Moderate Allocation (60% stocks)	+2.57%	-1.93%	+6.96%	+6.51%	+5.23%

The data in this table comes from Morningstar and is as of December 31, 2015.
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So, How Did I Do? Batting under 500. Regardless of how painful, each January, I review the accuracy of my predictions for the past year, and then share my predictions for the upcoming year. The January 6, 2015 MARKET REVIEW AND OUTLOOK forecasted that 2015 would be solid, with good results from foreign stocks, and growth stocks, a slowdown in real estate, and weakness in bonds. Some of my calls last January were accurate, but some misses were significant.

My three 2015 'winning' predictions were for growth versus value, real estate, and bonds. Not only did growth outperform value, but it did so handsomely. I expected much lower returns in 2015 for real estate (after a 28% gain in 2014), and it did indeed slow sharply, to only 2.4%. I expected general bonds to post low returns, and they fell slightly in 2015. We will call this three wins.

My four 2015 'losing' predictions (in red, below) were for stocks, and high-yield bonds. I expected each to return +5% or more, and all four lost money, with smaller US stocks falling 5%. Three wins and four losses isn't great. In summary, when I was right I was very right, but when I was wrong I wasn't even close.

Sector	2015 Prediction	2015 Actual	2016 Prediction
Large-cap US Stocks	More than +5%	-1.1%	More than +5%
Smaller US Stocks	More than +5%	-5.0%	More than +6%
Non-US Stocks	More than +8%	-1.6%	More than +8%
Growth vs Value	Growth outperforms	Growth +3.6%, Value –4.0%	Growth outperforms
Real Estate	Less than +8%	+2.4%	Less than +8%
General Bonds	Less than +5%	-0.3%	Less than +5%
High-yield bonds	More than +5%	-4.1%	More than +6%

2016 Predictions—I have only revised two predictions, and marked them in blue. Making predictions on investing has similarities to stretching a rubber band to see when it will break. The longer it goes without breaking, the sooner it will break. Given the loss suffered by smaller US stocks in 2015, and the relatively low 2014 gain, I expect that smaller US stocks will return to 'normal' soon, and have a better year in 2016 than larger US stocks. As high-yield bonds lost over 4% in 2015, and as they are yielding almost 8% now, I have raised my lower limit to +6% for them.

US stocks remain attractive, given the very low level of interest rates, and so I expect 'more than' results from them in 2016. The European region's outlook strengthened well in 2015, and I continue to expect strong results from Europe in 2016. The (small) loss in 2015 strengthens my expectation of good 2016 results. Real estate has done quite well in recent years, but came down to earth in 2015. With rising rates, real estate companies can find it more expensive to operate, and investors have less incentive to overinvest in real estate in 2016. For this reason, I am retaining the 'upper limit' on real estate. General bonds lost a little in 2015, but the Fed raising rates in 2016 will continue headwinds for quality, general bonds, and so I am leaving my 'upper limit' on them this year.

Oil—Oil fell sharply in late 2014, and continued to plummet in 2015. As was the case in March 2009, the bad news must end at some point, and once the energy market stabilizes, even at a much lower level, the energy sector should stop dragging down the US stock market. We don't need oil to recover to make 2016 a good year—it just needs to stop falling.

Lower oil prices bring many positive consequences, not least of which is more money in US consumers' pockets from lower gas prices. Low oil prices help manufacturers who use a lot of energy (or plastics, which often are derived from fossil fuels) and who can boost their profits when energy prices are low. Countries that import a lot of oil and natural gas, including Japan and most of Europe, are seeing an 'oil dividend' for their consumers, corporations, and government.

Lower oil prices introduce a global instability factor. Many middle-eastern countries (regimes) stay in power by using oil sales to fund services that keep their population satisfied. The lower oil prices go, the harder it is for these countries to continue to operate financially. Earlier this week, I read a story that ISIS is encountering financial difficulties due to the sharply lower oil revenues it is earning. Markets like stability and certainty. Should we cross a tipping point, matters could get very messy.

While the election season brings uncertainty, November brings certainty. Furthermore, election years are typically good for markets, as they often include wonderful promises from everyone looking to be re-elected, raising consumer and investor sentiment. Next year, though, watch out!

Final word—2015 was poor. 2016 should be better, and could be much better, at least for stocks. Expect continued, if not heightened, volatility. Rebalancing helps investors even more in volatile times. Our **Drop and Give Me Five™** program provides an additional method to benefit from the likely volatility in 2016. Age old wisdom for this year—"Plan your play, and play your plan!"