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Fourth Quarter 2015 Market Review and Outlook

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Market Review and Outlook

2015 was filled with volatility and disappointment for most investors. Stocks suffered their worst year since 2008 ending three consecutive years of double digit gains for the S&P 500 Index. For the year, the S&P 500 Index fell -0.73% finishing with a total return of +1.38% including dividends. The index closed 4.08% below its all-time high, set on May 21, 2015. Following a strong second quarter, international stocks fell sharply returning a negative -5.66% for the year. Emerging market stocks fared even worse plagued by falling commodity prices ending with a loss of -14.92%.

Asset Class	YTD 2015 Returns
U.S. Stocks	+1.38%
International Stocks	-5.66%
Emerging Market Stocks	-14.92%
Bonds	+0.55%

Source: Bloomberg Financial L.P.
as of December 31, 2015

2015 Stock Market at a Glance

Source: FactSet

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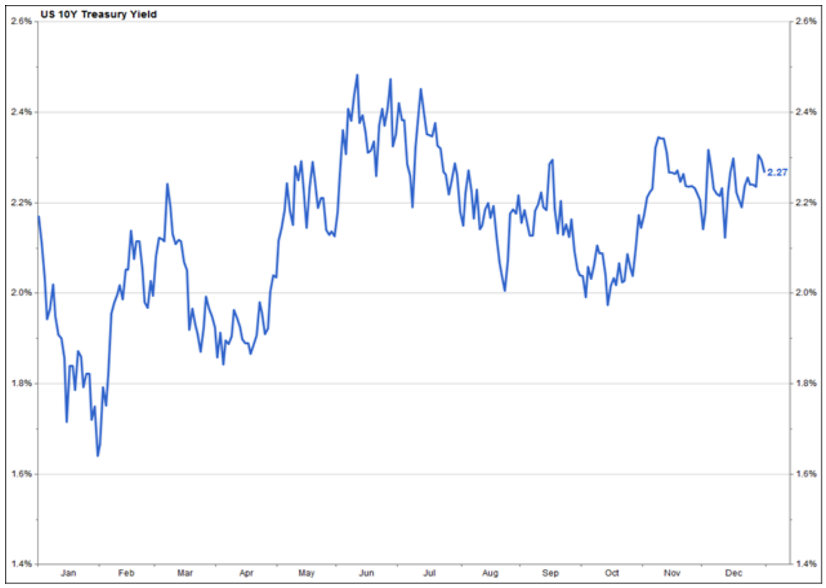
Source: Stephens Capital Management

Interest Rates Remain Stable

Interest rates were little changed for the year with the 10-year U.S. Treasury bond closing at 2.27% up slightly from 2.17% when the year began. Declining bond prices resulted in a return of +0.55% for the Barclays Capital US Aggregate Index.

10 year U.S. Treasury Note



Source: FactSet

Dollar Strength and Falling Energy Prices Trigger Earnings Recession

Profit growth stalled in the U.S. in 2015 due to falling energy prices and a strong dollar. Currently estimated earnings for the S&P 500 are expected to decline 0.7% from 2014.

With energy prices falling over 60 percent in the past 18 months, year over year energy company earnings are expected to decline 60% as well. Excluding the energy sector, earnings for the remainder of the S&P 500 are projected to be up 6.2% from 2014.

West Texas Intermediate Crude Oil

Source: FactSet

Oil Prices Decline Further

U.S. WTI crude declined by 30% in 2015 and is trading at $33 per barrel today, a level last seen during the global financial crisis of 2008.

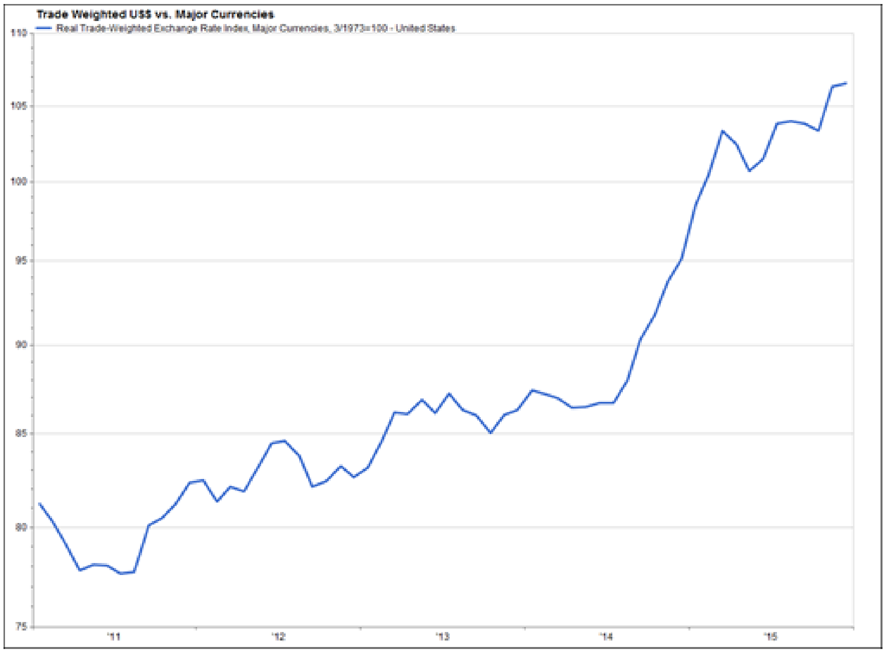
Energy Recession Deepends

New horizontal drilling and hydraulic fracturing technologies have allowed energy companies to unlock supplies of oil and gas from shale formations in the U.S. and Canada, and in 2015 the U.S. passed Russia and Saudi Arabia to become the world's largest producer. Lower energy prices means lower returns on investment for energy exploration projects, placing the survival of many energy companies at risk. As the price of oil has fallen, many debt-laden companies have reached their credit limits leaving them with no clear path out of the current crisis. Lower earnings for energy companies have driven down stocks with the energy sector of the S&P 500 as the worst performer in 2015, down -23.55% for the year.

The 24% rise in the trade-weighted U.S. dollar relative to other currencies over the past 18 months has also dampened corporate earnings. The strength in the dollar has been due in large part to a divergence of central bank monetary policy. The Federal Reserve began raising interest rates in the U.S. while the Eurozone and Japanese central banks are expected to continue and perhaps increase their monetary stimulus programs.

Dollar Strength Crimps U.S. Company Earnings

Trade Weighted US vs. Major Currencies



Source: FactSet

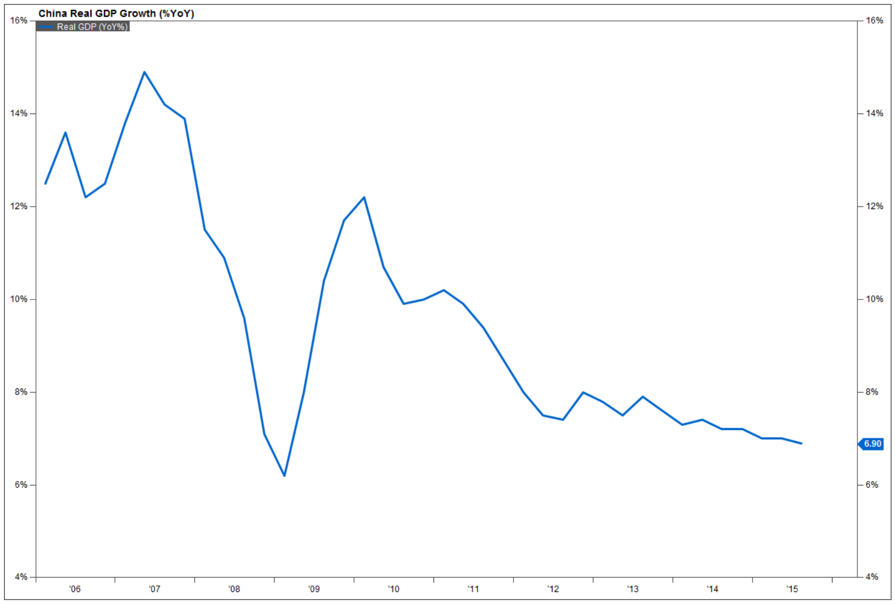
A strong dollar reduces exports and consequently manufacturing activity in the U.S. According to FactSet, the estimated earnings growth rate in 2015 for companies that generate more than 50% of sales inside the U.S., is 5.7%. For companies that generate less than 50% of sales inside the U.S., the estimated earnings decline is -7.7%.

A strong dollar does benefit consumers and businesses that are aided by lower import prices, however; the Federal Reserve will need to proceed cautiously with future rate hikes to ensure that a strengthening dollar does not crimp exports to the point of hampering a slow growing U.S. economy.

China's Growth Slowdown Continues

Economic growth in China weakened further in 2015 as government leaders attempt to negotiate a transition from a manufacturing and export driven economy to a consumer-driven economy. Concern about China's economy reached a crescendo in August when China's central bank unexpectedly announced it was devaluing the yuan. Markets interpreted the move as an indication of government's concern about slowing growth. China's combined private and public debts have soared to 244% of gross domestic product from 148% in 2008. At the same time economic growth has decelerated to an estimated 6.8% in 2015 from 9.6% in 2008.

China Real GDP Growth



Source: FactSet

It is evident that the days of double digit economic growth are no longer reasonable in China. The direct linkage between the Chinese and U.S. economies is quite small. The U.S. Exports roughly $124 billion in goods and services to China each year, which represents 7.0% of total U.S. exports and about 0.7% of U.S. Gross Domestic Product. Volatility in the Chinese stock market makes great headlines for the financial news media but long-term investors need to avoid the distraction.

Fed Liftoff

In December, the Federal Reserve finally had enough confidence in the labor market and the pace of economic growth to raise the federal funds rate by 0.25 percent to 0.50 percent. This is the first interest rate increase since 2006. Unemployment continues to trend lower with the likelihood the U.S. economy will be at full employment sometime this year. Inflation remains below the Fed's 2% goal, and Fed officials have pledged to be data-dependent when it comes to further tightening. We believe future rate hikes will be gradual. Our expectation is for a series of three quarter-point rate hikes in 2016. Moving from zero bound toward a normal interest rate level, should not be a significant headwind for stocks in the year ahead.

Outlook

The Outlook for Stocks Remains Positive

The future is by definition unknowable. The current bull market is 83 months old, the third-longest since 1932. Corporate earnings are the fundamental driver of equity prices. We expect the U.S. economy to continue growing slowly but steadily in 2016 despite the Federal Reserve's gradual rate hikes. Will U.S. companies be able to shake off the weight of a strong dollar and lower commodity prices to expand profit growth in 2016? Currently analysts are estimating year over year earnings growth of +8.62% for the S&P 500 companies. Emerging markets are estimated to have even higher earnings growth of +19.14%. When investors compare the yield on the 10 year U.S. treasury of 2.19% to the dividend yield of the S&P 500 of 2.16% and the earnings yield of 6.4% on a forward basis, it is clear the value resides in stocks.

Investor sentiment appears overly negative as we enter 2016. Historically, stocks struggle for the first six months following the first rate hike, but rarely if ever has it been a precursor to the end of a bull market. Investors would do well to ignore the high frequency news flow that creates unneeded distraction and stick to the fundamentals of investing. The correct strategic asset allocation combined with the appropriate risk-return balance and patience will be rewarded as in the past.