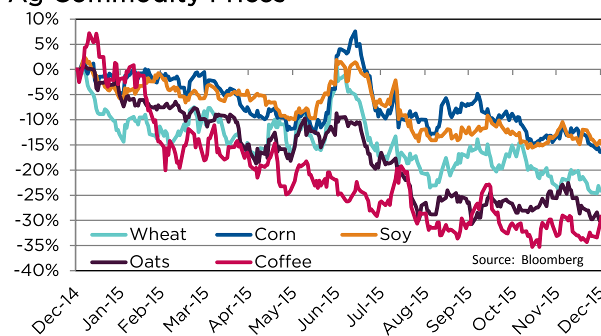
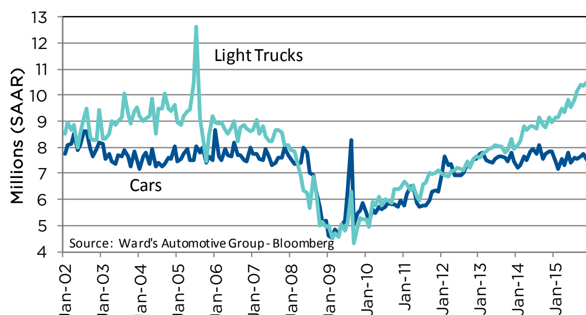
ECONOMIC REVIEW DECEMBER 2015

Stocks and bonds fell during December, closing off a turbulent year. U.S. growth stocks strongly outperformed their value counterparts and large-cap stocks bested small-cap stocks during 2015. Developed market foreign stocks fell for a second year and emerging market stocks posted a third consecutive losing year. High-yield bond issues lost 4.5% for the year, losing ground in six of the last seven months. Ten-year Treasury bonds gained 91 bps during the year as yields stayed in a narrow band after January. Mergers continued to be a major avenue to enhance earnings and lower costs. Dow and DuPont announced a proposed merger, while the Federal Trade Commission again blocked a merger of Staples and Office Depot based on highly concentrated market share. The office supplies market has few major retailers chasing a market battered by the expansion of digital workplaces. The chemical industry has seen headwinds from weak foreign demand and a stronger U.S. dollar. Agricultural demand softened, lowering the demand for fertilizers while slower industrial demand for chemicals brought Dow and DuPont together in order to streamline their workforces. Farmers held back crops from markets in hopes of raising sagging prices. Banks lent heavily in recent years for farmland purchases when prices were escalating rapidly and remained willing to lend, but more so for land purchases in crop-producing areas than for machinery and operating uses. U.S. consumers purchased new autos at a heightened pace, prodded by relatively cheap gas, low interest rates and an improved employment outlook. Car sales remained steady since 2012, while light truck sales, which include crossovers and SUVs, accounted for nearly all the growth since 2012.

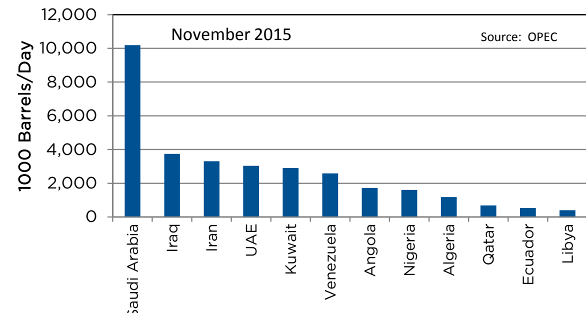
Ag Commodity Prices



U.S. Auto Sales



OPEC Oil Production



Market Returns

As of December 31, 2015

	December	3 Months	1 Year
S&P 500	-1.6%	7.0%	1.4%
Russell 1000 Value	-2.2%	5.6%	-3.8%
Russell 1000 Growth	-1.5%	7.3%	5.7%
Russell 2000	-5.0%	3.6%	-4.4%
MSCI EAFE	-1.4%	4.7%	-0.8%
Emerging Markets	-2.2%	0.7%	-14.9%
Barclays Agg	-0.3%	-0.6%	0.5%
3-Month T-Bills	0.0%	0.0%	0.1%

Following months of building expectations, the Federal Reserve raised interest rates 25 bps. Previous to raising rates, Fed statements had cited the need to observe data points within somewhat arbitrary ranges. However, by the last meeting of 2015, the FOMC had left itself little choice but to raise rates, even though inflation remained negligible and upward wage pressure had not materialized. By essentially committing to a rate hike by year-end earlier in 2015, the FOMC talked itself into action. Precious metal prices fell sharply shortly after the Fed's October meeting, foreshadowing high anticipation of an impending rate hike. Holding rates at zero percent for several years, even as the policy proved less effectual than theorized, left many Fed governors defensive amidst earlier calls for higher rates. Because the December rate increase was based less on statistical indications than sentiment, investors will be parsing Fed statements and speeches for future rate hike indications. Current forecasts call for rates to rise 50 to 100 bps in 2016. Rates are not expected to reach long-term average levels for the foreseeable future. The European Central Bank cut interest rates 10 bps, lowering its deposit rate to -0.30%.

The divergent trajectories of the U.S. dollar and most major foreign currencies will negatively impact U.S. corporate earnings and exports. With the continued transformation of China's economy and subsequent slower growth, optimistic forecasts for 2016 world growth are close to 3%, well below the 3.5% average seen in years without financial shocks.

In December 1975, President Ford signed into law a ban on oil exports. Following the Arab oil embargo that crippled U.S. gasoline supplies, successive leaders have continued the ban in the name of energy independence. Not until recent drilling developments, which include fracking and extensive tar sands processing, have U.S. and Canadian oil producers been able to influence global oil prices so profoundly. With the passage of the 2016 federal budget in December, the export ban was lifted and the first tanker carrying domestically produced crude oil departed Texas at the end of December. The opening of global markets to U.S. producers should alleviate some of the slowdown that punished drillers and steel manufacturers when oil fell to $37/barrel in December from $100/barrel in July 2014. West Texas and North Dakota have borne the brunt of the oil production slowdown. The ability to export oil likely will help stabilize production in the regions.

Tensions between OPEC members caused an early end to its December meeting without setting an oil-production quota. The lack of agreement comes on the heels of elevated Sunni-Shia fighting in the Middle East. Saudi Arabian Sunni leaders produced more oil and brought down prices as its Shia-led neighbors, Syria and Iran, fought to lessen Saudi influence in the region. Russian military support for Syria and Iran gave Saudi leaders further impetus to impart economic pain on these three, major oil-producing nations as they look to increase production to shore up increased military spending. As U.S. sanctions on Iran are set to ease, Iran is poised to significantly increase oil production, likely adding downward pressure to oil prices.

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