MURRAY
INVESTMENT MANAGEMENT

4th Quarter 2015 Update

Economic Review

The U.S. economy continued to grow during 2015 with 4th quarter growth expected to be around 2.0%. During the quarter and for the year, the U.S. economy expanded, but growth was below our long-term potential as it has been for most of the current expansion. In addition, slowing growth in China was an area of concern given its impact on the global economy.

U.S. employment improved during the year and showed particular strength in the 4th quarter. Average monthly job growth was 221,000, and the unemployment rate fell to 5% from 5.6% at the end of 2014. The strength in the job market and the overall improvement in the economy led the U.S. Federal Reserve to raise rates .25% in December. This was major news since rates had been near zero since 2008, and the move reflected the Fed's confidence in the strength of the U.S. economy

Equity Market Performance

	QTD	YTD
S&P 500	7.04%	1.38%
MSCI EAFE (International index net return)	4.71%	-0.81%
Rusell 2000 (small cap)	3.59%	-4.41%

Uncertainty about when the Fed would raise rates, a weak energy sector and slowing growth in China weighed on equity markets during 2015. The S&P 500 posted a modest gain but produced its weakest performance since 2008 with 5 of 10 sectors in the red and the energy sector down over 20%.

With many asset classes delivering negative returns, 2015 was a very challenging equity environment. These four significant areas of the equity market had negative returns for the year: small caps (-4.41%), mid caps (-2.44%), developed international (-.81%) and emerging markets (-14.60%).

Bond Market Performance

	QTD	YTD
Barclays US Aggregate Bond (Broad Bond Market)	-0.57%	0.55%
Barclays Municipal	1.50%	3.30%
Barclays US Treasury Long	-1.38%	-1.21%
Barclays US Corporate	-0.58%	-0.68%
Barclays US Corporate High Yield	-2.07%	-4.47%

The 10 year treasury rate bounced around during the year and ended slightly up at 2.27%. The broad bond market produced a modest .55% gain while the high yield space was under pressure and was down -4.47%.

Economic Outlook

For the U.S. economy, the current expansion should continue in 2016 with expected GDP growth of 2%-3%. While inflation should not change much, we could see continued strength in employment which could drive growth higher.

U.S. interest rates remain at very low levels, and the Fed is expected to raise rates patiently (roughly 1% / year) over the next 3 years. Rate increases will be monitored closely during 2016 and will be dependent upon the strength of the U.S. and global economies. One theme to note and monitor is the divergence in central bank policies globally as the U.S. raises rates while other regions lower them. This will likely have both market and economic implications.

The energy sector will be another area of focus during the year. Whether this space improves or further deteriorates will heavily impact the economy during 2016. The upside to a weaker energy sector is that lower gas prices benefit consumers, and this, along with an improving employment situation, could drive consumers to spend more and help the economy grow.

Market Outlook

As noted in a recent Wall Street Journal article, "many of the forces behind this year's disappointing performance-including low commodity prices, sluggish global growth, shrinking corporate profits and a stronger U.S. dollar-could persist in 2016." If we add a rising interest rate environment to the list above, we have a good summary of the headwinds that we face in 2016.

On the positive side, we have more clarity about the Fed's expected path for raising rates, a growing global economy, low expectations for market performance and reasonable (but not cheap) valuations.

We could see increased market volatility throughout 2016 as a fragile energy space, slowing growth in China and a continuing debate regarding the pace and magnitude of U.S. rate increases weigh on equity markets. In addition, we will need solid earnings growth to drive markets higher as further multiple expansion is not expected. A grind it out type of market with some ups and downs throughout the year would not be a surprising result in 2016.

Consistent with what we have seen over the last several years, interest rates remain low but are expected to rise. As such, the risk / reward profile for many fixed income securities is not

Source: bls.gov, federalrserve.gov, frbatlanta.org, Morningstar, bea.gov, Bloomberg, The Wall Street Journal and treasury.gov
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very favorable with very few attractive options. If rates increase as expected, this view could change, and portfolios would be adjusted accordingly. Currently, holding a larger level of cash and shorter term securities in the fixed income allocation seems to be a reasonable approach.

Murray Investment Management

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please give us a call. Also, please pass along our name to anyone that may be in need of investment advice.

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