Economic Updates and Outlook



"Cup of Joe"

The end of the year has been rocky, to say the least. The FED has raised rates, as anticipated, with very conservative guidance for future rate increases. Oil is also experiencing another leg lower after the Saudi's announcement last week that they will maintain the current level of production indefinitely.These two headlines were the driving force behind what has been a historically flat and volatile year in the equity markets. In this email blast, we will provide a broad summary of 2015 and what we see moving forward for 2016.

If you have been watching the economic headlines throughout the past 12 months or so, the two major factors influencing the markets have been the oil price decline and the Federal Reserves's raising of interest rates. Let's start with oil. Oil has had a monumental decline from its high of $147.50/barrel in 2007 all the way down to $34/barrel today. This has had major consequences that have reverberated through not only the equity markets, but the bond markets as well. As previously discussed, the S&P 500 is made up of a little more than 10% energy companies. When oil collapsed, these companies' share prices were cut in half, having a profound effect on the overall market performance. Hedge funds (giant investment fund managers), who were heavily invested in oil, have also been going belly-up as of late causing mass liquidations of their stock portfolios. Many hedge funds are posting losses of 20% or more for the year. Most fund managers and energy experts predicted that the price of oil would rebound toward the end of the year but that has proven to be untrue. The tipping point came a week ago when the Saudi's came out and basically said that the days of cutting supply to balance the market is over. This move is no longer profitable. Their new plan is to keep pumping more and more oil until the price gets so low that the U.S. and other oil producing nations suffer. This is their new plan to maintain and acquire more market share. So how low will the price of oil go? No one knows, but until oil finds a bottom, the market will continue to suffer. Now for the good news. As we have said numerous times in the past, LOW OIL PRICES ARE GREAT FOR THE CONSUMER. And these low oil prices look like they are here to stay for the foreseeable future. The years of $100/barrel oil are gone for now and that means more money in everyone's pockets. With the projected 70% of GDP (value of all goods and services produced over a period of time) driven by the consumer, more money in our pockets helps drive the economy. The unseasonably warm weather has also been causing heating oil and natural gas to plummet. We have already seen signs of this with robust auto sales numbers, home-building, and strong retail sales numbers. Stores like Macy's are hurting (brick and mortar stores) but companies

like Amazon are booming. The paradigm has shifted to shopping online and it seems like every year, the numbers continue to grow.

The second part of the story is interest rates. When will the FED raise rates? What will the pace of the rate hikes be? Is the economy strong enough to handle this? The experts and economists can all speculate but no one really knows until it happens. These questions have been floating around for a while now. Well, it finally happened and as anticipated, a 25 basis point increase was implemented. These factors are the primary cause of the historically flat market in 2015. The reason I keep including the word “historic” is that it is just that. The market hasn’t been this flat (hasn’t moved up or down measurably) for 90 years. That is quite a long time, and has befuddled most if not all of the financial prognosticators who use history and experience as their guide. The “great recession” of 2008-2009 was historic. The monetary stimulus that followed to rescue the economy was historic. Now they are raising the rates from ZERO. No adviser or money manager wants to stick their neck out due to the ever present fear that lingers in everyone’s mind from 2008. Let’s call it a 6-year hangover that never really goes away.

So what does this all mean for 2016 and beyond? We feel that the underlying economy is strong. Energy is looking to remain under pressure until it finds a bottom. Again, this is temporarily hurting the markets but great for the consumer. We will start to see large scale energy companies swallow the little guys and a mass consolidation will take place. Once this happens and the dollar weakens a little, energy will start to rebound. As for the rates, remember that Janet Yellen and the FED have said that their pace of a rate rise will be SLOW and dovish. There are no signs of inflation and workers' wages are just starting to rise. GOOD NEWS. We don’t expect robust growth in the U.S. next year due to the strong dollar hurting exports, but nevertheless, slow growth is better than no growth. Europe and other developed countries are looking favorable, having just started their own “easy money” policies much like we did 6 years ago and it's working great so far. We also feel as though emerging markets are looking to find a bottom sometime in the first or second quarter of the year, creating some interesting value plays. Financials are beginning to look attractive as well, looking to benefit as rates continue to rise.

Overall, we do not think the bull market is over. Fixed income looks to continue to pay feeble returns, creating an environment that favors equities for years to come. Lower rates for longer, coupled with increasing economic growth in the U.S., a stronger consumer, and the accommodative measures of the European Central Bank and the Bank of Japan look to keep our outlook modestly positive for 2016. While returns may not be as robust as they were immediately following the recession, we look to unlock value in other areas of the market while monitoring the ever-changing economic landscape. We are shifting the portfolios to take advantage of the areas we see the most potential for growth in and taking some money off the table in areas where the strong dollar is causing headwinds. We currently favor Europe, Japan, smaller U.S. companies, financials, and other specific sectors that will continue to grow such as Technology. We also like Apple and Berkshire Hathaway for the long term. NOTE: You will be receiving notification from TD Ameritrade of our latest re-balancing moves in your portfolio over the next week or so.

Thank you to all of our clients for your feedback, as well as your referrals, and remember to keep funding those retirement accounts! On a side note, my Dad and I have recently had the pleasure of meeting with some of our clients who been with us for over 30 years! Wow!!! This reinforces how much we appreciate the strong bonds we have built with you all over the years. All of the staff at Chapel Hill wish everyone a very Merry Christmas, a Happy Hanukkah and a prosperous New Year. As always, thanks for reading.

- Joe and Ryan

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