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2015 Recap and 2016 Markets Outlook

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With 2015 in the history books, we wanted to review the past year of market activity and outline some of the key trends, events, and headlines that we expect to dominate the New Year.

First, let's start with a 2015 recap. What we saw in 2015 was a carryover from how 2014 ended. Global economies have slowed, and companies have struggled to increase their top line sales. Unlike the past few years, 2015 did not set a new profit record, though that's not to say profits did not do well. Most companies were able to grow their bottom line, but this growth could not offset the declines coming from the energy sector and companies' non-US dollar earnings.

The few companies that were able to show meaningful top line sales growth became the new darlings of Wall Street and saw their stock prices appreciate quickly. That's because investors were eager to invest in companies showing revenue growth and as such, weren't deterred by the expensive prices. This has led to very narrow market breadth – in which relatively few stocks are leading the market while the vast majority of companies are trading below their highs.

Now, let's look ahead to 2016.

Market Valuations

There are certain segments of the market that are now quite expensive. Megacap companies and growth companies are trading at roughly six to seven times more than value companies (Source: DFA Global Market Review) - a little more than we'd expect.

In light of this, we are looking to buy companies that are more fairly to attractively priced. We do so knowing that we can never perfectly time when we're going to get rewarded for holding these companies, though we generally expect to be compensated over a three- to five-year period.

The most expensive names, while they've seen tremendous growth, must continue to meet high expectations in order for prices to keep moving higher. More reasonably priced stocks, on the other hand, already have much negative news already priced in and have a much lower bar to achieve. This is certainly true of international assets currently.

Interest Rates

The Fed announced on Dec. 16 that rates would go up by 25 basis points; we estimate that they will continue to move slightly higher, albeit slowly, in 2016.

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Inflation, which is a primary driver of interest rates, isn't growing enough to push rates much higher. As mentioned in previous commentaries, there are too many commodities sitting unused across the globe.

Inflation

If inflation pushes interest rates higher, what pushes inflation? Labor is one factor that affects inflation.
There remains a lot of underemployment in the U.S. right now. Many people are working part-time but would rather be full-time. Others have dropped out of the workforce altogether, though they didn't make that decision and would rather work if conditions were better.

Additionally, markets are anticipating slow growth globally, especially because the Chinese economy is slowing down. There are still areas of the globe that are quite dependent on energy (Canada and Australia) and/or trade with China (Japan), and because of China's woes, those regions are struggling or in recession.

U.S. Dollar

Despite concerns about the pressures on and threats to the dollar – which some think could cause it to lose its reserve currency status, it has strengthened over the past year and a half.

Though recently the dollar's movements have slowed, it's ticked a little higher. That keeps investments like commodities, which are priced in dollars, low. It's also causing investments denominated in other currencies to lose relative value.

The strength of the dollar has been great for consumers who conduct transactions using the U.S. dollar and for US assets. We believe investors should be diversified should the dollar resume it's longer-term trend lower against a basket of foreign currencies. The dollar's growth has been aided by speculators and momentum traders to a point which we believe is too expensive, though its momentum could certainly continue into 2016. With so many people piling into the dollar hoping to ride the momentum, there is the risk that the dollar could tumble if those same people flee it all at once.

To summarize, the items we were tracking in 2015 – interest rates, inflation and the strength of the U.S. dollar – will continue to be worth monitoring in 2016. As always, we remain aware that the global economy is interconnected, and headlines in one region of the world will almost certainly affect others.

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