The Fairlead Quarterly

Fourth Quarter of 2015

Fairlead Financial Advisors, LLC

www.fairlead-fa.com 415-381-6890

INSIDE THIS ISSUE

Quarterly Overview

After a bruising third quarter the markets rebounded in October and November only to slide again in December. While the markets finally got their long awaited quarter point rate hike from the Fed (the first since 2008), continued fear of a global slowdown led by China, and falling oil prices took their toll. The index returns while generally flat to slightly negative do not paint a fair picture of just how difficult a year it was. The FANG stocks- Facebook (+34.15%), Amazon (+117.78%), Netflix (+134.38%) and Google - (+44.56%) carried the indexes. A look at market "internals" reveals that the vast majority of stocks had a much more difficult year many down 10% and 20%. The Russell 1000 (Large Cap Stocks) ended the year up 0.92% but growth (with the FANG) was up 5.67% and value was down -3.83%. The NASDAQ Composite 100, which measures the 100 largest companies listed on the NASDAQ Exchange, and is a growth index (also FANG heavy) posted an 8.43% gain - the best performance of any index we track. The Russell Midcap Index, lost -2.44% with the growth side down a mere -0.2% and the value side down -4.78%. The Russell 2000 (Small Cap), was down -4.41% - again growth outperformed value, down -1.38% versus -7.47% for the year. The overseas markets had an even tougher year.

Overseas, the EAFE (Developed Overseas Markets) was down -0.38%, but Foreign Emerging Markets (MSCI Emerging Markets Index), generally more exposed to China's woes, were down -14.6% for the year, and were down -6.42% (per year) for the last three years - almost a -20% decline in value. All this in a year that began with many expecting it to be a turnaround year of outperformance for foreign stocks - which is the way it started in the first quarter.

The Barclays US Aggregate Index was up 0.55% during the year. TIPS (Treasury Inflation Protected Securities) were down -1.44%, and High Yield (Junk- lower quality bonds) bonds were down -4.47%. Emerging Markets Bonds, as measured by the Barclays Global Emerging Markets Index, were down -0.18% and the Lipper EM Debt Index was down -3.01%.

After a difficult three quarters Real Estate Investment Trusts (REITs-FTSE NAREIT ALL Index), staged a huge comeback in the fourth quarter posting a positive 7.13% return to end the year up 2.29%. Similarly, Utilities (DJ US Utility Index) which had a weak first half of the year posted a strong third quarter (5.78%), and a positive fourth quarter (1.13%) to cut its year end loss to -3.06%. The Alerian MLP (Energy - Master Limited Partnership) Index was down another -2.76% for the quarter to provide a very painful -32.59% loss for the year in a space long favored by yield starved dividend investors.

Commodities (DJ UBS Commodity Index) fared poorly investors running for the exits in the face of the China slowdown, the index ended the year down -24.66% giving it a -17.29% three year return – over a 50% decline in value. The Metals and Mining Index, fell -41.61% last year, down an incredible -30.65% for the quarter. Gold ended the quarter down -4.85% and the year down -12.11%.

The Backdrop

Oil & Commodities: The precipitous and unexpected decline in oil was certainly THE story of the year for 2015. According to the U.S. Energy Information Administration (EIA,) Brent Crude ended 2011at $107 per barrel, 2012 over $109, 2013 over $110 and steadily declined from a high in June 2014 of almost $112 down to $38 at the end of 2015. Right now oil has broken below $30. It is almost hard to believe that oil analysts who do nothing but evaluate supply and demand didn't see this coming. While this is terrible news for oil producers (domestically certain states and internationally certain countries), this should be a tailwind for our economy with lower costs for the consumer – and our economy is two thirds consumer based. But oil patch jobs were some of the best jobs created in an otherwise tepid recovery and the stocks of virtually all oil related companies have plunged. The potential ripple effect is that many energy companies issued a lot of debt in the high yield debt markets – and if we start seeing significant defaults, this may reverberate through both the stock and bond markets.

The Fed and Global Central Bankers: The Fed finally raised rates in December. After sitting on the fence for so long, with unemployment at 5% and a market rebound off of the August lows, they were backed into a corner and had to finally pull the trigger. The most significant impact of this rate increase has more to do with its global ramifications than the cost of credit in the US. We are entering 2016 with bifurcation in global central banking policy. The US has tightened while virtually every other central bank in the world is easing trying to stimulate their economies. The overall impact is that the dollar continues to strengthen against other currencies. This has a few negative side effects. Because oil is US dollar denominated it makes oil more expensive for other countries (though the decline in oil prices more than offsets the currency headwind). For those countries that have US dollar denominated debt it makes it harder to service those interest payments. US goods become more expensive for other countries which hurts US exports, and it depresses the earnings of multinationals (eg Procter & Gamble, Apple, and Johnson & Johnson) who earn money in foreign currency and then convert those earnings to US dollar terms.

U.S. and Overseas Economic Activity:

Europe: The European economy continues to be slow. The European Union's statistics agency said gross domestic product was 0.3% higher than in the 3 months to June and 1.6% higher than in the third quarter of 2014. On a quarter to quarter basis this result was down slightly from the second quarter's growth rate of 0.4%. The slowdown is attributable to weaker exports to large developing economies such as China and Latin America. In the face of this the European Central Bank is expected to remain accommodative.

U.S.: GDP in the third quarter slowed to 2% from a strong second quarter rate of 3.9%. Deceleration in GDP resulted primarily from deceleration in exports and an increase in imports which are a subtraction from the GDP calculation. Strong dollar equals more imports, fewer exports. The US economy is an $18 trillion economy and represents about 22% of the global GDP.

China: The extent of China's slowdown will continue to cause volatility in the markets as expectations and actual results are balanced. China set a growth target of 7% for 2015 and appears to have met that target (6.9% expected) with the services sector accounting for about half of GDP. In dollar terms the GDP is about $10 trillion USD. This is the slowest growth since 2009.

Inflation: Inflation continues to be low presenting a conundrum for the Fed. They have met their employment target for further increases but with dangerously low inflation they risk sending the economy back into recession. For the 12 months ended November 2015 the rate of inflation was just 0.5% – its lowest level since 2008.

Unemployment: In October 271,000 jobs were added and the unemployment rate dropped to 5.0%. 211,000 and 292,000 jobs were added in November and December, respectively, and the unemployment rate was 5.0%. The number of unemployed is about 7.9 million, but in addition there are about 1.8 million "marginally attached to the labor force" that are not counted as unemployed. These individuals were not in the labor force and were available for work and had looked for work in the past 12 months but not in the past 4 weeks.

Housing: The most recent Case/Shiller data (published with a two month lag – October data) showed that the US National index recorded a 5.2% annual gain, the 10-City Composite Index gained 5.1% year-over-year and the 20-City Composite Index was up 5.5%. According to David Blitzer "Generally good economic conditions continue to support gains in home prices". Expectations are for continued low interest rates and future economic growth. Sales of new homes remains soft as compared with sales of existing homes. "The latest economic projections published by the Fed following the recent rate increase suggest that the Fed funds rate will be around 2.6% in September 2017… home buyers need not fear runaway mortgage interest rates."

Going Forward

2015 was a much uglier year in the markets than the headline large cap indexes would suggest. Virtually every other segment of the market was negative – with energy and natural resources shocking the global markets. Growth has outperformed value the past few years but this relationship tends to be cyclical.

January has started out as the worst January on record and it is unlikely, with its precipitous start that the month will end positive. There is a market adage that says "As goes January so, goes the year", but whether it ends 2016 lower than it is currently is anyone's guess.

We continue to be cautious but most are entering the year with an allocation that is relatively conservative. We continue to monitor earnings and manufacturing as sign of a recession.

As always I am available to discuss the markets, the economy, your portfolio and your concerns. I look forward to meeting with each of you in the New Year.

John Vreeland

SUMMARY OF INDEX RETURNS

Global Markets Year to Date					
INDEX	4th Quarter 2015	YTD 2015	Calendar Year 2014	Calendar Year 2013	INDEX DESCRIPTION
Russell 1000	6.5%	0.92%	13.24%	33.11%	*US Large-cap Stocks*
Russell 1000 - Growth	7.32%	5.67%	13.05%	33.48%	
Russell 1000 - Value	5.64%	-3.83%	13.45%	32.53%	
Dow Jones Industrials - Total Return	7.70%	-0.21%	10.04%	29.65%	
S&P 500 - Total Return	7.04%	1.38%	13.69%	32.40%	
NASDAQ Composite	8.38%	5.73%	13.40%	38.32%	
NASDAQ - 100	9.86%	8.43%	17.94%	34.99%	
Russell Mid-Cap	3.62%	-2.44%	13.22%	34.76%	*US Mid-cap Stocks*
Russell Mid-Cap - Growth	4.12%	-0.20%	11.90%	35.74%	
Russell Mid-Cap - Value	3.12%	-4.78%	14.75%	33.46%	
Russell 2000	3.59%	-4.41%	4.89%	38.82%	*US Small-cap Stocks*
Russell 2000 - Growth	4.32%	-1.38%	5.60%	43.30%	
Russell 2000 - Value	2.88%	-7.47%	4.22%	34.52%	
MSCI EAFE	4.75%	-0.39%	-4.48%	23.29%	
MSCI World ex USA	3.97%	-2.60%	-3.88%	21.57%	*World ex USA (US$)*
MSCI Emerging Markets	0.73%	-14.60%	-1.82%	-2.27%	*Emerging Mkts (US$)*
30 Day Money Market - All Taxable	0.01%	0.02%	0.01%	0.01%	*Cash*
Consumer Price Index - US	-0.26%	1.07%	0.76%	1.50%	*Measure of Inflation*
Barclays US Corp. High Yield Index	-2.06%	-4.47%	2.45%	7.44%	*High Yield (Junk) Bonds*
Barclays US Aggregate Bond Index	-0.57%	0.55%	5.97%	-2.02%	*General US Bond Index*
FTSE NAREIT REIT: All	7.13%	2.29%	27.15%	3.21%	*Real Estate Investment Trusts*
Dow Jones - Utility Average Tot Ret	1.13%	-3.06%	30.65%	12.69%	*Utility Index*
Alerian MLP Index	-2.76%	-32.59%	4.8%	27.58%	*Master Limited Partnerships*
Dow Jones - UBS Commodity Index Tot Ret	-10.52%	-24.66%	-17.01%	-9.52%	*Basket of Commodities*
Gold - London PM	-4.85%	-12.11%	0.12%	-27.33%	*London Spot Price*

Source – Thomson Financial Company