GCG's Fourth Quarter Market Analysis

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When Doves Cry

No, this title does not refer to Prince's hit song from 1984. After seven years, the Fed finally pulled the trigger and raised interest rates from zero to something just marginally higher than zero. Though highly expected, and unanimously passed by the voting members, this move is a bit unsettling to those "dovish" economists who have concerns as to whether our economy can handle such a move. However, rates are still historically low and these changes are unlikely to have a meaningful impact at current levels. Now, the world is more interested in the pace at which the Fed will increase them from here.

Fourth quarter stock returns were strong across the board. However, weak third quarter performance led to a year with just marginal gains in large cap stocks, and losses in both large cap international and U.S. small caps. The two asset classes that had the toughest years were in commodities and emerging market equities. Interestingly, the average hedge fund (the so-called "smart money") has also struggled as of late, with negative returns in 2015 and just over 2% annualized returns over the last five years.[1]

Market Returns as of 12/31/2015 (%)

INDEX	2015 TOTAL RETURN	FOURTH QUARTER TOTAL RETURN
DJIA	0.21	7.70
S&P 500	1.38	7.04
Russell 2000	-4.41	3.59
MSCI EAFE	-0.81	4.71
Barclays Aggregate Bond	0.55	-0.57

Source: Bloomberg: Reflects total returns.

In the face of what was a tumultuous year, the fact that stocks were essentially flat shows the resilience of financial markets. Think of just a few of the global issues this past year that had the potential to derail financial markets:

- Greek and Puerto Rico debt crises
- Depressed prices in oil and other commodities
- The devaluation of the Chinese Yuan
- The Syrian refugee crisis
- Terrorist attacks in Paris and San Bernardino, among others.

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A PAINFUL WAY TO STAY FLAT

Part of what made this last year in stocks feel so bad was due to renewed volatility. The Dow Jones Industrial Average had over 70 days with a 1% move in either direction. This is in fact "normal" and right near its long-term average. However, it felt uncomfortable because we had just half as many of those days in 2014.[2] Quite frankly, it was the last 6 years of historically low volatility that was the anomaly, not what we experienced in 2015.

And speaking of volatility, the "flash crash" that occurred this summer was alarming, but ultimately short-lived. Since 1980, the average intra-year decline for the S&P 500 has been 14%. So this year's peak-to-trough decline of 12% is nothing out of the ordinary, and again, is just part of what we as investors can and should expect from the equity markets.[3]

This more recent volatility is likely to be at least one reason that individuals are so sheepish about the markets. American households currently have less exposure to stocks, and are holding more cash, than at any time since 2007.[4] In a still very low interest rate environment where a six month jumbo CD returns just $370 on a $100,000 investment,[5] we believe this cash will find its way to stocks, providing some support. Given the uncertain state of the global economy, however, we would advise that investors be prepared for sustained market volatility and somewhat modest stock returns going forward.

THE STATE OF THE U.S. ECONOMY

Though the U.S. currently holds the unofficial title as the strongest global economy, I don't think anyone is going to brag too much about that designation. Since 2009, we have experienced the slowest expansion in history. This period has been referred to by many as a "growth recession," as GDP has advanced at a meager 2% annually and hasn't exceeded 3% since 2005.[6]
Other reasons for caution are:

- There are many unknowns as to how China's slowing economy will affect global growth and financial markets.
- Weak commodity prices continue to plague many countries.
- Year-end corporate earnings may decrease from last year's level (in large part due to weakness in the energy sector). This would be the first time since 2009… we'll see.[7]
- Manufacturing advanced at its slowest pace since 2009.[8]

However, as arguably the most stable economy in the world right now, there are some glimmers of positivity:

- The U.S. budget deficit is the lowest in eight years.[9]
- Small businesses expect to increase wages in 2016 by the largest amount in 14 years.[10]
- Corporate balance sheets are in very good shape.[11]
- The balance sheet of the average U.S. household also looks good:
  - Net worth is at an all-time high and approximately 25% higher than in 2007; net debt is at a 35-year low.[12]
  - The personal savings rate is the highest it has been in three years.[13]
  - Home values are rising.[14]

CHINA

The genesis of weak financial markets in 2015 can most likely be traced back to the summer when fears of slowing growth in China arose after they devalued their currency. This has implications for already weak commodity prices (of which China is one of the largest consumers) and global growth in general. However, the Chinese government has shown its willingness to reassert stability in the stock market when needed. The efficacy of those moves, though, has yet to be determined.

The slowdown in China does not necessarily portend a slowdown in the U.S. S&P 500 companies derive just 2% of revenues explicitly from China,[15] and exports to China comprise just 1% of our GDP. The implication for global developed economies should likewise be muted, as exports to China from the Eurozone and Japan are less than 1.5% and 3%, respectively.[16] But we do have some concerns as it pertains to the effects it could have on emerging economies. If severe enough, this may ultimately make its way to the U.S. and could have a meaningful impact.

OIL

As of late, the U.S. stock market seems to be trading in tandem with the price of oil. This is a bit confounding, as the U.S. is a net importer of oil, and therefore lower prices should provide an overall benefit. The drop in gasoline prices over the last year alone has put $800 in the pocket of the average household.[17] The result has been record-breaking automobile sales, and should translate into revenues for other sectors such as stores and restaurants.[18] It is constructive to remember that energy is a bigger part of the S&P 500 than it is in the economy overall. Therefore, the negative impact it has had on the stock market is not necessarily reflective of its impact on GDP growth.[19]

ARE WE HEADED FOR A BEAR MARKET?

The Fed raising its benchmark interest rate illustrates the confidence Janet Yellen has in the U.S. economy. She has been very clear that going forward, the pace of increases will be gradual and measured, dependent on supporting economic data both here and abroad.

Regardless, global weakness has led many to fear that a bear market (defined as a sell-off of 20% or more) is just around the corner. As I have stated in past communications, trying to predict these kinds of turns in the market are nearly impossible, so I will not attempt to do so here. However, using history as a guide, we can look at past bear markets to see how similar the world looks now compared to then.

History suggests that bear markets tend to be caused by a few identifiable factors, including: recessions, commodity spikes, aggressive Fed tightening, and extreme stock valuations. Let's take a look at those individually:

1. **Recession:** Not very likely with slow but steady GDP expansion, low inflation, improving labor market conditions, and an upward sloping yield curve.
2. **Commodity Spikes:** Commodity prices are at historic lows.
3. **Aggressive Fed tightening:** HA!!!See first paragraph.
4. **Extreme equity valuations:** The S&P 500 is trading at or below historical levels on a forward P/E basis.[20]

Furthermore, the current interest rate environment hardly resembles those preceding the last five bear markets:

Where Interest Rates Stood At The End Of Past Bull Markets

Day Bull Market Ended (S&P 500 Index)	Fed Funds Target Rate	10-Year T-Note
9/30/15 (Ongoing)	0.25%	2.04%
10/9/07	4.75%	4.65%
3/24/00	6.00%	6.19%
8/25/87	6.75%	8.72%
11/28/80	18.00%	12.72%
1/11/73	5.75%	6.43%

Source: Bespoke Investment Group, Bloomberg

Source: Data as of: 9/30/2015

Of course, this provides no guarantee that we are not headed for a bear market. And the fact is that we are in the midst of one of the longest bull markets in history, which at some point will come to an end. But while history rarely repeats itself, it oftentimes does rhyme. As such, on the heels of our low interest rate environment and arguably no violation of the four scenarios listed above (at least as of this writing), the data does not appear to suggest that a bear market is imminent.

A DISCIPLINED APPROACH TO SUCCESS

Given the plethora of uncertainty that abounds, there are probably many of you questioning whether you should have exposure to stocks. Famous mutual fund manager Peter Lynch reminds us:

"In spite of crashes, depressions, wars, recessions...and numerous changes in skirt lengths, stocks in general have paid off fifteen times as well as corporate bonds, and well over thirty times better than Treasury Bills."

He goes on to say:

"Absent a lot of surprises, stocks are relatively predictable over twenty years. As to whether they're going to be higher or lower in two to three years, you might as well flip a coin to decide."

The chart below illustrates the probability of the S&P 500 being positive or negative over various time frames. To Lynch's point, the longer one has to stick with an investment plan, the higher their likelihood of success:

Playing The Probabilities

S&P 500: 1926–2015

Time Frame	Positive	Negative
Daily	54%	46%
Quarterly	68%	32%
One Year	74%	26%
5 Years	86%	14%
10 Years	94%	6%
20 Years	100%	0%

Source: Returns 2.0

To put this into context, since the Great Depression:

- The worst return on a rolling 5-year time frame was -2%
  -The best period was an annualized return of +29%
- The worst return on a rolling 10-year time frame was -1.4%.
  -The best period was an annualized return of +20%.
- The **worst return** on a rolling **20-year** time frame was **+6.8%**.
  -The best period was an annualized return of 18%.

And as painful as it may be to have owned foreign and emerging market stocks over the last couple of years, we continue to feel these asset classes offer attractive long-term growth opportunity. Though they tend to exhibit more volatility, they share similarly favorable historical return characteristics to the S&P 500 as illustrated above.[21]

The reality is that for most people to achieve their goals, they will likely need some exposure to stocks. And for those with a 10-to-20-year time horizon (and that really can apply to anyone up to 75 years old) hopefully the commentary above gives you some confidence that you can achieve that.

Having the appropriate asset allocation is essential in helping you achieve your objectives. Please speak with your financial advisor about what asset allocation is appropriate for you given your objectives, liquidity needs, and tolerance for risk.

From all of us at GCG, we wish you a healthy and prosperous 2016!

Andrew M. Gluck, CFA

As a seasoned investment practitioner, Andrew understands how to navigate the investment universe in pursuit of achieving long-term performance objectives, while minimizing overall portfolio volatility

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Andrew Gluck, the Managing Director of GCG's Wealth Management Group has over 15 years of experience as a Portfolio Manager and Security Analyst. His primary expertise is in providing a comprehensive assessment of proper asset allocation, portfolio construction, and security selection, based on each client's financial goals and tolerance for risk. As a seasoned investment practitioner, Andrew understands how to navigate the investment universe in pursuit of achieving long-term performance objectives, while minimizing overall portfolio volatility.

Prior to joining GCG, Andrew spent 10 years as a Portfolio Manager at Harris Associates in Chicago, where he worked with high net worth individuals and institutions. In addition, he has founded and managed two separate investment partnerships.
Andrew earned a Bachelor's Degree from the University of California, Santa Barbara, and his MBA in Finance from DePaul University, where he graduated with Distinction.

He has earned the designation of Chartered Financial Analyst (CFA) and is a member of the CFA Society of Chicago. Andrew is a member of Securian's Investment Policy Committee and a consultant to Securian's Investment Resource Group (IRG).

Giving back to the community is important to Andrew. For years he has volunteered his time as a coach and board member of AYSO, in addition to serving on the Finance and Investment Committee at The Center on Halsted.

Andrew lives in Glencoe, Illinois with his wife and twin boys.

Andrew is a Registered Representative and Investment Advisor Representative of Securian Financial Services, Inc.

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Each quarter, Robert Janson, Senior Vice President, Wealth Management will provide an in-depth analysis of the key drivers of economic activity in the United States. He will look at the results/trends in the markets and economy with a focus on interest rates as well as the stock and bond markets.

You don't have to leave home or the office to listen in to this event! After registering, a link will be provided for you to watch the webinar on your computer or listen by telephone.

We encourage you to invite friends and family who you believe could benefit from this timely information.

1st Quarter Economic and Market Update
January 27, 2016
8:30 AM and 4:00 PM (CST)

2nd Quarter Economic and Market Update
April 28, 2016
8:30 AM and 4:00 PM (CST)

3rd Quarter Economic and Market Update
July 27, 2016
8:30 AM and 4:00 PM (CST)

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October 26, 2016
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Questions, Please contact Bryan Marrichi at (847) 457-3184 or
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About Robert Janson, AIF, CIMA
Senior Vice President, Wealth Management, GCG Financial, Inc.

Bob is a member of GCG's Design Center. His primary area of expertise is in the design, implementation and management of investment portfolios. He is a Vice-President of GCG Financial responsible for investment services and strategies. He also serves as Investment Officer and registered principal. Bob has been with GCG Financial since 1997.

Bob has been developing his investment expertise for over 23 years. Prior to GCG, Bob's background includes working with Blunt, Ellis, & Loewi, Charles Schwab Institutional, and Retirement and Estate Advisors. Through this well-rounded experience, Bob has gained a solid understanding regarding the balance between the goals of the client and the ever-changing nature of the markets.

Bob approaches portfolio management with a disciplined and strategic approach that strives to maximize total potential returns while managing the overall risk and volatility of the portfolio. For each client, he develops an investment portfolio that is customized to the client's investment objective, time horizon, and risk temperament.

Bob's professional designations include his Accredited Investment Fiduciary (AIF®), and Certified Investment Management Analyst (CIMA®).

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01. HFRI Fund Weighted Composite Index. The HFRI Monthly Indices ("HFRI") are a series of benchmarks designed to reflect hedge fund industry performance by constructing equally weighted composites of constituent funds, as reported by the hedge fund managers listed within HFR Database. The HFRI range in breadth from the industry-level view of the HFRI Fund Weighted Composite Index, which encompasses over 2000 funds, to the increasingly specific-level of the sub-strategy classifications.
02. Wall Street Journal, December 21, 2015
03. JP Morgan Guide to the Markets, November 2015, pg 12
04. Barron's, November 30, Chief
05. JP Morgan Guide to the Markets, Q4 pg 64
06. Investors' Business Daily, December 19, 2015
07. USA Today, December 31, 2015
08. Investors' Business Daily, January 5, 2016
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11. JP Morgan Guide to the Markets, Q1 2016, pg 13
12. JP Morgan Guide to the Markets, November 2015, pg 18
13. Wall Street Journal, December 21, 2015
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15. Investors' Business Daily, August 15, 2015
16. JP Morgan Guide to the Markets, Q4 pg 45
17. Wall Street Journal, December 30, 2015
18. Wall Street Journal, January 6, 2016
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21. financeandinvestments.blogspot.com (data as of 1988-2013)

Neither diversification nor asset allocation guarantee against loss, they are methods used to manage risk.
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Past performance is not indicative of future results. Investments will fluctuate and when redeemed may be worth more or less than when originally invested. One cannot invest directly in an index.
The S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market. This world renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 75 percent coverage of U.S. equities, it is also an ideal proxy for the total market.
DJIA definition: A price-weighted average of 30 actively traded blue-chip stocks, primarily industrials including stocks that trade on the New York Stock Exchange (http://www.nasdaq.com/investing/glossary/d/dow-jones-industrial-average)
The MSCI EAFE (Europe, Australia, Far East) Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises 21 MSCI country indexes, representing the developed markets outside of North America
The Barclays Capital U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset backed securities.
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity performance in the global emerging markets. As of June 2007, the MSCI Emerging Markets Index consisted of the following 25 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.
The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index.
The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
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Investments in commodities and natural resources involve heightened risk due to leveraging and speculative investment practices, lack of periodic valuation requirements and potentially complex tax structures.

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