Fourth Quarter 2015 Client Letter

Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria.” ***-Sir John Templeton***

Happy New Year!? Equities are having a really tough start to 2016. In fact, this one goes down in the history books as the worst start ever to a new year in the stock market. When I say “ever” that would be since 1897 (or at least as long as records have been kept). What a wild ride!

The S&P 500 Index closed 2015 down -0.7%, with many stocks loosing much more. I for one am glad 2015 is in the past, but 2016 has greeted investors with multiple triple-digit down days. Turmoil in China’s stock market, and currency markets unleashed a global contagion that immediately spread to the U.S., causing further plummeting oil prices. Based on Templeton’s quote above, the current market does not sound like a euphoric environment to me.

The Market is not the Economy

Author of The Intelligent Investor, Benjamin Graham, pointed out, “The day-to-day market isn’t a fundamental analyst; it’s a barometer of investment sentiment. You just can’t take it too seriously.” During this current environment of unknowns, it is second nature for fear to sink in with concerns about what the future may hold, and what the ramifications of a severe correction will have on one’s financial or retirement plan. In talking with a good friend (and client) last week we discussed the idea of “going backwards” in his retirement account, and how frustrating it is to see his savings effort be reduced by the current stock market sell off. As a observer of psychological human behavior, I find it interesting that investing in publically traded companies seems to have a different standard than anything else in our lives. When it comes to investing, we have a tendency to believe that investments will always go up and when they go down we generally feel like everything ahead is going to be bad. We have come to believe that if stocks are going up then it must mean that everything in the world is good, and if the stock market is selling off then everything in the world must be bad, or about to become bad. However, if shop at Nordstrom when it is holding a 50% off sale, we are filled with joy. If we fly through San Francisco airport often enough, we assume a certain percentage of delays. Strangely, with investing we don’t like corrections (sale or clearances) or market volatility (delays).

How did we get this way? How can it be that one day we can read in the news that the economy is booming along, and the next day everything is on the verge of falling apart? Let’s put the recent market doom and gloom into perspective. The chart below shows the S&P 500 Index performance. The first chart is February 29, 1928 to present. Wow! Look at the amazing amount of growth over the past 88 years (almost as evident is the massive amount of volatility since 1993):

S&P 500 Index 2/29/1928 - 1/15/2016

It's surprising to me the amount of volatility we have experienced since I started in this business in January of 1998. At that time the S&P 500 Index was at 980. The index is currently up 92% over the past 18 years (not counting dividends).

On the next page I show the same index covering the last 10 years, and as you can see we are much higher than the lows in 2011. It is generally a good idea to look at the market data in a different light, especially during the recent turbulence.

S&P 500 Index 1/19/2006 - 1/15/2016

The S&P 500 Index topped out on May 21st, 2015 at 2130.82. We are now at 1881, down 11.7% since the high.

New Year's Resolutions

This time of the year most of us give some thought to what we would like the New Year to look like, and maybe what we would like to look like as well. With the start we are having here in 2016 we may be more fearful of the unknown because of the market's gyrations. This year will bring about significant change, one way or another. Some of the uncertainty coming this year include:

- The Federal Reserve raising interest rates: Finally! This is the first rate hike in nearly a decade (the last rate hike was in June 2006). The Fed raised its key interest rate by .25% and suggested a continued quarterly rate hike coming in our future. The rate hike is a small one, but it will affect most on some level.
- In the United States, the elections may have a significant impact on the markets and possibly on the economic direction the country takes.
- Falling oil prices should benefit consumers keeping more dollars in their pockets, but carnage could ensue in unknown ways such bankruptcy of weaker oil companies and loan losses on bonds issued to investors (i.e., leveraged loan investors & banks).
- China plays an important role in determining global expansion or contraction while it digests its slowing rate of growth.

With so much uncertainty in the world I recommend a plan. The trick with planning, however, is to find an objective approach that works specifically for your life and can be manageable, attainable, and most importantly, measurable.

A good start will include:

- Building out a comprehensive balance sheet and household cash flow. It should take into account all your assets and liabilities as well as recurring expenses both now and in the immediate future (say the next five years).

- Summarize your goals and issues. This list should include your financial, estate planning and personal goals for the next five and ten years, and finally when you pass from this world. Make this list as specific as possible. Next, consider prioritizing your list in terms of importance.

- Compare your balance sheet and cash flow with your goals, and your current risk allocation. Do you have enough liquidity? Do you have enough of a safety net in the event something changes?

I would like to work together with you on these three areas. Regardless of market volatility, it will be good to look back at 2016 and see what we have accomplished together.

In closing, I want to thank you for allowing Sheppard Wealth to be your wealth management company this past year. We look forward to helping you navigate life in 2016. I leave with you a quote from Warren Buffett, "Valuing the market has nothing to do with where it's going to go next week or next month or next year, a line of thought we never get into. The fact is that markets behave in ways, sometimes for a very long stretch, that are not linked to value. Sooner or later, though, value counts."

Happy New Year, and may your 2016 be filled with much success!

Sincerely,

John Swanson, AAMS