## Perseverance – A Key to Success

As a child, you might have enjoyed riding a rollercoaster, but it would not be surprising that as we grow older such a ride becomes unpleasant. Whether it is the slow ride to the top of the first drop, the eye watering descent or stomach churning corkscrews, it is hard to understand why anyone would actually want such an experience. We feel much the same way about the market rides and can only imagine how unsettling it must be for you.

The fourth quarter was strong for all US equities, ranging from 2.9% returns for small cap value stocks to 7.3% returns for large cap growth stocks, as well as for international equities with the EAFE and EM indices up 4.75% and 0.73% respectively, in US dollars. This was in stark contrast to the rest of the year and, consequently, year-end returns were negative for all equities except US large cap core and US large cap growth. These results were not unexpected as we had not, until 2015, had a true (>10%) correction in US equities since 2011 and most domestic P/E ratios were above their 20 year average. By historical standards this is quite unusual as the


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) CBOE.
*Guide to the Markets – U.S.* Data are as of December 31, 2015.

frequency of 10% or greater corrections in the S&P 500 averages out to about once a year. We did see a correction in August from which markets rebounded, but then markets seem to have entered an irrational fear driven state. US investors remained nervous about stocks despite the fact that US equities have a double digit average annual return since 1950.[1] And even though real return on cash is about -1.6%, investors have increased their cash holding by $691 billion and have withdrawn approximately $160 billion from US equity mutual funds in 2015.[2] Recall how investors continued to pull their money out of the market well past the market bottom in 2009. We see this type of irrationality in the market from time to time.

[1] J.P. Morgan Guide to the Markets, US 1Q 2016, pg 62.
[2] Dr. David Kelly, Chief Strategist J.P. Morgan Funds, Monthly Commentary, 1/12/2016.

## At the Forefront: China, Oil and the Dollar

Irrational behavior seems to be the normal response of US equity markets to any news from China, about oil, or the strength of the US dollar these days. While it is true that Chinese growth is slowing, it has been well telegraphed that the Chinese government is shifting their economy from a manufacturing oriented one to a service based one and simultaneously trying to align their policies with those of the global financial markets. The slowing of the Chinese economy is the natural outcome of an economy transitioning from an emerging state into a more mature economy. Slower growth should be expected. The Chinese government's amateurish attempts at regulating the volatility of their stock market really seem to be the main cause of US investors' fear and confusion. Though neophyte Chinese retail investors comprise the majority of its participants, we see a wildly fluctuating Shenzhen exchange and fear sets in.

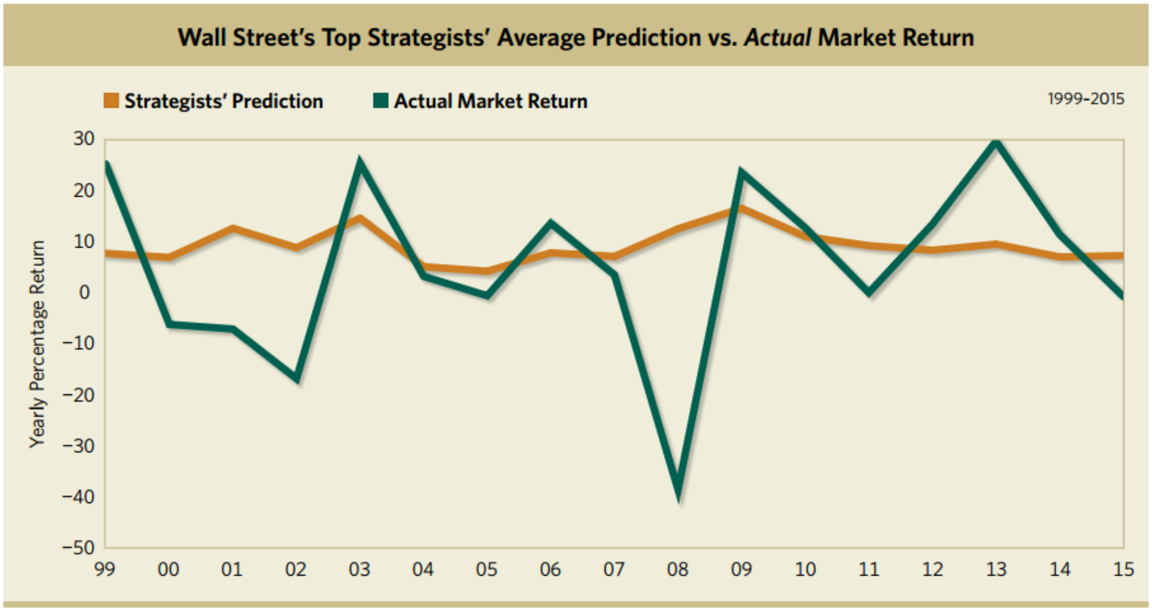
In addition, what do low oil prices and the high dollar foreshadow? Low oil prices on balance should help the US economy and though the dollar is high by recent historical standards, it is lower than it was from 1996-2004 and 25% below the recent peak in 2001.[3] The strong dollar does drag on the US economy, but the effect is relatively small, with a .7% reduction in growth over two years[4], as the US is not an export driven economy. The boost the strong dollar provides developing economies that rely heavily on exports helps offset some of the effects of globally depressed commodities markets. Additionally, international investments become much cheaper and these investments are a hedge against the dollar's reversal.

The reality is that the US economy, while not booming, is humming along quite nicely. There have been exceptional vehicle sales and solid retail sales. Inflation is under control, unemployment is at 5%, corporations hold massive amounts of cash, and US consumer debt is extremely low by historical standards.

## What to Do about Market Volatility

There is a tendency to rationalize what just happened with selected facts to support it. This is much easier, but not any more helpful than trying to predict market movements in the first place. Why? Short term market moves are nearly impossible to predict. The chart at the top of the following page shows how inaccurate Wall Street's best strategists are. Even investment professionals cannot accurately predict the market in the short term. Staying in the market is what builds wealth. Source: Davis Funds.

[3] J.P. Morgan Guide to the Markets, US 1Q 2016, pg 27.
[4] Federal Reserve bank of New York, http://libertystreeteconomics.newyorkfed.org/2015/07/the-effect-of-the-strong-dollar-on-us-growth.html




Source: Barron's. From 1999 through 2005, numbers reflect Dow Jones Industrial Average forecasts. In 2006, Barron's began using the S&P 500® Index exclusively.
**Past performance is not a guarantee of future results.**

In all the rolling 12-year periods between 1928-2014 for the S&P 500, 95.9% had positive returns and the median return was 240%.[5] While it is tempting to pull your investments out of the market when you experience sharp downturns, most people need to stay in the market in order to meet their retirement savings or wealth accumulation goals, particularly in light of our increased longevity and the costs of aging.

In spite of solid fundamentals in the US economy, most markets are down substantially in 2016. It is for situations such as this that Waypoint Advisors designs portfolios to manage risk. If you lose less during downturns, then there is less to make up when the market rebounds. This is the reason why a diversified portfolio will recoup its losses much more quickly than all-equity portfolios.

[5] Betterment website: https://www.betterment.com/resources/investment-strategy/portfolio-management/its-about-time-in-the-market-not-market-timing/