The Carnegie Counselor

THE CARNEGIE INVESTMENT COUNSEL NEWSLETTER

FOURTH QUARTER 2015

Belts and Suspenders

Last year was a difficult year in every investment asset class. There simply was no place to go in the pursuit of returns. We are all aware that money market assets have returned zero since 2009 and betting on one of the other asset classes has been the right bet. However, not in 2015, they all returned the same-near zero.

Even inflation, the risk of higher future prices, was moribund as commodity prices fell across the world. Inflation was so low that the Social Security Administration decided not to increase the COLA payments on Social Security for only the third time in the last 40 years. Considering the events that occurred in the year and the low point in the third quarter, ending the year flat was a success. It is not the result we expect when money is put at risk in the capital markets.

The last time we experienced a flat year in the stock market was in 2011; however, the bond market did well, producing a return on average of 5%. Not in 2015, bonds already at very low yields had the specter of the Federal Reserve threatening to push interest rates higher all year long. They first signaled the event would occur in June, then September would be the initial lift-off of zero, but it wasn't until December that they finally moved forward with a 0.25% hike in the Fed Funds rate. This overhang kept bond prices tilting lower and didn't help the high-yield market. Nearly every bond related to energy or commodities lost value as the Fed dithered. The High-Yield bond index was down more than (5%) in the year while the overall bond market managed to return only 0.5%. Considering the yield was ~3%, the impact of the falling bond prices dragged the overall performance to near zero.

The performance of hedge funds was no help either. This is where "smart money" is supposed to reside as savvy fund managers can make money in up or down markets. A flat market should be the perfect playground for managers who can bet against the weaker part of the market by shorting, and use leverage to go

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Schuylkill Capital Management merges with Carnegie

Carnegie is proud to announce the addition of Howard Trauger and Gene Kovacs of Schuylkill Capital Management. Howard will serve as Managing Director of our Philadelphia office.

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long in the strength. The average management fee of hedge funds is typically 2% per year and 20% of profits. Yet the profits were modest this year as the performance of the Barclay Hedge Fund Index managed a meager 0.3%.

We continually suggest that prices of stocks will follow the earnings produced. In 2014, the combined earnings of the S&P 500 Index were $118. Last year they ended at nearly the same combined number of $117. Earnings were flat year-over-year, so it shouldn't be a surprise that the performance of the stock market was also flat. Notably, the energy sector delivered 6% of stock market earnings in 2014, while providing zero in 2015. Therefore, the rest of the market had earnings gains of at least 6% to push the combined earnings back to flat. Any production from the energy sector in 2016 will be positive for this significant sector of the market.

We understand flat returns don't make for happy clients. A positive return is expected when putting assets at risk over a market cycle. This last notation, "over a market cycle" is vital to remember that 2015 was just a twelve-month snapshot. We have had a strong advance since the lows set in 2009. The avoidance of taking on too much risk is paramount at this stage of the cycle. Any list of the virtues of the market can be refuted by an equally long list of the pending risks. We are not optimistic interest rates will advance high enough that cash will be productive any time soon. Bonds have become a landmine field of issuer risk, interest rate risk, or inventory risk. A return of principal has replaced the pursuit of a return on principal. For equities we are tightening our belts and thinning out the stocks trading at higher multiples. We are also suspending investments in smaller growth companies and moving toward larger, blue-chip names. This is our Belts and Suspenders Plan for 2016, believing it is necessary for a volatile market in an ever-flattening world.

> Being defensive doesn't take you out of the game; it is intended to increase the likelihood of you reaching your financial goals.

Did you know...

Carnegie hosts "Carnegie College" at our Pepper Pike, OH location most months. We try to present speakers and topics of interest that you may find valuable. If you cannot attend or are out of state, videos of the presentations can be seen at www.carnegieinvest.com

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