This commentary closes out a year marked by contrasts. Despite crushing the energy sector, falling oil prices brought much needed life to the U.S. consumer. The U.S. Federal Reserve (the “Fed”) took an initial step to increase interest rates, while the Bank of China, the Bank of Japan, and the European Central Bank pledged further action to keep rates low. Facebook, Amazon, Netflix, Google, and a few other growth stocks pushed higher, but the rest of the U.S. stock market stumbled. Political crises marred former emerging market darlings Brazil and South Africa, whereas the election of the reformist and pro-business Prime Minister Narendra Modi revitalized India. And to top it all off, China ended the year and began 2016 by upsetting markets across the world with a slowing economy.

Domestically, while the U.S. enjoys the highest standard of living in the world, political forces battle over one party’s claims of an eroding middle class while the other searches for an approach and candidates that can appeal to more than just small groups of the fractured Republican party. As we take stock of 2015, it is important to review and reflect on the divergent themes that shaped global economics, financial markets, and politics throughout the year.

Major U.S. equity markets finished the year relatively unchanged, yet the year was marked by heightened volatility and powerful market swings. The S&P 500 Index (the “S&P 500”), a measure of the country’s 500 largest publicly-traded companies, began the year at 2058 and finished at 2044 (0.7% lower). During the year, the S&P 500 traded within a range of 1867 and 2130. While the Index remained relatively flat, it was powered by nine stocks—the “Nifty Nine.” Shares of Facebook, Amazon, Netflix, and Google (the “FANGs”), coupled with Microsoft, Salesforce, eBay, Starbucks, and Priceline gained more than 60% for the year, yet a number of blue chip companies (generally high quality, well established companies) struggled mightily (Financial Times). For example, shares of American Express, ExxonMobil, Procter & Gamble, Union Pacific, and Walmart were down anywhere between 10% and 35% for the year. Overall, shares of many dividend-paying companies priced either moderately or at a historical discount were dumped by investors while shares of the Nifty Nine quickly gained appeal with the financial media and Wall Street. In short, the hunger for growth outstripped the historical stability and income often found in some of America’s oldest and most fabled companies.

![U.S. Equity Market Performance (Stock Style)](image)

Like equity markets, the 10-year Treasury finished 2015 nearly unchanged. Many economists and Wall Street analysts expected rising yields and interest rates in 2015, yet fixed income markets saw little change until the final weeks of the year when the Fed announced a 25 basis point increase in interest rates. Widely anticipated by Wall Street, the move was the first interest rate hike in nearly a decade. The Fed noted not only that additional tightening would be “gradual,” but also that as many as four additional 25 basis point hikes could occur in 2016 based on economic and market conditions.
Widening credit spreads (or the yield difference between various fixed income alternatives and government debt) and higher rates caused some losses in the fixed income sector. Low commodity prices, specifically oil, drove the value of below investment grade bonds (“junk bonds”) to their lowest level since the fall of 2011, during the depths of the European debt crisis. Bonds as a whole nonetheless were slightly positive for the year as measured by the SPDR Barclays Aggregate Bond Index. Volatility in the fixed income sector will likely remain elevated in 2016, surprising investors who are accustomed to price stability.

While the Fed began raising interest rates and curbing its ultra-accommodative monetary policy, the Bank of China, the Bank of Japan, and the European Central Bank continue to remain accommodative, pledging further assistance in light of their respective troubling economic conditions. Those conditions include a stock market rout in China, worrisome demographics and deflation in Japan, and lackluster economic circumstances and a lingering debt crisis in Europe. While conditions remain challenging in both Europe and Japan, accommodative monetary policy should help cushion their respective stock market indexes in the year ahead. Last year, the two regions experienced solid gains in local currency terms, as measured by the Stoxx600 and Nikkei. However, those markets were down when measured in U.S. dollar terms (the U.S. dollar strengthened against a basket of global currencies). Despite China’s stock market rout that devastated equities during the summer, the Shanghai Composite Index still managed to post nearly double digit returns in 2015.

Outside of China and a few other nations (namely India), most emerging market countries where not able to post stock market gains in 2015. Emerging market stocks, as measured by the iShares MSCI Emerging Markets ETF, were down more than 15% during the year. Falling commodity prices coupled with a strengthening U.S. dollar proved too difficult for many countries. The MSCI Emerging Markets Index fell to a valuation of just 12.8 times 10-year average earnings at the end of September, taking it below the previous low of 13.5 times during the 1997-98 Asian financial crisis (Financial Times). For comparison purposes, the long-term average price-to-earnings multiple for emerging market stocks is 25 times. Surging growth in China and commodity prices might have unjustly inflated emerging market stocks during the past decade, but current valuations are presenting opportunities for patient investors.

Merger and acquisition activity hit a record high in 2015, surpassing the previous record set in 2007. Roughly $5.0 trillion in deals were announced and signed as a cheap debt and investor pressure to create growth spurred management. Noteworthy deals included Pfizer’s $148.6 billion takeover of Allergan, Anheuser-Busch InBev’s $105.6 billion buyout of SABMiller, privately-held Dell’s $66 billion offer for EMC, and H.J. Heinz buying Kraft Foods for $53.8 billion (Associated Press). It is unlikely that deal activity in 2016 will exceed 2015. However, given the ongoing need to satisfy shareholders and generate growth, it is no surprise that 74% of executives expect to actively pursue acquisitions in the next 12 months and 57% of companies currently have three or more deals in their pipelines (Ernst & Young). With lackluster prospects for organic growth, companies will look to buy growth or look to sell themselves.

![Global Merger & Acquisition Volume (in billions)](chart.png)

While 2015 has come and gone, many aspects of the past twelve months will spill over into and form the foundation for the coming year. Investors will closely monitor the United Kingdom’s referendum vote, China’s economic data, the U.S.’s presidential election, falling crude prices, and overall monetary policy (specifically the pace of future rate increases in the U.S.). As the bull market continues to age, we expect increased volatility and uncertainty surrounding equity and fixed
markets. As a result, we continue to build balanced portfolios, using niche ideas that provide our clients with attractive risk-reward opportunities in a variety of asset classes as potential opportunities present themselves.

Thank you for the continued opportunity to serve your investment management needs. Please contact us if you have any questions or would like to schedule a time to meet with your Advisor.

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Sources

Index Definitions
The Dow Jones Industrial Average represents large and well-known U.S. companies. The index covers all industries with the exception of Transportation and Utilities (www.djindexes.com).
The S&P 500 is the most widely accepted barometer of the market. It includes 500 blue chip, large cap stocks, which together represent about 75% of the total U.S. equities market. Companies eligible for addition to the S&P 500 have market capitalization of at least US$3.5 billion (www.standardandpoors.com).
The Barclays Capital Aggregate Bond Composite covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes government securities, mortgage-backed securities, asset-backed securities and corporate securities all with a maturity of greater than one year. (https://indices.barcap.com/index.dxml)
The Shanghai Composite Index tracks the biggest and most important public companies in China. (http://english.sse.com.cn/)
The STOXX Europe 600 Index is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the STOXX Europe 600 Index represents large, mid and small capitalization companies across 18 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom. (https://www.stoxx.com/home)
The MSCI Emerging Markets Index (SM)($) is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 23 emerging market country indexes: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey* and United Arab Emirates. (www.msci.com)