

the Connection

A Quarterly Review

4th Quarter 2015

2015 - The Year Nothing Worked

Stocks, Bonds and Cash Go Nowhere. It's the worst year for asset allocation funds since 1937.

A **2.2%** gain in the S&P 500 is roughly the best anyone could do

The idea behind asset allocation is simple: when one market struggles, it's *OK* because an Investor can jump into another that is thriving. *Not so in 2015!*

In fact, if you judge the past year by which U.S. investment class generated the largest return, a case can be made it was the *worst* for asset-allocating bulls in almost 80 years, according to data compiled by Bianco Research LLC and Bloomberg. With three days left in 2015, the Standard & Poor's 500 Index gained 2.2 percent with dividends, cash is up less, while bonds and commodities show losses.

WORST YEARS IN ASSET ALLOCATION SINCE 1926

Year	Stocks S&P 500	LT Bonds 30y Treasury	Cash 3M Bill	Commodities CRB Index	Best Return
1931	-43.42%	-5.32%	1.09%	-20.59%	1.09%
1937	-35.02%	0.22%	0.29%	-10.40%	0.29%
1953	-0.96%	3.63%	1.83%	-3.12%	3.63%
2001	-11.89%	3.70%	3.85%	-16.34%	3.85%
2015 YTD	2.19%	-2.04%	0.11%	-23.42%	2.19%

After embracing everything from Treasuries to high-yield bonds and technology shares amid seven years of zero-percent interest rates, investors found themselves with nowhere to run at a time when the Federal Reserve's campaign of stimulus drew to an end. Normally it isn't like this. Since 1995, practically every year has seen some asset deliver returns exceeding 10 percent.

"It's been challenging from the point of view that the equity market and bond market are probably more joined at the hip than normal," said Hayes Miller, the Boston-based head of multi-asset North America who helps oversee \$35.8 billion for Baring Asset Management LLC. "We've had high cash exposure relative to norm because we felt cash provides one of the only good diversifiers against the risk-off trade."

Bianco Research keeps track of the S&P 500, 30-year U.S. Treasury bonds, 3-month Treasury bills and the Thomson Reuters/Core Commodity CRB Commodity Index to gauge performance in stocks, bonds, cash and commodities. The four are the most common asset classes considered by investors when an allocation strategy is designed, according to Jim Bianco, the founder.

While the depth of losses in equities and commodities is nowhere near as bad as in 2008, the correlation of declines highlights the challenge for money managers who seek to amplify returns by rotating among assets. Among other things it's a recipe for pain among hedge funds, according to Bianco. The industry is heading for its worst annual performance since 2011, with closures rising, data compiled by Bloomberg and Hedge Fund Research Inc. show.

"The Fed stimulus lifted all boats, and then the Fed withdrawing the stimulus is holding the boats down," Bianco said by phone. "If the argument is right that the economy is going into 2016 weak and earnings are negative, those conditions will continue and therefore on the asset allocation level, I don't expect anything to break out just yet."

The Act of Giving

With nothing going up, exchange-traded funds that invest in different asset types as a way to diversify risk have struggled. Among 35 such ETFs tracked by Bloomberg, the median loss for 2015 is 5 percent. The iShares Core Growth Allocation ETF, which has a mix of 60 percent in stocks and 40 percent in bonds, has slipped 0.5 percent, and the First Trust Multi-Asset Diversified Income Index Fund is down 7.4 percent.

Uncertainty over the timing of the Fed's first interest rate increase in almost a decade and its potential impact on the economy weighed on markets throughout 2015, according to Michael Arone, the Boston-based chief investment strategist at State Street Global Advisors' U.S. Intermediary Business. Policy makers signaled the pace of subsequent increases will be "gradual" when finally tightening this month.

"The Fed has finally broken that cycle by beginning policy normalization, and hopefully this will provide the market some clarification and resolve in a more solid direction," Arone said by phone. "If the market feels comfortable at the pace of which the Fed moves interest rates and the economy is recovering, risk assets like stocks could perform well."

The S&P 500 has made little headway in 2015, adding 0.1 percent without dividends. Equities fared worse in dollar terms outside the U.S., with the MSCI EAFE Index dropping 3.1 percent while the MSCI Emerging Markets Index sinking 16 percent.

Commodities have fallen to a decade low as tepid global inflation dimmed the allure of precious metals, weak Chinese demand hurt raw-materials prices and a global supply glut sent crude oil tumbling. In the bond market, high-yield corporate debt is heading for first annual decline since 2008 amid a flood of investor redemptions from junk bond funds and concern rising borrowing costs will threaten corporate solvency.

According to Bianco's study, gains from the best-performing assets had surpassed 10 percent in all but one year since 1995. During the last nine decades, 23 years, or a quarter of the total, saw at least one asset class returning more than 30 percent, and only four ended with gains smaller than 4 percent.

"Investor expectations for both equities and bonds have been elevated by recent history," Lowell Yura, head of multi-asset solutions for BMO Global Asset Management in Chicago, said by phone. The firm oversees \$225 billion. "This year is a wake-up call to think about lower returns for the next several years."

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By Lu Wang
<http://bloom.bg/1lxRzpo>
Bloomberg

Below is an updated list of some organizations our clients are helping today. Please let Barbara know the names of organizations you care about and we will include them on list next quarter. Send email to bcorley@gencappm.com

All Local Food Banks

www.sfmfoodbank.org
www.shfb.org
www.foodbankccs.org

Image for Success

www.imageforsuccess.org

Maya's Music Therapy

www.mayasmusic.org

Canal Alliance

www.canalalliance.org

Friends of the Urban Forest

www.fuf.net

Guide Dogs for the Blind

www.guidedogs.com

Doctors without Borders

www.doctorswithoutborders.org

The Nature Conservancy

www.nature.org

National Kidney Foundation

www.kidney.org

Guide Dogs of America

www.guidedogsofamerica.com

Golden Gate National Parks Conservancy

www.parkconservancy.org

Fine Arts Museums of San Francisco

www.famsf.org

Canine Companions for Independence

www.cci.org

Alzheimer's Association

www.alz.org

The Foundation for Rotary International

www.therotaryfoundation.org