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2016 – A Year of Firsts

As I've written many of this year's educational emails, I have found myself constantly using the word "unprecedented." My joke when talking with clients is that I've had to use the thesaurus with unusual frequency this year trying to find new words to describe the unprecedented markets that we have experienced thus far in 2016.

Start to the Year:

The first ten trading days marked the worst start to any calendar year in the markets' history. By the end of trading on January 15th the S&P 500 had dropped over 8% on worries of oil prices, their impact to the financial industry which had lent money for its expansion, the impact both would have on the U.S. economy, and the slowing Chinese economy.

Role Reversal:

According to Wall Street Journal reporter Lu Wang, the worst performing 50 stocks in the S&P 500 in 2015 outperformed the best performing 50 stocks in the S&P 500 in 2015 by approximately 13% in the first half of 2016. According to her research, the S&P 500 had never seen a larger disparity since such data tracking began in 1990. As a result, over 80% of all large-cap managers lagged the S&P 500 during the first half of this year. In other words, what was working in 2015 lagged in 2016, and what lagged in 2015 worked during the first half of 2016. Areas like telecom, utilities, and energy were the top performing sectors with 24.8%, 23.4%, and 16.1% respectively. Areas like financials, technology, health care, and consumer discretionary provided little or negative returns (-3.0%, -0.30%, 0.4%, and 0.7% returns respectively). As of September 9th the market reversed again. The top performing sectors of the first half of 2016, telecom, utilities, and energy have been giving back performance, down -8.2%, -8.2%, and -1.0% respectively. The worst performing sectors of the first half of 2016 started to get back on track with financials up 5.5%, technology up 10.1%, health care up 0.6%, and consumer discretionary up 2.6% quarter to date. This shifting leadership has made it extremely difficult for tactical managers to add value let alone outperform their comparable benchmarks.

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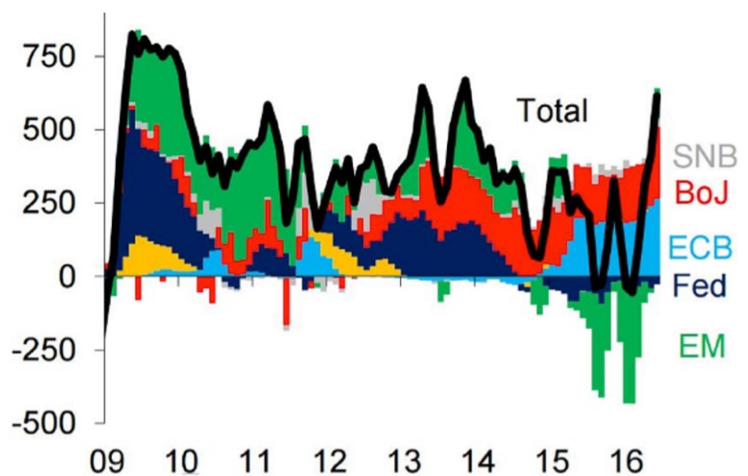
Brexit:

The British departure was another first. Never before had a country left the European Union. The initial drop that occurred after the vote was not surprising to many in the investment community. Central banks stepped in and saved the day. According to Matt King, credit analyst at Citibank, central banks stepped in and purchased hundreds of billions of dollars of equities to prop up the broader based markets in the days after Brexit, reversing the downturn that occurred in the first few days following the announcement. While the markets seem to now have shaken off future repercussions of the impact of Brexit, much still remains unknown.

The graph to the right illustrates the hundreds of billions of dollars that central banks used to purchase assets. We have not seen this amount of asset purchasing since 2013 and 2010. This massive asset purchase is, in part, credited with stopping the global stock market slide.

Figure 1. Global Central Bank Liquidity Rises to Highest Since 2013

CB* Asset Purchases, Rolling 3m, $bn



Source: Citibank
(SNB – Swiss National Bank; BoJ – Bank of Japan; ECB – European Central Bank; Fed – U.S. Federal Reserve Bank; EM – collective of all emerging markets banks)

The 10 Year Treasury:

We've written a lot about this subject in several of our educational emails. In July the 10 Year Treasury hit an all-time yield low of 1.32%. This is an amazing feat since the 10 year treasury was at 3% at the end of 2013. This historic drop is credited to foreign investors buying our bonds due to negative interest rates found in Germany and Japan (and near zero rates in many other countries) and the strength of the dollar to many major currencies. We warned that a reversal was expected, which has started as I write this piece. As of September 9th the 10 year treasury has moved to 1.67% yield.

US Government Bond 10Y

Source: www.tradingeconomics.com | U.S. Department of the Treasury

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Boring but Tight July and August:

The second half of July was another first. The intra-day high and low range over 11 days in July was only 0.92%. This is the tightest range ever in the 45 years of available data. We experienced another first when the market went 32 trading days with a range of 2.11%. According to research done by the Wall Street Journal, this has never happened before in the data they had dating back to 1962.

According to LPL research, at the end of July and into early August the Nasdaq was up for five straight days while the Dow Jones dropped each of these days. According to their research, this has never happened before. The only four day streak of similar magnitude happened in January 2000, just before the tech bubble.

Conclusion

I have a passion for history. I love to learn from the past, both what went well and to learn the mistakes from those who walked these paths before us. While I know that there is no way of predicting the future from knowing the past, I do believe that there is much that we can learn.

Rarely do we have a year with so many firsts. This is why I so often use the word "unprecedented." While short-term memory will quickly put 2016 in the history books when this year ends, it has been an extraordinarily difficult market to manage money and manage portfolio risk. I hope that this piece demonstrates some of the challenges faced while managing money this year.

I am very proud with how we've handled this year's firsts. I am confident in our strategies and where they will take us the rest of this year and in the years that follow.

As always, I welcome your comments and questions.

Sincerely,

Jeffrey J. Powell
Managing Partner

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