December 2015

Dear Clients and Friends,

To look at the level of the stock market as we approach the end of 2015, one might be fooled into thinking it had been a quiet year. After five years of strong gains, the markets are about flat for the year. However, the benign numbers mask turmoil along the way. One analyst aptly described the market this year as “violently flat”. The recovery from the bottom of the great recession may have been a tide lifting all boats (and stocks), but the story of 2015 was one of divergence – divergence among stocks, currencies, and countries.

While the markets as a whole are about flat for the year, *most* stocks were down. About two thirds of the stocks in the S&P 500 have moved more than 10% this year – and more of those moved down than up. The stocks of a few very large companies – including Amazon, Google, Microsoft, Facebook, and General Electric – had an outsized positive effect on the index. Some of these we own, and others we don’t (and probably won’t). Stocks in the energy sector – some of which we certainly do own – were severely hurt by the collapse in oil prices. In 2015, it was not enough just to own stocks; it mattered (again) which stocks you owned.

Divergence was also evident in the international landscape. With modest growth in the US and expectations of the Fed finally raising interest rates, the dollar continues to climb vs. other currencies. This actually hurts the earnings of large, multinational companies that sell a lot of products abroad -- the type of company that we historically have owned, like Proctor & Gamble, Ford, or Coca-Cola. We still feel that the benefits of international diversification outweigh these fluctuations, but it is simplistic to think that foreign or emerging markets are an automatic key to better investment performance. Other than Europe, most foreign stock markets fared much worse than the US markets this year.

This letter has focused on stocks, but for most of our clients, bonds make up a reasonable part of their portfolio. We continue to see the value in a balanced account with a laddered bond portfolio. We primarily buy well rated corporate bonds. In the current interest rate environment, buying municipal bonds or Treasury bonds still doesn’t make sense for most of our clients, but that could be changing. While it will not be a “magic bullet”, if we have indeed entered a phase of rising interest rates, our clients’ income will benefit from gradually rising yields on new bonds that we can buy. Most importantly, when stock markets are volatile, as they have been this year, the bond portion of the account will hold a steady value, and even outperform stocks.

The same fears from a year ago still cast their shadows – plunging oil and commodity prices, shaky economic growth, and once again, the real threat of global terrorism. In such an uncertain environment, a balanced portfolio of large, steady, dividend paying companies, coupled with quality bonds, puts our clients in a good position to navigate uncertainty in 2016 and beyond.

Wishing you a Healthy, Happy, and a Prosperous New Year,

Stewart & Patten Co. LLC