

Nauset Market Commentary Fourth Quarter 2015

Market Performance Recap: Stocks End Year Mixed

With a strong October rally, US stocks recovered from the Q3 selloff to finish 2015 at +0.9% as measured by the large cap Russell 1000. However, many indices were negative for the year including small-mid cap Russell 2000 at -4.4%, international stock MSCI EAFE, off -0.8%, and MSCI Emerging Markets Equity Index, down -14.9%. Within stock sectors, the winners in 2015 were healthcare, tech and consumer discretionary. With a Q4 decline due to the Fed rate hike, bond gains were pared to only +1.1% for the year in the Barclays Intermediate Gov't/Credit Index. And the Barclays US Corp. High Yield Bond Index fell -4.5% for 2015.

Economic & Market Discussion: 2016 Outlook

Looking over the next twelve months we are focused on four big themes: (1) caution, more volatility ahead; (2) US equity: from leader to laggard? (3) live local, think global; and (4) can alternatives shine?

- Caution, more volatility ahead – After an up and down 2015, we foresee more of the same ahead this year. Investors are nervous as the effects of slow global growth have seeped into many sectors and regions. As we already seen in the opening days of 2016, investors are skittish and quick to sell on a variety of factors – China slowdown, geopolitics, oil dynamics or the next poor economic report. As long-term investors we don't overreact to every zig or zag, but we do search for attractive values in favored sectors or subsectors amid the choppiness.
- US Equity: From Leader to Laggard? – We assess the prospects of US equities on three key factors. Two factors are slight negatives weighing on stocks - most valuation measures are high historically and the Fed has begun raising interest rates. The third factor, earnings growth, could provide support for gains in 2016. If reported profits hit the forecast range of +5% to +8%, then positive stock returns may follow. While the path won't be smooth, we believe there is opportunity for gains in some sectors.
- Live Local, Think Global – While the US central bank has taken its foot off the stimulus accelerator, other central banks, such as the Bank of Japan and the ECB, are still looking for levers to stimulate their economies. Emerging markets have taken a beating and their near term prospects look weak given their exposure to China and to commodities. That said, valuations are becoming more interesting and not all of them are handcuffed to China or commodities. While perhaps not attractive for near-term performance, we see hints of opportunities on the horizon for long term investors.
- Can alternatives shine? – Alternative investments try to produce returns that are not correlated to general stock and bond market indices. Given the current low market return expectations, we are overweighting portfolio allocations with a set of non-traditional investments that seek positive returns with risk-buffering benefits. This could be an area of relative opportunity this year.

While we are following this scenario, we are constantly monitoring market developments, and remain flexible to adjust to new data as the year unfolds.

Portfolio Strategy: Using a Wide Net

Our managed risk asset allocation portfolio strategy is based on using a diversified set of investments. In today's environment, we believe that using a wide range of return opportunities is critical to deliver both returns and manage risk. At present, we are taking action in the following areas:

- Over- and underweighting key sectors – Based on our market view, we are overweight growth stock sectors and high yield, and underweight government and corporate bond holdings.
- Increase alternative investments – We are increasing the number and use of alternative investments, such as long-short equity funds, with the objective of producing positive returns while buffering market risk.
- Opportunistic buying – Market volatility often creates opportunities in areas that we find attractive, like high quality growth stocks in tech, health care and financial stocks.

Market Performance**% Change for Periods Ended 12/31/2015**

Market Index	Fourth Quarter	2015	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	6.50	0.92	0.92	15.01	12.44
MSCI EAFE – Non-US	4.03	-0.82	-0.82	5.01	3.60
Russell 2000	3.59	-4.41	-4.41	11.65	9.19
MSCI Emerging Markets Equity	-0.03	-14.91	-14.91	-6.78	-4.80
DJ US Real Estate	7.23	2.14	2.14	9.77	10.77
Bloomberg Commodity	-10.52	-24.66	-24.66	-17.29	-13.47
Barclays Gov't/Credit Intern. Bond	-0.69	1.07	1.07	1.10	2.58
IQ Hedge Multi-Strategy	-0.24	-1.16	-1.16	2.99	2.87
3-Month T-Bill	0.01	0.02	0.02	0.04	0.05