Bell Wealth Management

Equity & Fixed Income Outlook December 2015

Federal Reserve Monetary Policy

It looks like the highest probability of Federal Reserve action in December is on the Fed fund rate increase. The Fed is still hedging its position by saying it is "more focused on the rate of interest rate increases rather than the timing of the increases." Last month we mentioned that December is not a very good time to catch markets off guard. It is hard to tell if the Fed is communicating a rate increase in December or a delay until early 2016.

Inflation

It looks like the Fed is banking on rising inflation rates as a reason to raise interest rates. This is not happening currently. The year-over-year consumer price index (CPI) released in November was 0.2%. That will change in the coming three months, but not because current reported inflation rates are expected to climb. Rather, inflation rates rolling off from the same three months last year were all negative numbers. We expect to see year-over-year inflation move from its current level of 0.2% to 1.5% to 2% in the coming three months.

Economic Activity

Oil prices remain under pressure with a price per barrel hovering around $40. This suggests that supply is higher than needed and/or that demand is less than expected. It is the second theme that concerns us. A growing economy tends to use more energy. If the demand for energy is not growing, it suggests the economy may not be growing much either. This same pattern shows in other commodities like copper, metallurgical coal, zinc and even agricultural commodities.

Last month we mentioned U.S. debt was $18.1 trillion. Today it is $18.77 trillion.

Concerns about retail sales declines that started with Walmart's earnings announcement in mid-November have not gone away. Gap, Old Navy and Banana Republic all reported store sales declines of 4% to 19% compared to last year. The reason for the decline is largely the consumer having to prioritize purchases. After accounting for inflation, incomes have remained flat for the last seven years. Consumers are two-thirds of the U.S. economy, which is why we pay close attention to their activity when forecasting economic growth in the coming year. This consumer indicator tends to make our growth forecasts closer to actual reported growth than popular economic estimates.

Our early gross domestic product growth (GDP) projection forecast for 2016 is 2%.

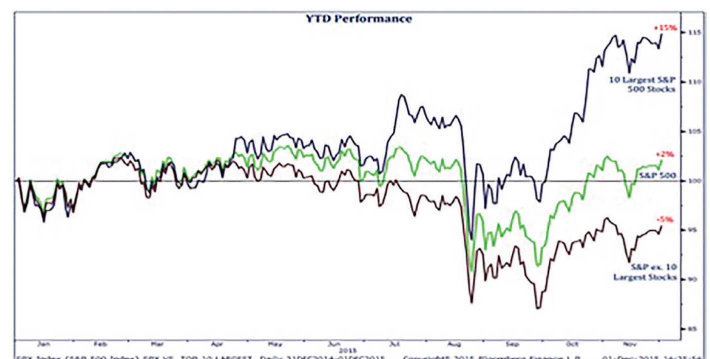
Fixed Income

In both fixed income and equity markets, returns tend to gravitate back to their averages. The long-term average return on the 10-year U.S. Treasury bond is about 5%, and the long-term return on the S&P 500 is about 9.5%. Using the Barclays Indices as a surrogate for bond returns, the last five-year return was 3.05%. To get a 10-year return to match the 5% long-term average, the return on this index needs to be 7% over the coming five years. There is very little probability of this happening. The last five-year return on the S&P 500 was 14.37%. An average stock return of 4.84% over the coming five years would combine with the 14% return over the last five years to meet the long-term stock average of 9.5%.

As hard as it has been to generate income for bond investors in the current low interest rate environment, we expect it will be even harder over the coming few years.

Stock Market

The forgotten 490: The price changes of the 10 largest stocks in the S&P 500 are up 15% year to date as of December 1, 2015. Omit those 10 stocks, and the other 490 are down 5% over the same time period. Put them all together, and the price move year to date is 2%. This is a lopsided market, but what is the message?



Greg Sweeney, CFA,
Chief Investment Officer

Tenure: 9/92

Years of Investment Experience: 30 years

Education: Greg holds a bachelor's degree in business from the University of North Dakota and is a CFA charter holder.

Not FDIC insured | May lose value | Not financial institution guaranteed | Not a deposit | Not insured by federal government agency