EMERALD ASSET ADVISORS, LLC

Investment Strategists for **Successful Families**

January 19, 2016

Thank you for reading GreenThought$. It is our privilege to provide you with our insight on current financial market events and our outlook on topics relevant to you.

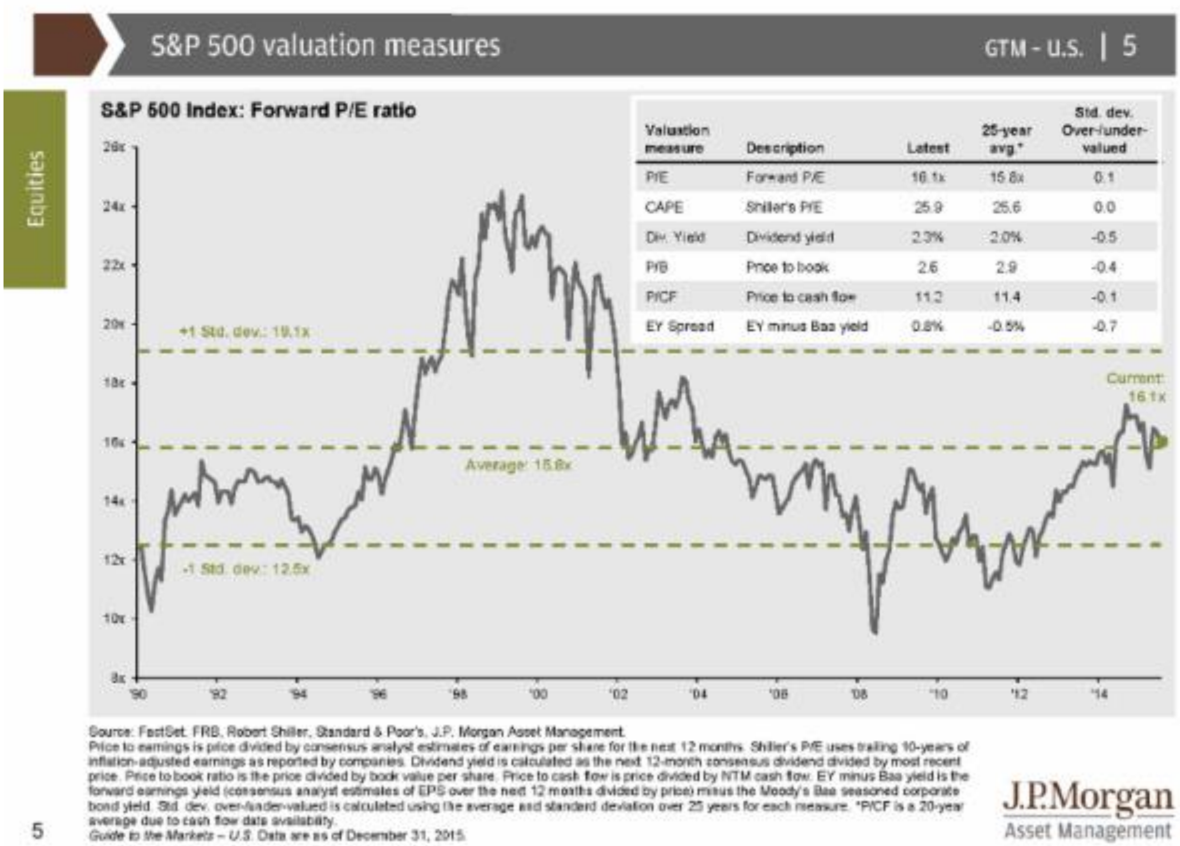
2015 Market and Economic Review

2015 was a story of a very few stocks doing extremely well and the majority doing not so well. This resulted in the S&P 500 index having positive total return (including dividends) of 1.4%, while U.S. small cap stocks as measured by the Russell 2000 were down 4.4%; international developed country stocks lost .8%; and emerging market stocks lost 14.9%. There was a huge disparity in the performance of U.S. growth stocks versus value stocks, with growth gaining 5.1% and value losing 4.1%. Pressure on the energy complex continued, with crude oil prices declining even further. Performance was mixed in the fixed income markets as well, with the Barclays U.S. Aggregate index up .6%, while the Barclays Global Aggregate index (representing global bonds), was down 3.2%.

The market concerns we've addressed in prior newsletters like falling oil prices and the uncertainty surrounding the Chinese economy and markets still exist. The U.S. Federal Reserve (the Fed) finally raised interest rates in December by 25 basis points (a quarter percent). The financial markets are worried because the Fed is signaling that there may be four additional rate hikes in 2016, while many observers (and bond market participants) think that two hikes would be more appropriate.

There is a saying that the stock market climbs a wall of worry. Howard Marks, founder of Oak Tree Capital, commented in a recent newsletter "That's one of the crazy things: in the real world, things generally fluctuate between pretty good and not so hot. But in the world of investing, perception often swings from flawless to hopeless." As usual, there is no shortage of new things to worry about. However, there were numerous positive developments on several domestic economic fronts. The U.S. economy continues to grow, albeit slowly. The best news came just recently in the employment reports, where almost 300,000 new jobs were created in December 2015, while the unemployment rate held up at 5% and the participation rate continued to improve. The improving employment picture bodes well for the U.S. economy, since it means even more discretionary income in the hands of the consumer, who is already enjoying big savings at the gas pump.

It is against this backdrop that we continue to work with you to maximize your risk-adjusted returns. Putting most of your assets into cash is not a viable long term option, in our opinion, since interest rates are still close to zero. There is always inflation in some parts of the system, so that earning no return on your money causes you to lose purchasing power. Investment opportunities exist, particularly in the stock market where investors are unnerved by the action in the first week of 2016. The chart below from JP Morgan shows valuations in the S&P 500 index. Despite a lot of handwringing by financial television pundits, the stock market is actually undervalued by several metrics. Keep in mind that the prior year's losers may often be the next year's winners. We also see some opportunities to invest in alternative investments that have little correlation to either the stock or bond markets.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	16.1x	15.8x	0.1
CAPE	Shiller's P/E	25.9	25.6	0.0
Div. Yield	Dividend yield	2.3%	2.0%	-0.5
P/B	Price to book	2.6	2.9	-0.4
P/CF	Price to cash flow	11.2	11.4	-0.1
EY Spread	EY minus Baa yield	0.8%	-0.5%	-0.7

If you have any questions, or would like to discuss, our outlook for the economy and the financial markets, please do not hesitate to contact us. We always look forward to hearing from you.

Regards from the Emerald Team

Disclosure

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