USI Advisors, Inc.

Market Update

January 2016 Review

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"A Not So Happy New Year?"

The first three weeks of 2016 represented one of the worst starts of a New Year on record as major equity indices lost between 5% and 10%. In our opinion, what led to this tumultuous start is a repeat of similar themes that played out in the summer of 2015, including global growth worries, plummeting oil prices and uncertainty regarding central bank policies. Although market volatility has increased significantly after years of relative calm, it is important for investors to pay attention to long term fundamentals as opposed to short-term noise.

Fears about slowing growth in China and plunging oil prices have reemerged, dragging down investor sentiment and leading to extreme volatility in the first month of the year. It was therefore not uncommon to hear talk about a potential recession during this turbulent month. It is important to evaluate the fundamentals of the U.S. economy to understand if a recession is warranted. Although the U.S. economy only grew at an anemic 0.7% in the fourth quarter, total growth for 2015 was positive at 2.4% and consumer spending is expected to continue to increase steadily this year due to lower gas prices and hopefully higher wages. In addition, Americans continue to find work as the unemployment rate stays at a healthy 5% and the housing market continues to strengthen, with home prices up 5.8% on a year on year basis. Overall, there are more positives than negatives in the U.S. economy and in the developed world, which supports continued global growth in 2016.

Domestic indices suffered in the first few weeks of January but they ended the month in a strong rally. For the entire month, the Dow Jones Industrial Average (DJIA) lost 5.4% while the S&P 500 Index was down 5.0%. The NASDAQ posted the largest negative returns domestically at -7.9%. In terms of investment style, value outperformed growth, which is likely a reflection of investors' increased appetite for high quality investments. This signifies a reversal of the trend that we saw last year as growth stocks outperformed value stocks by a large margin.

	January 2016	YTD
DJIA	-5.39%	-5.39%
S&P 500	-4.96%	-4.96%
NASDAQ	-7.86%	-7.86%
MSCI EAFE	-7.23%	-7.23%
MSCI Emerging Markets	-6.49%	-6.49%
Barclays Aggregate	1.38%	1.38%
Barclays Corp High Yield	-1.67%	-1.67%
	1/31/2016	12/31/2016
US 10-Year Treasury Yield	1.94%	2.27%

Corrections of more than 5% have become more common in the last few months, but if history is any indication, the current volatility should subside just as it did in August. Even if the declines reach the negative 20% bear-market threshold, it still does not mean that our economy would go into a recession. In fact, there have been 3 declines of this magnitude without recessions in the past: 1987 (-33.5%), 1998 (-19.3%) and 2011 (-19.4%).

Much of the volatility this year has been driven by a continued drop in oil prices, which is mainly a problem for the energy companies as their earnings continue to drop. The recent oil crisis is driven by oversupply, therefore it can not be used as an indicator of global growth. If it were a problem driven by demand, it would be significantly more concerning. Low gas prices should help the consumer by putting more disposable income in their pockets. In the meantime, we expect to see continued restructuring in the sector and prices should stabilize as we work through the excess supply. However, as oil prices continue to hit new lows and the U.S. dollar continues to hit new highs, earnings can erode. As companies continue to report fourth quarter results, it is possible that earnings will show a decline for a second consecutive quarter.

Aside from oil prices, one of the other primary sources of recent market panic has been China. As described in detail in our most recent Market Alert in mid-January, Chinese policymakers continue to interfere in the markets in a disorganized manner. Just as an example, the country's officials announced that they would freeze any trading if there was a market sell-off of more than 5%. The issue with this rule is that the typical market participant in China does not pay attention to valuations, but instead are mostly looking to catch a momentum trade. Therefore, by telling these clients that they are going to shut the market down if there is a sell-off, it is no surprise that they will want to get their money out as soon as possible. Additional market rules and continued manipulation of the Chinese currency all caused anxiety in the markets leading the Shanghai Stock Exchange to drop over 22% in January. In total, emerging markets were down 6.5% as represented by the MSCI Emerging Markets Index. The developed world suffered bigger losses as indicated by the MSCI EAFE Index, which was down 7.2% during the first month of 2016. The only safe haven in January was the intermediate-term bond sector in fixed income which gained 1.4% as represented by the Barclays Aggregate Index while the Barclays Corp High Yield Index was down 1.67%. The yield on the 10-Year Treasury Note fell to 1.94% from 2.27% last month, reflecting low confidence in the markets and higher demand for safe investments.

Many of the themes that have been causing panic seem relatively short term in nature. The Chinese market sell off and the country's slowing economy can be concerning, but from an international trade standpoint, a very small share of developed countries' growth comes from exporting goods to China. In addition, the Chinese economy is slowing steadily, but not in an alarming fashion. In fact, the Chinese economy is not declining, it is simply growing at a slower rate. Finally, volatility in the equity markets is a very common occurrence in the backdrop of monetary tightening. The Federal Reserve has already communicated their intent to implement rate hikes gradually to avoid sending markets into shock. Given all the recent market volatility, it would not be suprising for the Fed to hold rates steady at their next meeting in March and return to a more data dependent decision for future rate hikes. Overall, the global economy is in much better shape than it was before the last recession and investors should not overreact to short-term news. Changing your asset allocation in reaction to recent market movements could potentially lead to the inability to meet your long-term investment goals. It is important to stay the course as we are returning to a more volatile market environment.

For previous market commentaries please click here.

An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The 10 Year Treasury Yield is the interest rate the U.S. government pays to borrow money for a 10-year period. In addition to influencing how much the government pays to borrow over this timeframe, the 10-year Treasury Yields also determines how much investors earn by investing in this debt and it is a good indicator of investor sentiment. The higher the yield, the better the economic outlook.