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January 2016 Market Report

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2016 is off to a rocky start. As of January 20, 2016, global capital markets were reeling amidst a broad selloff as investors re-priced risky assets to the downside. Most notably, the U.S. stock market's decline now finds itself in correction territory, having dropped over 12%. Besides U.S. stocks, losses have spanned geographies and asset classes from emerging markets to credit and commodities. After nearly seven years of strong returns from risky assets, the current environment is showing signs of transition regarding investor's willingness to accept risk. Recent developments in two key areas have heightened the tenuous status for risky assets.

1. The acceleration of the decline in commodity prices

2. The string of disappointing economic news coming from China and the faltering faith that the government hasn't doctored even the disappointing data releases

The decline in commodity prices has had deep and far reaching (negative) impacts including MLPs (Master Limited Partnerships), natural resource equities and bonds and emerging markets equities and currencies.

China has generated a "double-whammy" of sorts for emerging markets, piling onto the impact of falling commodity prices. In China, the law of diminishing returns appears applicable to each subsequent round of government stimulus. Confidence in the managed slowdown has deteriorated in fairly short order. Lowered borrowing and reserve rates, "encouraging" government sponsored companies to purchase equities, limiting equity sales, depreciating the Yuan (and the pressure for more), ghost cities and commodity/raw material inventory buildup are stories that have all been around for some time, but investor's acceptance of them has only recently waned.

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The Fed's December rate hike, while old news at this point, certainly implies the days of easy money and government stimulus, at least here in the US, are coming to an end. Other developed market governments (most notably the BoJ and the ECB) have given no such indication, suggesting an additional currency headwind for US based investors, at least for the foreseeable future.

It's not much of a stretch to believe in the contagion of negative investor sentiment from commodities and emerging markets to US and international developed market equities, not to mention the global credit markets. Those latter three asset classes certainly have their own issues, but investors have been spooked, and risk is being re-priced globally, and quickly.

FEG's philosophy is based upon taking a long-term approach, allowing valuation criteria to guide investment decisions and a reliance on diversification and accessing skillful investment managers to enhance returns. That being said, we recognize that during periods of market stress investors collective concerns grow, as do ours. Know that we are just as concerned as you and we are having continuous internal debates about the risks in various asset classes as well as the potential opportunities. We continue to re-underwrite our portfolio biases and examine the appropriateness of the risks. The potential for an equity market drawdown has always been there, we just haven't had a significant one in a number of years, making it seem all the more unusual (and painful). Drawdowns of this pace and magnitude are not uncommon, but they are also not to be dismissed. Thoughtful investors with long time horizons often see periods of stress as opportunities. All of us at FEG are working every day to assess those risks, find those opportunities and bring recommendations to you when we believe they are warranted.