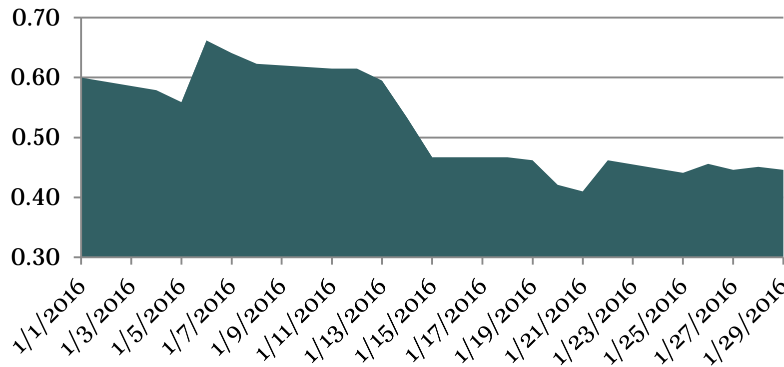
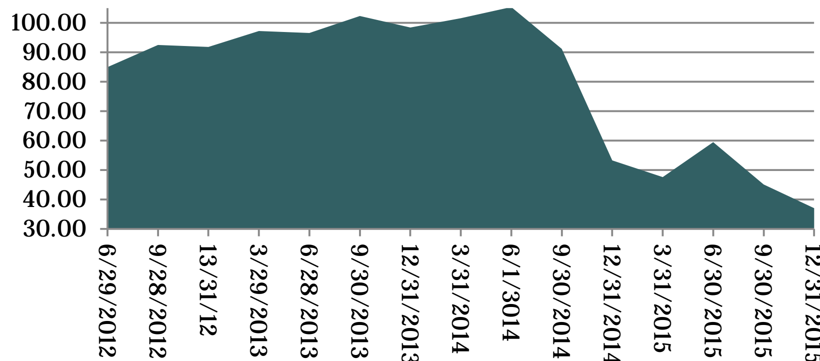
Quarterly Investment Report

September 2015 – November 2015

Patterson & Associates

A Volatile Month Driven by Global Forces

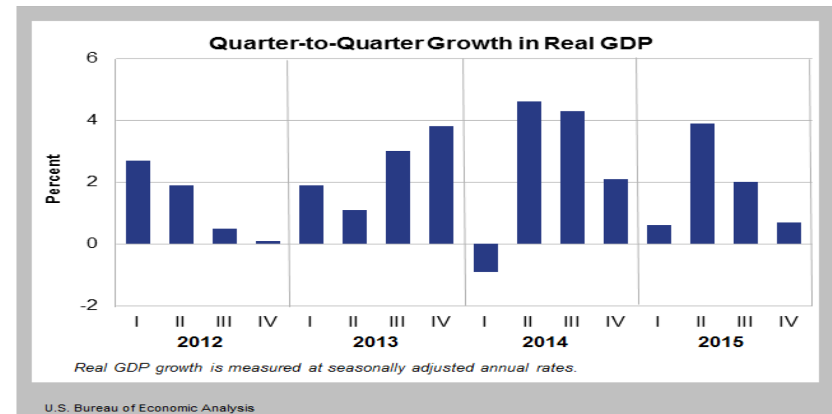




- Four major forces were at play in January and the markets were whip-sawed all month because of them.
- **Oil** continued its slide from $105 in June 2014 to end at $33.74 and hit below $30 temporarily. Supply was dictated by geo-political games as Saudi Arabia opened the spigots to hurt its arch rival Iran. But the drop has hurt energy companies and the banks, which loaned to them. Many investors had to sell, adding volatility to stocks.
- The execution of a Shia cleric added to concerns over Middle East instability as did the highly unstable dictator in North Korea with his claims of a tested hydrogen bomb.
- Although resulting in a veritable tax break for consumers, oil's price slide lead other indicators in a global slowdown. The month-end stabilization of price however may slightly ease the deflationary concerns.
- **China** tried to control liquidity and support its yuan and found it is not so easy to control capital markets. The meltdown in the Shanghai market added to concerns that the second largest economy was cratering.
- The slowdown in China has dropped **commodity** use and prices worldwide and hurt emerging markets which exported the ores. The drop was extenuated by the $3.8 trillion in dollar denominated debt those sub-Saharan countries had issued.
- The amount of the debt is not as dangerous as the strength of the dollar. **Currencies** have materially added to volatility this month. The dollar is strong because of our strength, its credit backing and the fact that only the US is raising rates. All other central banks are lowering rates to support their exports and stave off further economic weakness in their respective countries.

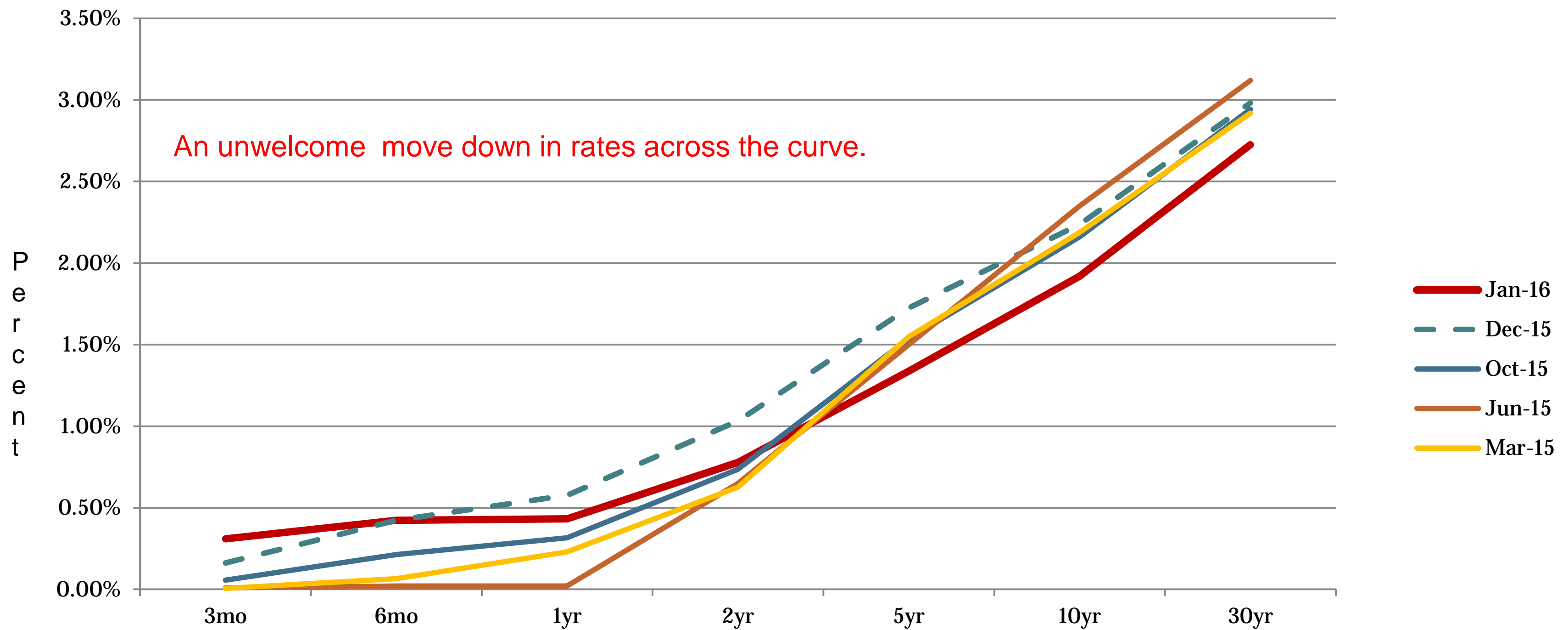
The Fed is in a Tight Spot

- Globally central banks are moving to reduce their currencies and stave off recessions. The ECB's Draghi recognized the weakness in Europe and more potential easing. Brazil is already in recession and trying to reduce rampant inflation. The Bank of Japan moved to lower its yen and support its exports. All these moves unnerved markets.
- The BOJ surprised by taking a step contemplated by Swiss, Danes and Swedes and introduced a *negative* 0.1% deposit rate for banks on certain excess deposits. It also increased its massive quantitative easing program. They will buy certain ETFs and REITs all in an effort to reach a target 2% inflation rate.
- The Federal Reserve also moved from its optimistic view in December and has retreated to a "data dependent" view. The predicted four rate hikes has been reduced to a possible two. This announcement calmed the markets somewhat as investors anticipated continued dovish sentiment and possible actions from the Fed. However, after just having raised rates in December the Fed can hardly reverse course just because of volatile markets. The balance between employment growth and tightening financial conditions is a tenuous one.
- Dependent head winds the US has managed to grow near a 2% rate for 6.5 years but the Chinese situation, the dollar's strength and oil's price has slowed GDP to a 1.8% (pending revisions) in 2015. That is still near the 2% ongoing rate although below the earlier anticipated 3%. Global moves and the lack of inflation will continue to weigh along with the dollar.
- Financial stability is the Fed's third mandate and the Fed is being held captive by outside trends. It is definitely a *wait and watch* mode.



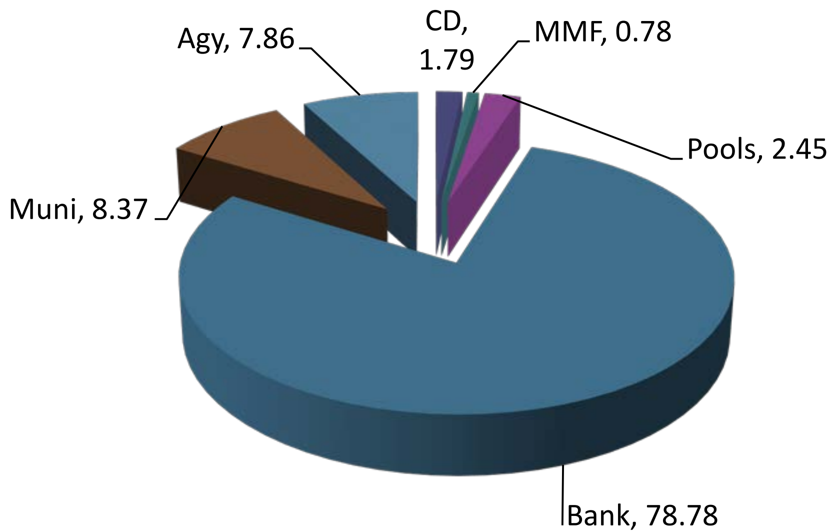
Rates

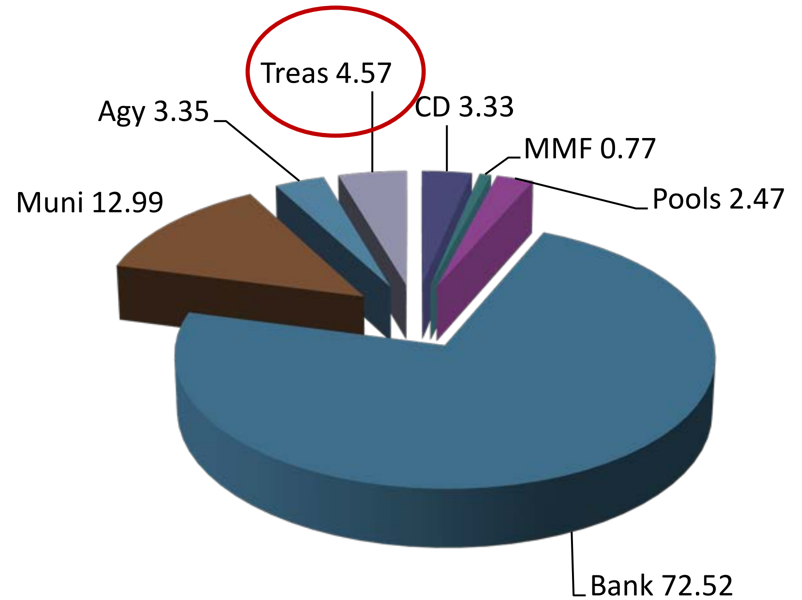
- The 2-year Treasury Note is definitely the fulcrum of the curve. Shorter rates are rising and longer rates are decreasing leading to a flattening curve.
- The decrease in rates from December 2015 (in all but the 3 month area) is a direct result of the slowing US economy and the dovish message from the Fed which hints at much fewer rate hikes this year.
- With every other nation and central bank lowering their rates the US markets remain relatively high in rates along with the relative safety they afford investors. The volatility in January also pulled funds out of the stock markets into the relative calm of bonds.   If the Fed is not going to raise rates then holders of bonds will see profits accruing until the economy re-starts.



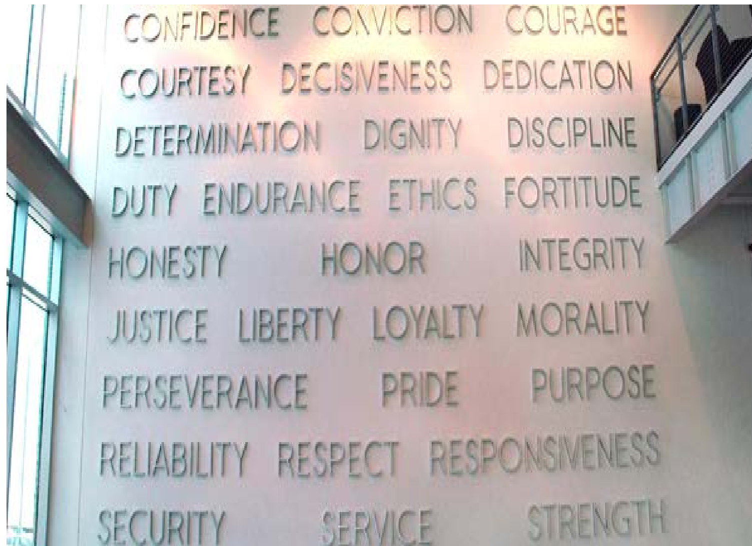
End of Month Rates - Full Yield Curve – Fed Funds to 30yr

Asset Allocations – Pooled Funds





Del Mar's Partner in Treasury Management



Patterson & Associates
Austin, TX