Plimoth Investment Advisors®
INVESTMENT MANAGEMENT & TRUST SERVICES SPECIALISTS

FOURTH QUARTER – WINTER 2015

INVESTMENT SPOTLIGHT

"Oil is like a wild animal. Whoever captures it has it." – J. Paul Getty

It seems hard to imagine, but it has been almost a decade since financial media headlines were dominated by stories of energy production shortfalls and the revival of "peak oil theory" suggested our new energy extraction capacity had finally reached a peak. It was around that time that oil prices rose to $145/barrel, with many projections of $200/barrel. Gas prices in many locations around the country topped $4.00/gallon and U.S. consumers across the northern part of the country were being pounded by escalating home heating bills. At that time it appeared as though J. Paul Getty had it right; oil became an even more precious commodity, with the spoils going to those lucky enough to own it.

One of the fascinating things about working in this industry is the speed at which perceptions and indeed realities can change. Over the past several years, technological advances have made it economically feasible to extract oil and natural gas from locations that were previously unreachable. Add into the mix several large deep-sea and land discoveries, and suddenly oil is not nearly as precious a commodity…for now.

With global demand growth steady, production capacity increasing, and most importantly, OPEC abandoning pumping quotas, oil prices have cratered, falling below $40/barrel for the first time since 2004. Of course, financial speculators have also participated in crude oil price volatility, driving prices significantly higher and lower on a daily basis. At this moment in time, J. Paul Getty's "wild animal" is not rare, and those who have it are trying to sell it as quickly as possible.

There are always repercussions from significant price changes in the marketplace. In this case, the benefits of lower energy costs to consumers are thus far being overshadowed by declining capital expenditures in the energy segment and rising high yield (aka junk) bond yields. Many small energy companies used the cheap funds available in the high yield bond sector to finance energy extraction activities. As the prices fell, so did the debtors ability to repay the debt. Thus, we have seen a significant rise in borrowing costs in the high yield segment and rising probabilities of defaults in the energy sector if oil continues to fall. While falling energy prices are generally constructive, plummeting prices can cause dislocations that have detrimental impacts. ■

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Economic Review & Outlook

Economic growth during 2015 followed a similar pattern as several prior years with GDP weakening in the first quarter followed by stronger months through the middle of the year. However, the magnitudes of the quarterly GDP changes were muted relative to prior years. For the year, final GDP will likely finish between 2 and 2.5%. Once again, the U.S. economy will likely fail to reach the 3% growth target many economists had forecast.

Throughout the year, manufacturing activity struggled to achieve consistent growth. The biggest headwind in this sector of the economy was the relative strength of the U.S. dollar. As the dollar continued to strengthen throughout the year, U.S goods became more expensive to overseas buyers, muting export activity and thus domestic manufacturing activity. We expect the dollar to remain strong in 2016, providing ongoing headwind for domestic manufacturing activity.

Unlike the manufacturing sector, the service sector of the economy (roughly 70% of gross economic activity) remains solidly in expansion territory.

S & P 500 Sector Performance

	Q4-2015	YTD-2015
Consumer Disc.	5.79%	10.11%
Consumer Staples	7.64%	6.60%
Energy	0.20%	-21.20%
Financial	5.96%	-1.53%
Healthcare	9.22%	6.89%
Industrial	8.00%	-2.53%
Info. Technology	9.17%	5.92%
Materials	9.69%	-8.38%
Telecommunications	7.61%	3.40%
Utilities	1.07%	-4.85%

The employment situation showed continual improvement throughout the course of the year. The unemployment rate fell steadily throughout the year, ending at 5%. Even the underemployment rate (those working below their skill level or multiple part-time jobs) began falling in the latter half of the year. The same was true of wage growth, which remained stubbornly illusive but showed signs of modest growth into the end of the year. With weekly jobless claims remaining very low, we anticipate continued stability in the employment market with wage growth and hours worked continuing to improve at a modest pace. Despite the improvement, slack still remains in the labor force.

With the continued stability in employment, we expect the strength in housing to continue into 2016. After peaking in June, housing activity slowed into the fall months. Most analysts blamed a lack of inventory for slower sales numbers, leading to more new construction opportunities for builders. The only headwind we see for housing would be an increase in borrowing costs related to the Federal Reserve rate hike in January. However, as will be discussed in the Bond Market section, we believe upward pressure on the long-end of the curve will be muted compared to previous rate-tightening cycles. Should this be the case, borrowing costs in 2016 will likely remain historically low for home buyers.

Consumer spending will be interesting to watch in 2016. The stable employment environment, modestly rising wages and a significant reduction in energy costs should bode well for discretionary consumer spending. We thought this would be the case in 2015, but the uptick we anticipated did not materialize. With energy prices being down since the fall of 2013, perhaps consumers will see the cost reductions as permanent, and begin increasing discretionary purchases.

Finally, our global economy requires us to consider the impacts of growth in China, Europe and Japan when considering our own prospects. China's transition from an export and fixed investment economy to an organic consumer based economy has been unsteady, giving cause to heightened skepticism as was reflected in the global equity rout in August. At the end of December, Chinese officials released general details of their 2016 economic reform plan which included structural reforms to foster a more competitive growth environment. European economic conditions improved during 2015 as the ECB embarked on their own Quantitative Easing program. Results are mixed across the Eurozone, but the growth trend remained positive for most of the year. The Japanese economy showed signs of life in 2015 with an anticipated growth rate of 0.9%. Though below their target of 2%, the economy avoided recession with the implementation of Prime Minister Abe's reform plan. ■

Scituate Harbor

Bond Market Review & Outlook

After years of talk and speculation, the Federal Reserve finally lifted the Federal Funds rate by 0.25% at the December meeting. Unlike previous tightening cycles, most believe the Federal Reserve will take a slow and pragmatic approach to future rate decisions. While this is likely the first in a series of rate hikes, we believe the pace of rate increases will be slow, ensuring minimal capital market and economic disruption along the path.

	Q4-2015	YTD-2015
Cash:		
T-Bill Index	0.01%	0.03%
Taxable Fixed Income:		
Barclay's US Agg. Bond	-0.57%	0.55%
Barclay's Govt./Credit Int.	-0.69%	1.07%
Barclay's Govt./Credit Long	-0.79%	-0.94%
BofAML High Yield Index	-2.17%	-4.64%
Tax Exempt Fixed Income:		
Barclay's Muni. 5 Yr.	0.66%	2.43%
Barclay's Muni. 7 Yr.	1.27%	3.26%
Barclay's Muni. TR	1.50%	3.30%

With the anticipation of further hikes, we believe the short-end of the Treasury yield curve will move commensurately higher in unison with Federal Reserve decisions, though we do not believe four rate hikes are in the cards for 2016 as some Fed governors have put forth. Since the Fed has already ended their QE program, however, they have much less control over the long-end of the yield curve which is driven by market participants and their perspectives on inflation and general economic conditions.

While the Federal Reserve may be done with QE for now, Central Banks across the globe are fully engaged in the program to drive down interest rates and foster economic activity. This being the case, there is pressure on the long-end of the yield curve as large yield disparities between U.S. Treasuries and other Sovereign bonds will present opportunities for traders. Thus, while we believe the short-end of the curve will continue to rise, the long-end of the curve will continue to see global pressures that limit the potential for rising yields. In this environment, expect long-term yields to rise more modestly. This will be good for borrowers, such as new homeowners, but will continue to be a drag for investors looking to increase their portfolio income. ■

Stock Market Review & Outlook

2015 was the tale of two equity markets. The first half of the year featured extremely low volatility, with a trendless market that did not stray by more than 3% higher or lower than the year-opening level. The second half of year witnessed a spike in volatility with equity markets swinging from losses to gains seemingly on a day by day basis. The month of December truly captured the nature of the second half with the Dow Jones Industrial average moving by triple digits on 17 of the 22 trading days.

From a valuation perspective, markets look very similar to the beginning of 2015: steep declines in energy and commodity earnings pulled down overall index earnings, resulting a P/E ratio for the market at the end of the year that was similar to year-opening levels. By the close of 2015 the S&P 500 stood at 2,045, 14 points below the year-opening level of 2,059.

During the course of the year, growth stocks outperformed more value-oriented companies while mid and small-capitalization companies trailed large-cap companies that may be viewed as less volatile and speculative in nature. Developed international equity markets performed generally in-line with U.S. markets. Emerging markets felt the most pain in 2015 with the MSCI EM index falling by 14.60% over 2015. ■

	Q4-2015	YTD-2015
DJIA Index	7.70%	0.21%
S&P 500 Index	7.04%	1.38%
Russell 2000 Index	3.59%	-4.41%
EAFE Index	4.75%	-0.39%

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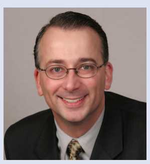

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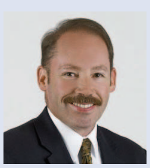

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Closing Thoughts

After years of seemingly endless annual gains in equity markets, investors were reminded that yes, stocks do go down, sometimes quite quickly. While we continue to believe that stocks remain within a range of "fair-value," the investing climate is clearly more cautious heading into 2016. We will continue to watch global economic activity for signs of possible strength or weakness. We will also be monitoring the credit and liquidity environments to determine if we should be less optimistic about future growth prospects. A stabilization in oil prices will be another key factor to watch for in 2016. Finally, we have political and geopolitical concerns both here and abroad that can clearly change investor sentiment overnight.

As always, we will continue to monitor economic and market conditions to ensure timely and appropriate investment action. If we can be of assistance, please do not hesitate to call us at the numbers provided. ■

If you are interested in receiving this quarterly newsletter electronically, please contact Thom Miller at tmiller@pliadv.com. We will be happy to take you off the mailing list and add you to the e-mail list.

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