BEACON POINTE
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Beacon's Point: New Year's Resolutions

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Confidential – Proprietary

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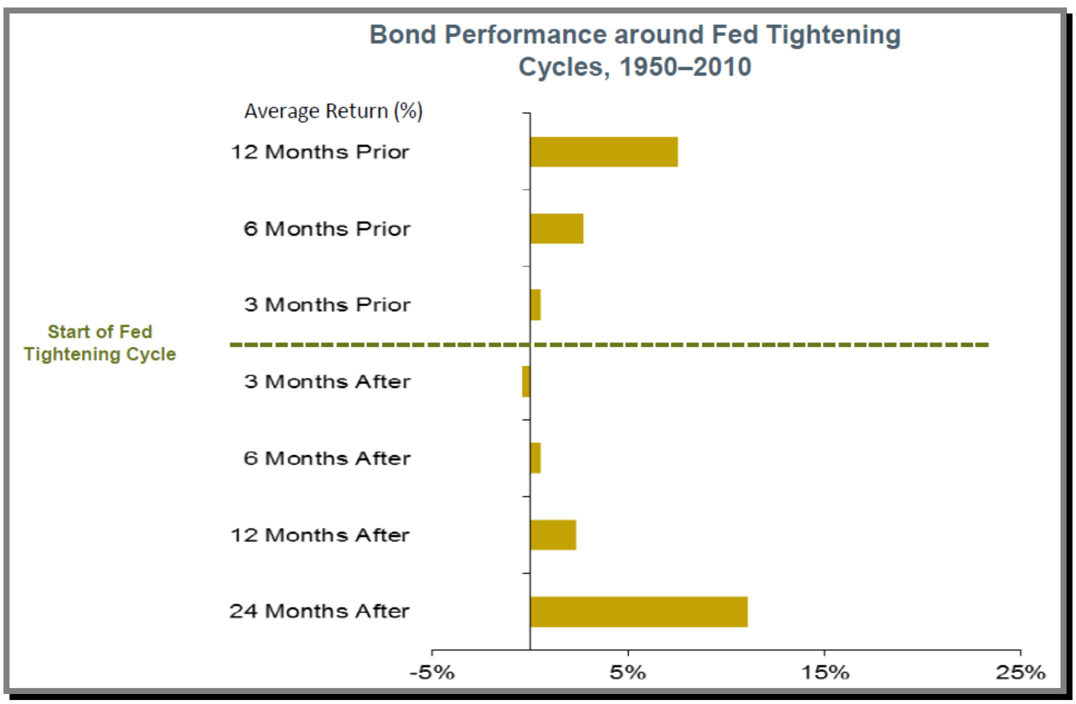
New Year's Resolutions

After holding its collective breath for most of 2015, the market can finally exhale a sigh of relief. The long-awaited interest rate hike is here. This was the first such move by the Federal Reserve since June 2006. It was a modest increase, but an increase nonetheless. The central bank's target range for the federal funds rate was raised from 0.00%-0.25% to 0.25%-0.50%. Meanwhile, the Federal Open Market Committee's median expectation for the same benchmark rate at the end of 2016 is now 1.3% and its longer-run projection stands at 3.3%-3.5%. According to Chairwoman Yellen, the Federal Reserve remains accommodative.

Naturally, investors and market observers are attempting to determine what this Fed action means for financial assets and investment portfolios. According to Fidelity Investments and based on historical data, fixed income performance is typically flat leading up to the first rate hike and the months immediately following the event. However, bond markets tend to regain strength relatively quickly, especially if the pace of subsequent interest rate increases is gradual. In the current cycle, the exact impact of Fed action on bond prices will become clearer as 2016 unfolds and will likely differ meaningfully among fixed income market segments as a function of duration positioning, credit sensitivity, and geographic exposures.



Source: Fidelity Investments

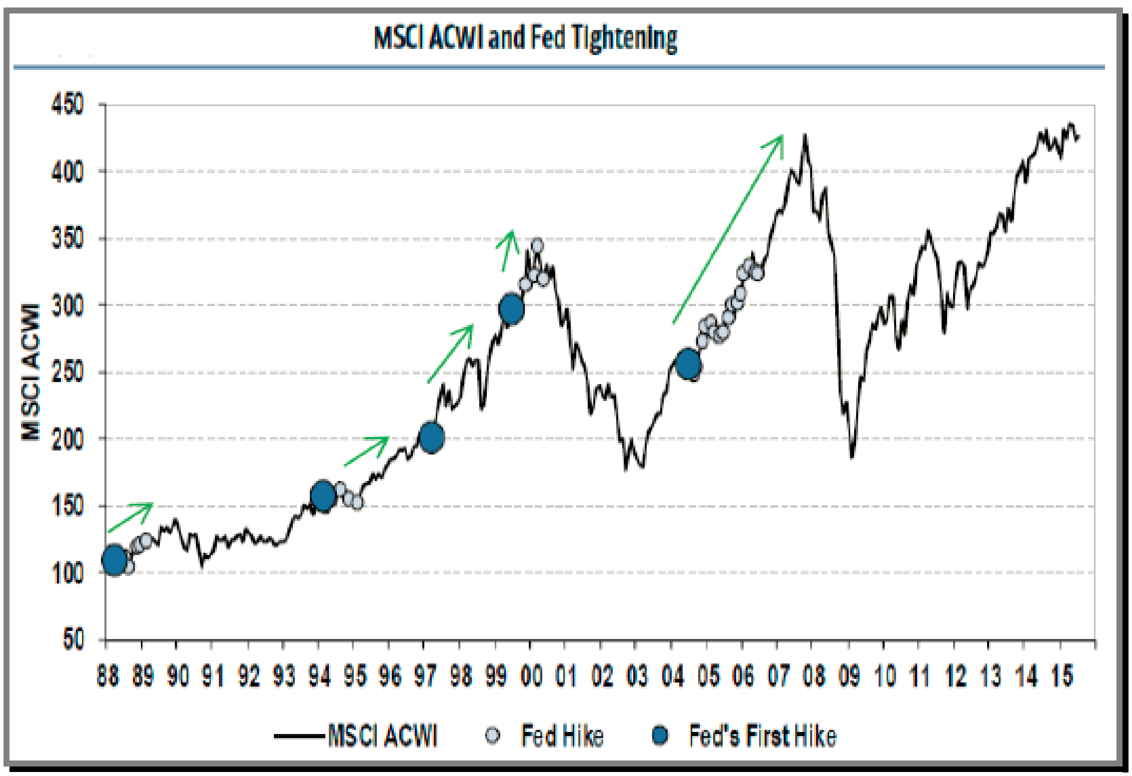
U.S. stock prices have historically exhibited less correlation to interest rate increases than fixed income instruments. Fidelity Investments summarizes its research findings on this topic in the table on the next page. Six of the last seven tightening cycles saw the S&P 500 with double digit gains; only once (mid 1999-mid 2000) did the index post negative returns. On average, the index performance was 21% and returns were solidly in positive territory for the periods prior to, during, and following the initial Fed rate increase. This certainly does not apply uniformly to all sectors, as they exhibit different levels of interest rate sensitivity, but overall trends are favorable.

Fed Tightening Cycles and S&P 500 Price Performance

			S&P 500 Price Performance in Relation to Initial Fed Rate Hike		
Fed Rate Hike Start Date	Duration of Tightening Cycle (Days)	Change in Fed Funds Rate (ppt)	1-Year Prior	1-Year After	Tightening Cycle
3/31/1983	133	1.06	36.6%	4.1%	18.1%
3/29/1984	133	2.13	4.0%	13.3%	49.8%
1/5/1987	262	1.44	19.6%	2.6%	10.8%
3/30/1988	413	3.31	-11.5%	13.3%	31.7%
2/4/1994	362	3.00	4.5%	1.9%	35.3%
6/30/1999	321	1.75	21.1%	5.1%	-10.8%
6/30/2004	726	4.00	16.1%	4.4%	11.3%
Average:	**336**	**2.38**	**12.9%**	**6.4%**	**20.9%**

Source: Fidelity Investments

Similarly, global stocks have historically not faced meaningful headwinds following Fed tightening, as shown in the performance chart for the MSCI All Country World Index below.



Source: Fidelity Investments, Bank of America Merrill Lynch, MSCI, Bloomberg

Caution is very much still warranted, however. A policy mistake, such as an overly aggressive tightening trajectory, could render all historical data irrelevant and wreak havoc on the economy or disrupt financial markets. In addition, even though the key question around the timing of the Fed's first interest rate hike was answered before 2015 wrapped up, many more issues of vital importance await their resolutions in the New Year. Chief among them are:

- How far will the oil bear market go and how long will it last? Who will be the casualties of plummeting commodity prices?
- Will distress in the high-yield market persist? Is the unprecedented gating of the Third Avenue Focused Credit Fund an aberration or will it have spillover effects on other areas of the market and create further liquidity challenges?
- Can China's policymakers engineer a soft landing and successfully transition the world's second largest economy from export-oriented to consumption-driven?
- What is the new normal level for global growth? Can the developing world restart its engine? Will Europe and Japan contribute to or detract from the world's economic wellbeing?
- How will the U.S. Presidential campaigns and elections unfold? Who will win the Republican and Democratic primaries? Who will claim victory in November?

Commenting on the outlook for stocks, Voya Investment Management states: "Earnings – likely to hit another all-time high in 2015 – have been driven in large part by rigorous expense management and the utilization of corporate finance measures like stock buybacks, and are vulnerable without better support from top-line revenue growth. Meanwhile, those stocks that have been able to generate top-line growth have grown crowded, leaving them susceptible to wild swings in investor sentiment should their metrics disappoint." Given this challenging background, we believe it is critically important to invest with a strong discipline, to emphasize original research, to pay attention to valuations, and to build portfolios with risk management in mind. These are all traits shared by the domestic and international equity managers Beacon Pointe recommends to clients.

Future fixed income returns, according to Prudential Investments, are expected to be healthy, especially in the riskier spread sectors, but to follow a bumpy ride. The bond market has had a long time to brace itself for a rate hike cycle, yet uncertainty lingers. Going forward, fixed income investment managers should see increased opportunities to add value through sector allocation, issue selection, duration and yield curve positioning, and currency management. Flexibility of mandates could prove beneficial as opportunities are periodically created by volatility within a specific segment or the overall market. Significant prior experience and a global perspective should also favorably impact managers' investment results. We are confident that our clients' bond portfolios are positioned well for a period of rising rates and potentially lower liquidity that is likely to test fixed income managers' skill.

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.