

## December 31, 2015 Quarterly Report

First, I want to wish you a Happy and Prosperous New Year! I am personally excited about investment prospects going forward and using the New Year to improve my professional capabilities each and every day.

Also, I want to thank you for your trust in the decisions we make. As we have said many times, we are not always right and we don't always win, but we do not make any decision without spending countless hours researching. One of the luxuries I am afforded in my profession life is the ability to sit, read, learn and analyze while at a job I truly enjoy (however, like most things in life, some days are better than others and some years are much better than others). Thank you for allowing me the opportunity to provide you with investment solutions.

### Good Riddance to Bad Rubbish

2015 was by far our most difficult investing year since the 2008-09 financial crisis. The list of issues that affected performance for all investors is numerous. If I were to pick the most salient of these issues, it would be the end of the Fed's Zero Interest Rate Policy (known by the unimaginative acronym: ZIRP). The actual end of ZIRP as well as the anticipation on the timing of the end of ZIRP was a dragging theme throughout 2015 that made asset allocation decisions difficult to say the least.

Asset allocation usually works to offset underperforming investments with investments that outperform. This was not the case in 2015.

According to data compiled by Bianco Research LLC and Bloomberg, a case can be made it was the worst for asset allocation in almost 80 years. The Standard & Poor's 500 Index only gained 1.2 percent with dividends (it returned a loss on a price basis), cash and bonds were up marginally, while commodities had a large negative return.

The chart below includes some of the worst years of investing and the best asset allocation return for individuals was the lowest since the end of the Great Depression in the 1930's:

<u>Year</u>	<u>Stocks S&amp;P 500</u>	<u>LT Bonds 30Y Treasury</u>	<u>Cash 3M Bill</u>	<u>Commodities CRB Index</u>	<u>Best Return</u>
<b>2015</b>	1.19%	0.81%	0.21%	-21.77%	1.19%
<b>1937</b>	-35.02%	0.22%	0.29%	-10.40%	0.29%
<b>1931</b>	-43.42%	-5.32%	1.09%	-20.59%	1.09%
<b>1953</b>	-0.96%	3.63%	1.83%	-3.12%	3.63%
<b>2001</b>	-11.89%	3.70%	3.85%	-16.34%	3.85%

With the end of ZIRP, there were not many investment choices that work. This is not normal. Since 1995, practically every year has seen some asset deliver returns exceeding 10 percent.

While the depth of losses in equities and commodities is nowhere near as bad as in 2008, the correlation of declines highlights the challenge for us to implement a traditional rotation among asset classes. International Equities, not reflected in the chart above, fared worse in dollar terms than all but the CRB Index, as the MSCI EAFE index declined 3.3% and MSCI Emerging Markets declined 14.92%

### Where Do We Want to Go?

I really enjoy the following chart and it is something that we use to illustrate on how we like to invest. The chart below represents the 11 sectors of the S&P 500 and their annual performance over the last 13 years. It provides a great visual to show that various sectors go through cycles in various years.

For example, in 2003 and 2005, Telecom stocks were one of the worst performing sectors; however, Telecom stocks were one of the best sectors in the subsequent years of 2004 and 2006. Again, the Utility sector was one of the worst performing sectors in both 2012 and 2013, but it ended up being the best performing sector in 2014.

The way we like to invest is to find value investments (which as one might expect are usually within the worst performing sectors) and hold them while the cycle completes the turnaround.

## S&P 500 Sector Performance

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
INFT 47.2%	ENRS 31.5%	ENRS 31.4%	TELS 36.8%	ENRS 34.4%	CONS -15.4%	INFT 61.7%	COND 27.7%	UTIL 19.9%	FINL 28.8%	COND 43.1%	UTIL 29.0%	COND 10.1%
MATR 38.2%	UTIL 24.3%	UTIL 16.8%	ENRS 24.2%	MATR 22.5%	HLTH -22.8%	MATR 48.6%	INDU 26.7%	CONS 14.0%	COND 23.9%	HLTH 41.5%	HLTH 25.3%	HLTH 6.9%
COND 37.4%	TELS 19.9%	FINL 6.5%	UTIL 21.0%	UTIL 19.4%	UTIL -29.0%	COND 41.3%	MATR 22.2%	HLTH 12.7%	TELS 18.3%	INDU 40.7%	INFT 20.1%	CONS 6.6%
INDU 32.2%	INDU 18.0%	HLTH 16.3%	FINL 19.2%	INFT 16.3%	TELS -30.5%	S&P 26.5%	ENRS 20.5%	TELS 6.3%	HLTH 17.9%	FINL 35.6%	CONS 16.0%	INFT 5.9%
FINL 31.0%	COND 13.2%	S&P 4.9%	COND 18.6%	CONS 14.2%	COND -33.5%	INDU 20.9%	TELS 19.0%	COND 6.1%	S&P 16.0%	S&P 32.4%	FINL 15.2%	TELS 3.4%
S&P 28.7%	MATR 13.2%	MATR 4.4%	MATR 18.6%	INDU 12.0%	ENRS -34.9%	HLTH 19.7%	S&P 15.1%	ENRS 4.7%	INDU 15.4%	INFT 28.4%	S&P 13.7%	S&P 1.4%
UTIL 26.3%	FINL 10.9%	CONS 3.6%	S&P 15.8%	TELS 11.9%	S&P -37.0%	FINL 17.2%	CONS 14.1%	INFT 2.4%	MATR 15.0%	CONS 26.1%	INDU 9.8%	FINL -1.5%
ENRS 25.6%	S&P 10.9%	INDU 2.3%	CONS 14.4%	HLTH 7.2%	INDU -39.9%	CONS 14.9%	FINL 12.1%	S&P 2.1%	INFT 14.8%	MATR 25.6%	COND 9.7%	INDU -2.5%
HLTH 15.1%	CONS 8.2%	INFT 1.0%	INDU 13.3%	S&P 5.5%	INFT -43.1%	ENRS 13.8%	INFT 10.2%	INDU -0.6%	CONS 10.8%	ENRS 25.1%	MATR 6.9%	UTIL -4.8%
CONS 11.6%	INFT 2.6%	TELS -5.6%	INFT 8.4%	COND -13.2%	MATR -45.7%	UTIL 11.9%	UTIL 5.5%	MATR -9.6%	ENRS 4.6%	UTIL 13.2%	TELS 3.0%	MATR -8.4%
TELS 7.1%	HLTH 1.7%	COND -6.4%	HLTH 7.5%	FINL -18.6%	FINL -55.3%	TELS 8.9%	HLTH 2.9%	FINL -17.1%	UTIL 1.3%	TELS 11.5%	ENRS -7.8%	ENRS -21.1%

Abbr.	Sector Index	Annual	Best	Worst
COND	S&P 500 Consumer Discretionary Index	11.44%	43.1%	-33.5%
CONS	S&P 500 Consumer Staples Index	10.27%	26.1%	-15.4%
ENRS	S&P 500 Energy Index	9.43%	34.4%	-34.9%
FINL	S&P 500 Financials Index	2.89%	35.6%	-55.3%
HLTH	S&P 500 Health Care Index	9.96%	41.5%	-22.8%
INDU	S&P 500 Industrials Index	9.42%	40.7%	-39.9%
INFT	S&P 500 Information Technology Index	10.69%	61.7%	-43.1%
MATR	S&P 500 Materials Index	8.79%	48.6%	-45.7%
TELS	S&P 500 Telecommunication Services Index	7.28%	36.8%	-30.5%
UTIL	S&P 500 Utilities Index	10.69%	29.0%	-29.0%
S&P	S&P 500 Index	8.90%	32.4%	-37.0%

Past performance does not guarantee future returns. The historical performance is meant to show changes in market trends across the different S&P 500 sectors over the past twelve years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/15.

This chart also illustrates our belief to remain invested in the Energy Sector. As shown, the Energy Sector has been the worst performer the last four years and, by a large margin, the worst performer over the past two years. The amount of vitriol and disdain being written and discussed about this sector reassures our fundamental investing philosophy. You can also see from above that the Energy Sector far outpaced the overall S&P 500 return in the years 2004 through 2007.

The final point I want to add about the prospects of the Oil & Gas/Energy Sector and the attractive risk/reward prospects it now offers, comes from the thoughts of a colleague of mine, whose investing acumen I highly regard. While these are not my exact words, the thoughts are identical:

I like to use simple analogies to justify investing in industries and companies that are out of favor. When an industry has more than one thing causing it to be out of favor, I call it a double whammy. For instance, McDonald's in 2003 was doing very poorly overseas and was having trouble with franchisees balking against price promotions that were costing them money. Also, it was the subject of public scorn and potential legislation outlawing certain items on its menu because they were so unhealthy. In this case it was suffering a triple whammy- three sources of trouble that hurt the company's profits while at the same time damaging its perception in the public eye.

None of these things were unsolvable and they were all addressed by a company with huge financial resources and it has now recovered almost tenfold.

Apple was in a similar situation back in 2003 with unfashionable colored personal computers (the two year old iPod was viewed by many as an admission that Apple was no longer competitive in personal computers), infighting and lack of leadership, and was losing a battle against juggernauts called Microsoft and Sony.

Its stock has since risen over one hundredfold.

Oil and gas are currently suffering a quadruple whammy-

1) Production Increase. Foreign production has increased in places like Iraq and shortly in Iran (prompting Saudi Arabia to increase production to maintain its market share and weaken its Shia rivals) and the shale and seismic exploration technology revolution has massively increased production in the US.

2) Politics & PR. The global warming debate and environmental movement has resulted in everything from proposed legislation limiting carbon emissions to tax incentives for increasing renewable energy production. In addition efforts to demonize the oil industry for hiding knowledge of greenhouse gas effects as well as lax monitoring and attempts at cover ups in the BP Macondo oil spill have gathered increasing attention. We should not forget the ongoing questions over the chemicals that are being injected into shale wells and their effects on groundwater.

3) Global Economy. The global economy has slowed and people are extremely worried about China's and the rest of the world's continued growth in petroleum consumption.

4) Industry Spending. The industry overall embarked on a gigantic spending spree- much of it financed by debt- on onshore and offshore oil drilling rigs, massive LNG plants and shipping infrastructure, offshore boats, fracturing sand mines, pipelines and trains to transport oil, trucks to pump sand at high pressure into oil wells and numerous other expenditures. This investment bonanza was based on the belief that prices would keep rising from \$100 per barrel not begin falling towards \$35 per barrel and the stock and

bond market adjustment has been calamitous.

The point about whammies is that not only do industries and companies face cyclical and company-specific problems, but they also become decidedly unfashionable, if not socially repugnant as well. There is a very strong movement among endowment and pension funds to get rid of investments in companies that contribute to carbon emissions and many fund overseers have decided to not continue to invest in the coal industry but to divest any holdings in coal companies.

Coal qualifies as perhaps the only sextuple whammy industry I have ever seen. However, because coal is considered to be the dirtiest energy industry and due to the fact that there are ready alternatives, it will never return to anywhere near the economic status it once enjoyed. And to add to the downward spiral; the coal industry has been collectivized in many ways by the healthy companies having to contribute more money to industry wide pension and healthcare funds as well as environmental remediation trusts when weaker companies fail, thus insuring the financial collapse of the entire industry.

The interesting irony of comparing the oil and gas versus coal industries is, as I previously stated, that the collapse of the coal industry will be one more reason why the oil and gas industry will rebound. The substitution of natural gas for coal in electricity generation has really gained steam (pun intended) and will provide continuing incremental demand for natural gas that few people currently are acknowledging- partially because of the unseasonably warm winter so far.

My final thoughts on [Where We Want to Go](#) includes rounding out your portfolio by continuing to diversify across Asset Classes, Sectors, and Geographies. We have been holding onto a large amount of cash to be able to invest at better prices. The start of 2016 is shaping up to be a year where stock selection, sector selection and diversification will contribute mightily to your portfolio.

### Index Returns

Even though we discussed various index returns above, for consistency sake, we will report the quarterly performance of some of the same indexes in the chart below

Index	Q4 2015	Q3 2015	Q2 2015	Q1 2015	5 Year Annualized
<b>*MSCI ACWI ex-US</b>	2.88%	-11.61%	-0.42%	2.90%	-1.65%
<b>S&amp;P 500</b>	7.04%	-6.44%	0.28%	0.95%	12.57%
<b>Russell 2000</b>	3.59%	-11.92%	0.42%	4.32%	9.19%
<b>Barclay's US Agg</b>	-0.57%	1.23%	-1.68%	1.61%	3.24%

Data provided by MorningStar Office

\*MSCI ACWI ex-USA PR USD is the Price Return of the Morgan Stanley Capital International Index excluding US based companies

**Current US Economic Indicators:**

- Consumer Confidence up 3.9 pts
- Employment Trends Index up 0.82%
- Help Wanted OnLine down 276,800
- Leading Economic Index up 0.4%
- Measure of CEO Confidence down 3.0 pts

Conclusion

It appeared that the 4<sup>th</sup> quarter was going to offer a respite to the concerns of equity investors and to some extent it did. However, the first few trading days of 2016 appears to present a new set of problems. We are, perhaps, in that period of global cycles where growth and growth oriented stocks such as Apple, Amazon, Google, etc...have begun to retreat, and where value stocks, such as BP, Pfizer, Verizon, etc..., are more attractive.

Time will be the ultimate arbiter.

Should you have any questions please feel free to call me directly at 314-726-550 or email at [bgrunzinger@chrysalisim.com](mailto:bgrunzinger@chrysalisim.com).

Sincerely,



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