DELTA
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Economic Comments

To the surprise of few, the Federal Reserve's Open Market Committee raised U.S. overnight interest rates following its mid-December meeting. This was the first central bank initiated interest rate increase in more than 9 years. After having kept short term rates at effectively 0% for almost 6 years, the Federal Reserve raised its target by 0.25 percentage points. Driving this momentous decision was the considerable improvement in the U.S. labor market and the Fed's contention that inflation will rise, over the intermediate term, to its desired 2% target.

With this policy shift, the U.S. central bank faces the delicate task of guiding the American economy back to more historically normal interest rates without killing the current tepid economic expansion. This effort is made appreciably more challenging by the headwinds coming from various economies and financial markets around the globe. Among the more prominent issues are modest global economic growth, rising debt levels and an ongoing commodity bust. Further complicating the situation is that the central banks in Japan and Europe are engaged in a vastly divergent policy from that of the American central bank.

Where the Federal Reserve has indicated its desire to raise interest rates by one percentage point in 2016, 2017, and 2018, its European and Japanese counterparts are actively engaged in the opposite, full-bore monetary easing. In fact, the European Central Bank (ECB) recently cut its deposit rate to be even more negative, a minus 0.3% from minus 0.2% - meaning that financial institutions actually have to pay to place money at their own central bank! Moreover, the ECB has pledged to continue its current bond-buying program through at least March 2017.

In anticipation of this long discussed shift in U.S. monetary policy, the greenback has strengthened nearly 25% in the past 18 months. From an overseas perspective, newly devalued currencies help lift their respective economies, boosting their manufacturing sectors and providing additional economic stimulus.

For the U.S., the concerns are the inverse with U.S. exporters and manufacturers particularly at risk. Between 2010 and 2014, the U.S. added over 800,000 jobs in durable goods manufacturing. However since the greenback started appreciating 18 months ago, these jobs have been in decline. Additionally, a strong dollar also tends to keep commodity prices lower. While benefitting many consumers and businesses, depressed commodity prices will continue the current woes of America's oil industry, a sector that had been a source of job growth through 2014 but is now quickly shrinking.

Despite the substantial contraction in energy related employment, overall national unemployment, having dropped seven-tenths of a percentage point this year, now stands at 5.0%, a seven and a half year low. At these levels, the

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unemployment rate is in a range that many Federal Reserve officials see as full employment. Recently new payrolls have been more robust with the early January report showing jobs creation of almost 300,000 positions. This helped modestly reduce the still dismal overall labor force participation rate which stands near 38 year lows.

Despite Fed Chair Yellen's optimism, financial markets continue to disagree with her economic assessment, at least as measured by interest rates projections. While Fed officials have shared their belief that the target overnight rate will be between 1.25% and 1.5% by year-end 2016, investors do not forecast short term rates to exceed 1%. To put the situation more in perspective historically, the Fed has usually tightened interest rates while the economy and profits were accelerating. This time, the economic expansion is mature and profit margins, which rose from 6.2% in 2009 to 9.7% in 2014, are now narrowing.

The central bankers' thought processes appear to be that monetary tightening is required now because with unemployment down to 5%, it is only a matter of time before prices and costs pick up. Core inflation excluding food and energy, now just 1.3% by the Fed's preferred index, is similarly likely to edge higher as downward pressure from the dollar, oil and health costs start to dissipate. Supporting this thesis, a recent analysis by the Federal Reserve Bank of Atlanta, indicates that the typical worker's wage is already growing at a 3.1% pace, up from a rate of 2.0 - 2.5% in early 2014.

Nonetheless, while every recession is different, they all tend to share the same critical ingredient: inflation. Despite an abnormally long economic recovery and short-term interest rates still near zero, inflation remains quite low. Unfortunately, so too is growth with the average 2016 forecast for U.S. economic growth among economists surveyed by Bloomberg being 2.5%.

For the coming year, the central bank's role will be to complete the difficult task of moving toward more normalized interest rates while avoiding the rocky shoals of economic recession. Although the economy is still, albeit slowly, growing, the wrong move in one direction by the Fed could drive the economy into recession and the wrong move in the other direction could spark an inflationary surge. While challenges abound in threading this difficult course, we are hopeful that our central bank can successfully negotiate this vital transition.

Analyst Corner

Given current demographic trends and political winds, healthcare remains a rapidly growing component of the American economy. With ever increasing dollars flowing into this sector, there is an even more growing need to efficiently manage healthcare information and medical records. Cerner Corporation *(NDQ: CERN)*, a developer of healthcare information technology and content solutions, sits at the nexus of these two issues. With a pristine balance sheet, quickly growing earnings and high levels of customer retention, the company seems to fill the bill on many counts. However, these wonderful attributes are costly as the company does trade at a richer premium than many securities. While not appropriate for all investors, we do believe that Cerner could be a meaningful addition to the right portfolio.

Market Comments

Closing out a rocky year, U.S. stocks had their worst annual performance since 2008 with the S&P 500 showing a full year gain of only 1.38%. If not for stock dividends of almost 2%, U.S. stocks would have shown a modest loss for the year. Given the year's 30+% rout in oil prices, none should be surprised that the energy sector was the worst performing with a 21+% loss. On the positive side of the ledger, consumer discretionaries provided support to the market with their relatively impressive 10.1% advance.

Meanwhile the U.S. bond market continues to reflect reservations about U.S. economic strength. In recent weeks, the shape of the interest rate yield curve has become less steep with 10-year Treasury securities only commanding a premium of 1.22% over the yield of 2-year Treasuries. As a quick refresher, a steeper yield curve typically suggests that the economy is gaining strength. Robust economic activity pushes investors to demand higher rates on long term debt to compensate them for the risk of accelerating inflation. Conversely, an inverted yield curve, where short-term rates are higher than long term rates, is usually a foreshadowing of imminent recession. The last yield curve inversion, in June 2007, correctly anticipated the financial crisis/downturn with the inversion occurring only months before the market's Fall 2007 peak.

Returning to the equity markets, much air has been wasted discussing the bull market's increasing age. We consider the extended duration of the current bull to be a more modest issue. The more critical problem appears to be that the bull's engine, i.e. corporate earnings growth, appears to be running out of fuel. Per-share profits of S&P 500 companies fell an estimated 6% in 2015. Granted, without a big drop in the energy sector, earnings would have climbed a more reasonable 5.6%. However, these gains were appreciably enhanced by share buybacks, which boost per-share profitability, rather than as the result of a strong increase in overall corporate profits. Analysts are starting 2016 with relatively robust expectations for S&P 500 profits to expand 7.6%, according to FactSet. For at least the next several quarters, we anticipate that low commodity prices and the strong greenback will weigh on earnings for both energy and multinational companies. Lackluster profits would be tolerable if stocks were cheap, but they are not. At year-end, the S&P 500 was trading at a historically lofty 19.5 times operating earnings – this in a time when the Fed is raising interest rates.

Following a tumultuous year that included disappointment in everything from U.S. stocks to emerging markets and junk bonds, investors are approaching 2016 with modest expectations. Most Wall Street equity strategists still expect gains for U.S. stocks this year. They also once again expect higher levels of volatility than in years past. Three factors should prove critical to the market's performance in coming months: Chinese economic growth, fallout from the collapse in oil prices and the U.S. Federal Reserve's monetary tightening policy shift. While we believe that these challenges may be met successfully, we also believe that 2016 could well prove to be a tumultuous time for investors.

Performance as of 12/31/15

	Close	Month	1 Year
DJIA	17,425.03	-1.52%	0.21%
S & P 500	2,043.94	-1.58%	1.38%
NASDAQ Comp.	5,007.41	-1.98%	5.73%

	Year end yield	Prior Year end yield
10 yr. U.S. Treasury	2.27%	2.17%

Planning Thoughts

Having commenced another New Year, we all must start thinking about the dreaded annual chore of tax preparation. For years, stockholders have had the difficult burden of keeping accurate records on securities that they (or their family) might have owned for years and even decades. In an effort to ease the record keeping burden, and also to enhance tax collection through improved reporting, the Internal Revenue Service (IRS) started requiring several years ago that all brokerage firms maintain accurate cost basis records of their clients' stock positions.

With few exceptions, stock brokers now report through their yearly 1099 tax report an accurate summary of client gains, losses, income to the IRS along with investment advisor fees. As a result, our year-end tax report is now largely irrelevant so we will not be mailing the report this year or moving forward. If you happen to be among the few exceptions mentioned previously, please reach out to us and we will uniquely generate this report for you. Otherwise, your brokerage produced 1099 should act as your definitive source for all investment related income. If you have any questions on this matter, do not hesitate to call us. Otherwise, we wish all of you a healthy and happy New Year!

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