

**William H. Wrean Jr., M.A.**

**William H. Wrean, Ph.D.**

**148 Linden Street, Suite 204**

**Wellesley, Massachusetts 02482-7904**

**Telephone 781-237-9290**

**SACAJAWEA & COMPANY, LLP**

**Economic & Financial Research**

February 29, 2016

Dear ,

In a cursory look, it appears that not much happened in the stock market in 2015. The total return on the S&P500 was 1.38%. If you look deeper, however, a lot happened. The price of oil continued to fall, losing about 30% of its value during the year and down nearly 75% from its high. This has caused many energy industry companies to struggle. We saw a buying opportunity and bought energy related stocks. Although the stocks we bought were down 30% or more, it was a little like catching falling daggers and several continued to fall. Despite this, we are confident we made good investments and these stocks will recover and grow. As the year drew to a close we were heartened by the fact we saw more non-energy industry companies fall to valuations we were comfortable with. We bought several of these and have continued to buy more in 2016. We like the fact we are able to increase your investments while improving your portfolio’s diversity. In the short-term, we hope for further declines in stocks so that we can get our clients fully invested again. So remember, on days when the stock market falls, we are smiling, for now.

Another way the 1.38% total return on the S&P500 is misleading is that this return was not evenly distributed across all stocks. It was powered by Facebook, Amazon, Netflix and Google. These four stocks, nicknamed FANG, accounted for 4% of the S&P500 total return (Fortune.com). Without these four stocks the S&P500 would have lost almost 3% in 2015. All four of these companies are young and do not have long histories. To invest in a company, we require twenty years of history which allows us to be comfortable with our expectations for the future of the company.

Last year we discussed the fact that stock prices relative to company fundamentals were very high. On average, that situation has improved during 2015. However, again it has been uneven. The stock prices of some companies have fallen significantly, resulting in reasonable valuations while others are still very high. We expect that some of the high priced stocks will fall in 2016 while some that are already beaten down will start to recover. Our model works well in this environment because we focus on individual securities. It is plausible that, even if the market is slightly negative or flat in 2016, your portfolio will grow as some of the beaten down stocks we purchased recover.

So what will happen in the stock market this year? We do not know; no one does. We think the market will be driven by the Chinese economy, the European Union and the Federal Reserve (“Fed”). Unfortunately, we have no faith that our elected officials will execute fiscal policies that will lift the U.S. economy. That does not look like it will change as a result of the next election. This has dumped the responsibility of supporting our economy on the Fed which was not designed to have that much influence. The Fed has tried hard, using techniques to support the economy that have not been used before, the Quantitative Easings being examples.

The Fed’s primary tool is to keep interest rates low. Reducing interest rates is supposed to be a short-term action to improve growth. Lower interest rates stimulate the economy by allowing people to buy bigger houses or new cars. Additionally, businesses can borrow money at lower rates, enabling them to lower their costs, raise salaries and invest in research. It also allows entrepreneurs to borrow money cheaply to start new businesses. Unfortunately, forcing interest rates to record lows for a long time encourages risky behavior. The federal funds rate has been at 0.00 to 0.25% for 6.5 years. This is unprecedented and dangerous in several ways.

First, many people live on income earned on bonds. Riskier bonds pay higher interest rates. As interest rates have been driven down, people are buying riskier bonds. Many people now buy “junk bonds” in order to generate the income they need. Unfortunately, “junk bonds” have a high likelihood of default. When they do, the owners lose all their income and much of their principal.

Second, a market economy is based on the availability of information and competition. When functioning well, competition drives innovation while keeping prices low. When interest rates are forced to unnatural lows for a long time, businesses take risks they would not otherwise take. The longer interest rates are held down, the more money is used in risky ventures. The more money is used in risky ventures the more our growth is dependent on these risky ventures. The longer interest rates are held down, the bigger the “bubble” that forms. When the ventures fail, the “bubble” breaks and growth slows. The U.S. economy currently is growing at less than 2% annually. If we have a bubble that bursts, it is likely that growth will fall more than 2% and we will have a recession. We believe it is past time for the Fed to normalize rates and are glad they have started the process.

We hope that they will continue to raise rates despite the recent short-term turbulence in the markets.

Our model may underperform the market when a bull market extends past reasonable valuations. However, it usually out performs the market when the bull market ends. The current bull market has lasted almost 6 years and looks to be long in the tooth. We want to thank you for your trust and for your patience as we progress through this current business cycle.

Sincererly,

William H. Wrean William H. Wrean Jr.