The Lam Group

Investment Management

While global equity markets recovered in the 4th quarter (Column B), 2015 was a challenging year (Column A).

Despite a strong start to the year in the 1st quarter (Column D), the strengthening of the US dollar (up +9.3%), the plunge in energy prices (oil down -46.1%), the instability in the Middle East, and the economic slowdown in China, negatively affected the markets in the 3rd quarter (Column C) enough to result in a calendar year where only three equity asset classes (international small cap +9.6%, US REITs +4.5% and US large cap +1.38%) and two fixed income asset classes (US investment grade bonds +0.55% and EM debt (denominated in US dollars) +1.18%) had positive return.

In addition to these meager contributions, other asset classes struggled in 2015, with emerging markets equities (down - 14.9%), commodities (down -24.7%) and non-$ bonds (down -5.54%) leading the laggards. The bulk of this year's volatility began in the 3rd quarter with the unexpected devaluation of China's currency. The downturn in emerging markets equities that followed was swift with the fears of a worldwide economic slowdown and the possibility of a decreased demand for commodities prompting investors to head for the sidelines.

While investors may question what could have been done differently, it is important to realize that very few investments did well in 2015.

Table 1: Periodic Asset Class Returns as of 12/31/15	A	B	C	D	E	F	G	H
EQUITY ASSET CLASSES	**2015**	**4Q 2015**	**3Q 2015**	**1Q 2015**	**Post Lost Decade Annualized**	**Total**	**"Lost Decade" 2000-09 Annualized**	**Total**
S&P 500 Index - *Domestic Large Cap Stocks*	+ 1.38%	+ 7.04%	- 6.44%	+ 0.95%	+12.98%	+107.98%	- 0.95%	- 9.10%
Russell 2000 Index - *Domestic Small Cap Stocks*	- 4.41%	+ 3.59%	-11.92%	+ 4.32%	+11.95%	+ 96.86%	+ 3.51%	+ 41.23%
MSCI EAFE Index - *International Large Cap Stocks*	- 0.81%	+ 4.71%	-10.23%	+ 4.88%	+ 4.28%	+ 28.62%	+ 1.17%	+ 12.38%
MSCI EAFE SC Index - *International Small Cap Stocks*	+ 9.59%	+ 6.79%	- 6.83%	+ 5.56%	+ 8.79%	+ 65.81%	+ 6.45%	+ 86.89%
MSCI EM Index - *Emerging Markets Stocks*	-14.92%	+ 0.66%	-17.90%	+ 2.24%	- 1.21%	- 7.07%	+ 9.78%	+154.28%
DJ US Select REIT Index - *Domestic Real Estate*	+ 4.48%	+ 7.54%	+ 3.09%	+ 4.71%	+14.81%	+129.00%	+10.67%	+175.59%
S&P Global (ex-US) REIT Index - *International Real Estate*	- 3.54%	+ 1.86%	- 4.29%	+ 2.68%	+ 7.51%	+ 54.39%	N/A	N/A
FIXED INCOME ASSET CLASSES	**2015**	**4Q 2015**	**3Q 2015**	**1Q 2015**	**Post Lost Decade Annualized**	**Total**	**"Lost Decade" 2000-09 Annualized**	**Total**
BarCap Aggregate Bond Index - *US High-Grade Bonds*	+ 0.55%	- 0.57%	+ 1.23%	+ 1.61%	+ 3.79%	+25.00%	+ 6.33%	+ 84.75%
BarCap High-Yield Bond Index - *US High-Yield Bonds*	- 4.47%	- 2.07%	- 4.86%	+ 2.52%	+ 6.65%	+47.19%	+ 6.72%	+ 91.58%
BarCap TIPS Index - *US TIPS*	- 1.44%	- 0.64%	- 1.15%	+ 1.42%	+ 3.17%	+20.57%	+ 7.70%	+110.02%
Bloomberg Commodities Index - *Commodities*	-24.66%	-10.52%	-14.47%	- 5.94%	- 9.03%	-43.31%	+ 7.13%	+ 99.12%
Citigroup Non-$ World Govt Bond Index - *Non-$ Bonds*	- 5.54%	- 1.38%	+ 1.71%	- 4.36%	- 0.24%	- 1.46%	+ 6.60%	+ 89.41%
JPM EMBI Global Diversified Bond Index - *Emerging Markets Debt*	+ 1.18%	+ 1.25%	- 1.71%	+ 2.01%	+ 6.48%	+45.73%	+10.90%	+181.52%

Sources: Morningstar & Dimensional

With all the volatility in emerging markets and commodities, the portfolio's inherent diversification and balance mitigated some of the impact of these negatively performing asset classes. However, nothing in 2015, with the exception of international small cap stocks, had meaningfully positive performance. *It is worth noting that the international small cap asset class is one that is not normally included in most conventional investor portfolios, but one that we have a substantial exposure as part of our general investment policy.*

While some might be disenchanted with the performance of emerging markets over the last several years, we remind ourselves of the "Lost Decade" (Columns G & H) for US stocks where the S&P 500 underperformed (down cumulatively -9.10%) all asset classes (equity & debt). During this period, many questioned the continued inclusion of underperforming US large cap stocks in our globally-diversified strategy. *In all investment environments, it is important to stay disciplined to portfolio allocation targets*, and the performance of US large cap stocks since the "Lost Decade" ended (Columns E & F) in 2010 has more than justified their continued inclusion in a long-term portfolio management strategy.

We remain confident emerging markets equities will rebound to make future contributions to the portfolio for several reasons:

- *Current valuations argue for higher expected returns from emerging and developed equity markets vs domestic equities.* From a valuation standpoint, emerging markets equities look as inexpensive as they were in early 2009 (and 2001), while US stocks are currently almost as expensive as they were in 2007 (pre-global financial crisis levels). Developed markets seem fairly-valued relative to the last 15 years.

- *The monetary stimulus playbook works.* While the monetary stimulus programs used by Federal Reserve to bolster US markets (2008-2015) have come to an end, Europe, Japan and China have only just begun their stimulus programs, which are intended to have similar effects in those markets.

- *Risk and return are related.* With higher risk, higher return has been known to follow. Because our portfolios have experienced the volatility inherent in riskier asset classes, it is important to wait for the return. To be a successful long-term investor it is essential to have patience.

Reporting negative annual performance is never pleasant. However it is an unfortunate reality with so few asset classes delivering positive returns in 2015. In any successful investment strategy, down years do happen, and this is the price investors must pay to capturing long-term risk premiums.

We look forward to a better 2016.