MISSION
MANAGEMENT & TRUST CO.

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2015 disappointed almost all investors. At the start of the year, there was unanimity among strategists from all major investment firms that the Fed-supported stock market rally would continue. It did not, as the average U.S. stock declined and at year-end was 24% below its 52-week high. The strength in a small number of institutional favorites kept the major equity indexes from similar declines. In fact, while the total return on the Dow Jones Industrials was negative, a 2% dividend return on the S&P 500 lifted that index out of the negative column to a total return just above 1%. Risk-free cash equivalents continued to provide no return, and bonds were mixed with the broadly followed Barclays Aggregate Bond Index registering a total return of 0.55%. At the lower end of the quality spectrum, high yield bonds lost 4% for the year.

Such nondescript returns masked an unprecedented level of volatility. Throughout the year, there were repeated violent market swings with no lasting trends developing. Hedge funds had a particularly difficult time – with some of the most successful over the past few years dropping by 20% or more. Warren Buffett's normally profitable Berkshire Hathaway Corporation declined by 12%.

As we begin 2016, investment strategists and economists are once again convinced that stocks and the economy are primed for a positive year. We disagree. About four months ago, I wrote a blog explaining why Mission believed that a major bear market had begun. Subsequent events have done nothing to dampen that conviction. Let me update the major factors that led to that belief.

Even after the worst first week of a new year in U.S. stock market history, valuations remain higher than ever before but for the months surrounding 2000's dot.com peak. Data stretching back more than a century make the point that returns for the years following periods of significant overvaluation tend to be much weaker than average. It has been in such time spans that the market's most destructive declines have unfolded.

The vast majority of U.S. stocks are trading below their 50- and 200-day moving averages, showing that they are trending down. Of the 46 world markets that we monitor, only five are trading above their 200-day moving averages and only three above their 50-day.

Even on most rally days, more stocks are reaching 52-week lows than 52-week highs. The market's internal deterioration can be seen clearly in statistics compiled by Lowry Research Corporation, an institution with an 88-year history of highly respected research. In twelve months through December 30, the percentage of stocks within 2% of their 52-week highs declined significantly: Large caps from 27.1% to 17.45%; Mid caps from 23.24% to 15.53%; and Small caps from 14.38% to 3.33%. Over the same time period, the percentage of stocks down from their 52-week highs by 20% or more increased dramatically: Large caps from 8.87% to 19.81%; Mid caps from 18.06% to 34.36%; and Small caps from 39.05% to 61.71%. These statistics are not consistent with a healthy market.

This internal deterioration took place while our Federal Reserve and other major central banks were flooding their respective economies and markets with historic amounts of monetary stimulus. The European Central Bank and the Bank of Japan have pledged to continue that torrent of new money, but the

Fed has begun a belated process of "normalization". Interest rates have been nudged above the zero bound for the first time in years, and the essentially free new money from quantitative easing will be missing in 2016. We can only speculate how the economy and markets will behave without that familiar stimulus.

In a process that began over two years ago, volume going into rising stocks has deteriorated steadily relative to volume going into declining stocks. In the second half of 2015, the cumulative volume total going into declining stocks surged above the volume going into advancing stocks. As measured by Ned Davis Research since 1981, the S&P 500 has on average declined when that condition has prevailed, and the index has performed an annualized 13.5% worse than when advancing volume has dominated.

For most of the past two years, the yield on lower quality debt has been rising notably-- both absolutely and relative to U.S. Treasuries. That trend has preceded some of history's most severe stock market declines.

Those who interpret Dow Theory announced a bearish signal in August when both the Dow Industrials and Transports descended below their October 2014 lows. The precipitous market decline in 2016's first week has brought the Transports to a new low not yet confirmed by the Industrials.

Weakness in technical conditions is not alone in sounding an alarm. Fundamental conditions, as well, continue to deteriorate. Notwithstanding consistently optimistic forecasts from investment bankers and brokerage firms, worldwide growth remains weak. The International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD) and, most recently, the World Bank have all once again dropped their estimates for both U.S. and world growth. IMF head Christine Lagarde last week forecast 2016 global growth to be "disappointing and uneven."

China's growth continues to slow, and smaller emerging economies are increasingly distressed by the strengthening U.S. dollar. After China's surprise devaluation of the yuan, an increasing number of countries are likely to be motivated to weaken their currencies to maintain or improve their export potential. Aggressive currency wars are possible as countries fight to avoid recession. When last common, such currency wars contributed greatly to the length and depth of the 1930s' worldwide depression.

In the U.S., corporate earnings declined in 2015 and are at approximately the same level as at the end of 2013. With no net earnings growth for two years and the most optimistic forecasts projecting uncertain growth in 2016, valuations not far below all-time highs make no sense.

Weak technicals and fundamentals by themselves pose significant dangers. Mix them into an environment marked by the highest debt levels in history throughout most of the world, and the risk of severe and rapid market price declines is high.

Standing guard against such an outcome are Janet Yellin, Mario Draghi and central bankers worldwide. For several years, they have stepped into the breach whenever significant price declines have threatened.

History argues strongly, however, that central bankers can prevail over weak fundamental conditions only so long. Markets eventually adjust to fundamental levels, and the adjustment can be abrupt if, as now, prices have diverged dramatically from underlying fundamentals.

We continue to caution investors against being lulled into a state of complacency by apparent central bank control over market prices. In past communications, we have highlighted two striking 2015 examples of the power of markets ripping control from the best efforts of governments. The highly respected Swiss National Bank (SNB) saw the euro diverge from the franc by 38% in minutes when the SNB dropped its long-held peg between the currencies. Far less respected Chinese monetary authorities were shocked when stock prices plummeted by 45% in weeks despite significant governmental support for markets. More surprises are likely in 2016.

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