HILLIARD LYONS TRUST COMPANY LLC

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The more things change, the more they stay the same

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World-weary French journalist Jean-Baptiste Alphonse Karr penned the epigram that is the title of this year-end commentary. Although he wrote these words in 1849, they fit the investment markets of 2015. "Violently unchanged" is our preferred description for the markets last year. The total return for the Dow Jones Industrial Average was 0.2% while the S&P 500 return was 1.4%. On a price basis only, excluding dividends, the Dow declined by 2.2% while the S&P 500 dropped 0.7%. The S&P 500 Index crossed the unchanged line a total of 30 times during the year, a new record. Violently unchanged indeed.

Asymmetrical gains and losses: While the stock market indices were essentially flat for the year, there was turbulent action raging throughout the markets. Most of the upward movement in the S&P 500 was concentrated in the 10 largest stocks, which were up an average of 18%. The other 490 stocks in the Index declined by an average of 4%. The largest declines were found in the energy and minerals sectors. With the price of oil and other commodities plummeting throughout the year, stocks in the energy sector declined by 21.1% and materials stocks were down 8.4%. Some more heavily indebted companies in these sectors saw their stocks decline by over 50%, and some may be heading for bankruptcy if commodity prices don't rebound quickly. The lesson for investors? Avoiding the big losers can be just as important to successful investing as owning the big winners.

Slow and sluggish: The economic environment last year was largely unchanged from recent years, with stubbornly slow nominal growth rates in both the United States and around the globe. Interest rates and inflation remained at historically low levels throughout the year, with the 10-year U.S. Treasury bond yield moving from 2.17% at the beginning of the year to 2.28% at year's end. Growth rates and interest rates throughout Europe and Japan remained significantly lower than those in the United States.

Survival of the fittest: This frustratingly slow economic growth has led to a harsher, more Darwinian business climate. When the economic pie grows this slowly, it creates an environment of winners and losers. Those companies that have the best business models with advantages over their competition are thriving. Those that don't are struggling to survive. There simply isn't enough economic growth to accommodate everyone. Under these economic circumstances, investors should be more careful than ever to invest in only the highest quality companies.

No more ZIRP: One final important occurrence late in 2015 was the Federal Reserve (Fed) raising the Federal Funds rate by 0.25% after seven years of a zero-interest-rate policy (ZIRP). As the Fed begins to unwind its unprecedented attempts to stimulate a damaged economy, it is important to note a profound change that is affecting the U.S. and world economies: For most of our lives, the primary economic enemy that investors, the Fed, and other central banks had to deal with was elevated inflation levels. By contrast, in recent years, the biggest economic threat is no longer inflation, but deflation. A quick look at plunging commodity prices tells us that the winds of deflation continue to blow. In a world with heavy debt burdens in both the public and private sectors, declining asset prices is the quickest path to insolvency. This is the primary battle the Fed is fighting and helps explain their thinking in maintaining ZIRP for so long. The battle against worldwide deflation is still being waged, and central banks around the world are at the forefront of this fight.

What's ahead: As we look forward into 2016, prior trends seem likely to continue. It is reasonable to expect slow economic growth combined with low levels of inflation and interest rates. And all of the frustrations that accompany this slow-growth world will presumably continue. Commodity prices need a pickup in economic growth for a meaningful, sustained recovery to occur – and that doesn't seem likely in the near term.

It's a presidential election year, so the airwaves will be filled with economic policy proposals from across the political spectrum. Our fervent hope is that voters choose wisely and put a government in place that can enact policies that effectively address some of the vexing difficulties we face as a country. One of those many challenges is to help rev up the engine of economic growth.

An inauspicious start: Obviously, the stock market is off to a very shaky start in 2016. The first week's decline of 6% is the largest weekly decline in four years and the largest five-day decline to start a new calendar year in history. A primary reason for the decline is uncertainty about China and its economic future. There are also a number of mixed economic signals in the United States and around the globe, while commodity prices continue to tumble.

We don't know exactly what the future holds for China, nor does anyone else. But we can tell you that we firmly believe that our long-held investment beliefs and strategies are well-suited for today's uncertainties in the world. We adhere to our mission of helping our clients achieve their investment objectives through the long-term ownership of carefully selected high-quality securities:

- In *equities*, we seek companies with winning business models and sturdy cash flows that are run by excellent managers who excel at capital allocation.
- In *fixed income*, we invest primarily in high-quality bonds of short and intermediate maturities with an eye on limiting portfolio risk.

We strive to have clients' portfolios prepared for tough times. We don't believe investors can consistently anticipate when markets will become particularly challenging, so it is best to always be prepared. We have embraced this philosophy over several decades, and you can rest assured we will not stray from this approach.

Moving ahead: We look forward to a new year filled with opportunities and challenges, just like every other year. And we are most grateful to you, our clients, for the loyalty you display. We appreciate the trust that you place in us and pledge our best efforts on your behalf in the years to come.

Past performance does not necessarily predict future results, and historical prices and returns may not be achieved in the future.

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