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DEIGHAN WEALTH ADVISORS

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21 Years

Deighan Wealth Advisors
1994-2015

MARKET COMMENTARY

2015 was a peculiar tug of war year. Divergent, headline-grabbing economic themes pushed and pulled the markets in unexpected ways, fueling investor uncertainty and resulting in a year of volatility and disappointing market results. US equities ended the year on a sour note - the raw S&P 500 index fell 0.7%, only buoyed by re-invested dividends to end slightly up at 1.38%. The Dow Jones fell 2.23%, its first annual loss since 2008. The chart below tells the story. Most other stock indices fared worse worldwide. Commodities saw their fifth consecutive year of declines. Bonds went negative in the fourth quarter eking out just 0.55% for the year, while cash equivalents remained basically flat.

ASSET CLASS	REPRESENTATIVE INDEX	2015 RETURN:
US Large Cap Equities	S&P 500 Index	1.38%
US Small and Midcap Equities	Wilshire 4500 Completion	(2.64%)
Developed International Equities	MSCI EAFE (Net)	(0.81%)
Emerging International Equities	MSCI EM (Net)	(14.92%)
Hard Assets	Bloomberg Commodities	(25.23%)
Broad Fixed Income	Barclays US Aggregate	0.55%
Cash Equivalents	BOA/Merrill Lynch T-Bill 3-Month	0.01%

To add to the frustration for US investors, 2015 brought an uneven, narrow market for domestic equities. Only six companies, comprising 12% of the S&P's total market capitalization, propped up the index preventing it from diving deeper into the red: Google, up 43%; Microsoft, up 22%; Amazon, up 118%; GE, up 26%; Facebook, up 34%; and Netflix, up 135%. Without these top performers, the S&P returns would have looked a lot more like those of the Dow. A little over half of the companies in the S&P ended the year in the red, with 173 companies down more than 10%. Companies delivering disappointing results included stalwarts like Exxon Mobil (-12.47%) and Proctor and Gamble (-9.96%). While the narrow nature of the S&P 500 performance is reminiscent of the 1999 tech bubble, the exuberant environment of the 90's is replaced by investor worry and wariness.

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The foregoing results might lead an investor to believe that the US economy is contracting. However, economic data reflect an improving economy. Unemployment fell to 5.0% in 2015, the lowest it has been since before the 2008 crash. First-time requests for government assistance fell to about 15 million in 2015, the lowest number since the 1990s. GDP is positive at 2%. Monthly housing starts and auto and light truck sales are up. So, why are we seeing such poor domestic stock returns this year? There are four good reasons: China's bumpy economic transition, rising short-term interest rates, a strong dollar, and falling oil prices.

As we have discussed in our previous two newsletters, China, the second largest economy in the world, is in a state of economic transition from an industrial-based economy supported by cheap labor to a more modern service-based economy supported by a growing middle class. We do not want to belabor this point; nevertheless, the China effect continues to weigh heavily on US markets and will for some time. Even as we write this year-end review, the Shanghai Composite Index (SHCOMP) has taken yet another nose dive, losing nearly 7% thereby skimming a cool 2.5% off most developed market indices; an uncomfortable start to 2016. We once expected 10% annual GDP growth from China, but now, as it transitions to a more sustainable, mature economy, we cannot expect that same level of growth. Many analysts have cut their GDP growth predictions for China in half, which is still an impressive growth rate especially given China's

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huge population. In this era of globalization, we are inextricably linked; its economic pull is inescapable. Thus, as China continues its development, the entire world is swept along for the ride.

Short-term interest rates are on the rise and, this too, has made investors apprehensive. After keeping rates at near zero since the recession, the Federal Reserve has finally begun to increase interest rates with the intention of bringing rates back to historically "normal" levels. Still, many investors worry about the pace and intensity of future rate increases despite the Fed's assurances that increases will be instituted thoughtfully. Others are unsure whether the US economy can sustain the increases, and whether the program will even continue. That said, the December 2015 increase has already caused some major shifts in the US and world economies. Like any change, there have been those who benefit and those who are burdened. Banks and other financial institutions are the most prominent beneficiaries of the rate increase by increasing returns on their lending operations. However, this in turn has increased the costs of borrowing in the US making borrowed money more expensive for consumers and businesses alike. The rate increase has also attracted foreign investment to the US. Since other developed economies have continued their "easy money" economic policies (quantitative easing), keeping their interest rates low, foreign investors look to US debt securities for better interest payments. This increased foreign investment has caused the value of the dollar to surge relative to other currencies. Our strong dollar may be welcomed by US consumers traveling overseas or buying imported goods, but it causes the cost of US exports to rise as the cost of imported goods fall. This is a double negative for US manufacturing. Additionally, multinationals such as Proctor and Gamble have watched profits generated overseas melt to losses as those profits are translated back to rising cost dollars. While the strong dollar may seem like a boon for foreign interests, this is not universally true. A strong dollar can have adverse consequences for companies abroad too; see the discussion of emerging markets below.

Finally, oil, once fuel for economic growth, has become an anchor. As recently as eighteen months ago, oil closed at $107 a barrel. While oil prices had once made it economically infeasible to drill domestically, the combination of high prices and improved technologies turned the table and encouraged exploration and production. As new production escalated – especially from US shale oil fields, OPEC began to lose market share. In 2014, Saudi Arabia began a price war in an attempt to counter this trend and put other more costly North American and North Sea oilfields out of production. On December 31, 2015, oil closed at $37 a barrel, a 65% drop in just 18 months. The global oversupply of oil has even prompted Congress to lift the ban on exports that has been in place since the 1970s. While the US oil industry has been hurt, the US consumer and energy reliant businesses have benefited from cheaper oil. Again, the push pull effects of cheap oil have set off unexpected cross-currents.

Looking around the globe, disruptions continue. Emerging markets had an especially dismal year. The MSCI Emerging Markets Index ended the year down almost 15%. Emerging markets rely heavily on exports of raw materials to support their economies. These export activities, and the countries themselves, are financed principally with debt denominated in US dollars. Since the Great Recession, historically low interest rates have encouraged many corporations in emerging markets to borrow heavily to grow their operations. Falling commodities prices prevented this growth from materializing despite the new investment. This situation was exacerbated by the appreciating US dollar. The increase in the value of the US dollar relative to local currencies effectively increased their debt loads. When sales drop and the cost of doing business rises, losses ensue. Nevertheless, while emerging markets are currently under considerable pressure, the longer term outlook remains favorable.

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Developed markets fared better than emerging markets with Japan leading the pack. The Nikkei 225 topped its previous high from the year 2000 and closed the year with a positive 8.71% return. Europeans fared much worse, with the FTSE 100 (UK) ending the year at -6.72% and the STOXX 50 (Europe) at -4.47%. Earnings per share growth expectations are positive for both Continental Europe at 8% and Japan at 7.4%, in line with US EPS growth expectations of 8.1%. Yet, normalized price-to-earnings ratios are considerably lower in Europe, the UK and Japan versus the US, suggesting that stock valuations are more favorable in developed markets, a theme we will be closely following.

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With 2015 behind us, we inevitably look toward the coming year and wonder what is in store for us. As we see the headline, "Dow Jones gets worst start in 84 years," it is difficult to look toward 2016 with cheer. Certainly China will continue to cause market volatility as it transitions to a service-based economy. The Fed plans to continue interest rate increases while other countries show no inclination to close the gap between our divergent monetary policies. Oil and commodities prices are at deep lows and are likely to stay that way for some time. Still, there is a ray of hope. Flat years are often followed by a gain in the following year. In fact, according to the Wall Street Journal, the S&P 500 saw a gain in the subsequent year after all five of its flattest years. The Dow saw a gain subsequent to four out of five of its flattest years. Economists in The Wall Street Journal's forecasting survey along with most Federal Reserve officials predict growth in 2016 in the mid 2% range. Whomever you ask, dove or hawk, it looks like 2016 will be unsettled.

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As we move forward with this forecast of market volatility in mind, it is important to remain calm, cool and collected. We look to the old adage, "don't put all your eggs in one basket." Diversification is probably the most important component in reaching long term financial goals while minimizing risk. As volatility swings the markets, the temptation to exit certain sectors or markets arises. If we give in to this temptation, the eggs get distributed into fewer and fewer baskets, inviting disaster. Prudent investors, like prudent farmers, diversify to manage risk. If you have any questions or need reassurances, please call or email us. In the meantime, enjoy the New Year!

The Deighan Team

PORTFOLIO CHANGES

Year end is a busy time for portfolio managers. This past year was no exception. While the following list provides brief explanations of some of the changes we've made to client portfolios during the last quarter of 2015, some maneuvering was specifically designed to minimize the tax bill come April. It's a double-whammy when portfolio values are down for the year and clients still have to pay capital gains taxes. So, we try to do what we can to offset realized capital gains. We may or may not re-purchase companies sold at a loss depending on their long-term growth prospects. In any case, we have to wait at least 31 days after incurring a capital loss before we can repurchase the same security or the capital loss recognition will be disallowed due to the IRS "wash sale rule". While we are careful not to let the tax tail wag the dog, we do what we can to mitigate onerous capital gains taxes when it makes sense to do so and does not impact the overall structure of client portfolios.

REMOVED

Cummins (CMI)

Currency headwinds have hurt Cummins due to their large international exposure. Decreased mining demand and low oil prices will continue to have a negative impact on earnings as well, and their North American truck order growth is suffering as evidenced by their high inventory to sales ratio. The company could see a 15% decline in sales for 2016 with the cycle expected to continue well into 2018. Additionally, Paccar, one of Cummins' largest customers continues to increase production of its own engines. We don't see a positive catalyst for earnings growth for the next few years.

Qualcomm (QCOM)

Earnings growth at Qualcomm is decreasing in comparison with their peers. Increased competition from Intel, the loss of a large contract with Samsung, and significantly less product position with Apple's iPhone are eating into market share. The likelihood of gaining the same market share that Qualcomm had in the 3G market in higher bandwidths such as 4G is low, which will lead to decreased royalties over time. While we search for a better opportunity in the tech sector, we have chosen to replace this position with Guggenheim S&P500 Equal Weight Technology ETF (RYT).

BHP Billiton (BHP)

It is unclear whether BHP's metals businesses have reached bottom yet due to uncertainty in China's economy and resulting low demand. Copper, one of BHP's larger segments isn't expected to recover in the near term. We were quite dismayed to learn that the company's Samarco joint venture with Vale in Brazil experienced a dam burst on November 5, 2015 that released 60 million cubic meters of mud/mine waste that killed 13 people in a nearby village and polluted the Rio Doce river valley. The lawsuit faced by Samarco for this incident is projected to be in the $5-7 billion dollar range. While details on the situation are still emerging, we have chosen to exit BHP in client portfolios.

Schwab International Equity ETF (SCHF)

We chose to replace this ETF with Schwab International Index Fund (SWISX), which tracks a different developed foreign index – the MSCI EAFE (Europe, Australasia, Far

SOUNDBYTES

Jean Deighan attended the Bob Veres Insider Forum in September, and the Schwab Impact Conference in November. Both are important conferences featuring industry leaders presenting on current financial planning and portfolio management topics.

Tyler Hoxie sat for the Level I CFA exam, one of three required in addition to relevant work experience toward obtaining the Chartered Financial Analyst designation. The CFA program is considered among the most rigorous in our industry. Good luck, Tyler!

Derek Jones will be serving on the Governing Council of the New Lawyers Section of the Maine State Bar Association. Derek also attended The Crossroads of Ethics and the Practice of Law as part of his continuing education requirements as a member of the Bar.

We all enjoyed attending the Junior Achievement-Maine Business Hall of Fame North dinner in November where laureates honored included Larry Shaw of MMG Insurance, Joe Cyr of John T. Cyr & Sons, and Edward Hennessey, Jr. of Machias Savings Bank. Congratulations to all!

East) Index. In addition to performance issues and valuation metrics, the reasoning behind the switch is that SCHF's benchmark index includes Canada, a country that is heavily dependent on energy and basic materials – two sectors of the global economy that we don't currently favor. SWISX's index does not include Canada. Additionally, South Korea is included in SCHF's portfolio as part of the FTSE index, but is not a holding in the EAFE index as it's not considered a developed country. Since we already have emerging markets exposure in client portfolios with other funds and ETFs, our preference is not to overweight the asset class by continuing to hold SCHF.

ADDED

Nicholas Fund (NICSX)

Nicholas is an all-cap equity growth fund. Their concentrated portfolio focuses on buying companies at attractive valuations intending to hold them for a long, long time. In addition to an investment process that aligns with ours, the company is committed to serving their community, which ties in well with our company culture and philosophy. While the fund has seen decent growth in assets under management over the years, we think it's still a bit of a hidden gem. NICSX doesn't pack a ton of unnecessary marketing expenses into their budget that might ultimately be passed on to investors. We appreciate the fund's excellent long-term track record, and think that its holdings nicely compliment other mid-cap investments in client portfolios.

Parnassus Core Equity Investor Fund (PRBLX)

This fund invests primarily in large-cap domestic stocks, but may invest in foreign and smaller companies. Parnassus screens companies for ESG (Environmental, Social, and Governance) criteria prior to purchase, and only holds companies that continue to meet its stringent standards. They exclude companies that derive significant revenues from alcohol, tobacco, gambling, weapons, nuclear power, and Sudan. Gone are the days when ESG-screened funds had trouble keeping pace with their benchmarks and the returns of their non-screened peers. Portfolio manager and Chief Investment Officer, Todd Ahlsten, has led this fund to solid long term results. PRBLX fits nicely in our large cap active manager space.

SPDR Dow Jones Global Real Estate ETF (RWO)

We've chosen this exchange traded fund (ETF) to replace an actively managed mutual fund that we've used for a number of years for exposure to the real estate asset class. This ETF is a much lower cost alternative with better long-term results. RWO seeks to track the performance of the Dow Jones Global Select Real Estate Securities Index, but is not required to purchase all of the securities represented in the index. While interest rate increases can wreak havoc on real estate investment trusts (REITs) – especially mortgage REITs – fundamentals are strong for this fund's underlying companies, and mortgage exposure is minimal. We are allocating approximately 3% of client portfolios to real estate at this time.

LIVING RICHLY THROUGH THE ARTS

As a wealth management firm, we know from experience that living richly is as much about the quality of our community and of our lives as it is about the size of our respective wallets. This is why firm members not only volunteer on many non- profit boards and committees, but also we have taken further steps as a firm to assist some of our local organizations through corporate sponsorships. As a small firm, we decided to focus our support in two areas where we felt some consensus of passion and where we might also have meaningful impact: education and the arts.

We see education as the great equalizer. Through education, students have the opportunity to develop the skills, tools, and confidence they need to get ahead in life. We see the arts as the nutrients of society providing the soul lifting light and inspiration that elevates the spirit. Some of the arts organizations we support include: the Bangor Symphony Orchestra, the Penobscot Theatre Company, the American Folk Festival, and most recently we were delighted to underwrite two years of free admission to the University of Maine Museum of Art (UMMA). We are eager to support a healthy arts scene in Eastern Maine as we believe it is key to the overall wealth of the community. To that end, starting in early January 2016, we will be commenting not only on financial matters, but also posting arts events on our blog for all to consider.

As we turn the final page on 2015 and open the book for 2016, we will continue to work hard with and for our wonderful clients whatever the market environment. We will also take joy in "doing good" in an effort to make life richer for everyone in Eastern Maine.

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