NOTTINGHAMADVISORS
ASSET MANAGEMENT

2016 OUTLOOK

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."
-Mark Twain

I've been told it's never a good idea to publically make a fool of oneself, yet despite that sage advice, here I go again with my annual vain, and foolish, attempt at predicting the future – or better known as, The 10 Things I Think I Think!

With 2015 mercifully winding down, the Federal Reserve finally, after 10 years, raising short-term interest rates, and equities charging towards new highs, I suppose this is as good a time as ever to take a stab at estimating trends we're likely to see in 2016. So, here goes nothing…

1) <u>We'll have snow in Buffalo.</u> Okay, cut me some slack, I needed one guaranteed prediction! Silly as it seems, but we have yet to measure any snowfall here in Western New York – the latest such aberration in recorded history (or 100 years anyways). But it's coming, we know that. Despite good ole El Nino, Lake Erie still isn't frozen (and is quite warm actually) and it won't take much for us to gather 3-4 feet over a long weekend. As a skier, my fingers are crossed!
2) <u>The Federal Reserve will take a very measured approach in its interest rate normalization process.</u> This is what markets are prepared for, so any deviation from this course will likely be greeted with increased volatility. Credit market worries and slow growth fears aside, it's time to move off the zero-bound and, if nothing else, modestly higher interest rates will give the Fed room to move when the next recession strikes.
3) <u>U.S. equities will likely see a pause in 2016.</u> While we're not predicting a big selloff, we feel it will take a meaningful change in revenue growth (like, maybe something north of 0%!) to propel U.S. stocks higher. Financial engineering has largely been responsible for the rise in earnings per share over the past few years and there's only so much that M&A and stock buybacks can do. Top-line revenue growth will be key to any advances from here.
4) <u>International developed market equities should finally have their day.</u> Despite suffering from the same low-growth environment as U.S. companies, international equities are modestly cheaper and should be supported by strong central bank QE throughout 2016. Having underperformed U.S. stocks by nearly 67% over the past 5 years, the EAFE Index (EAFE = Europe, Australasia, Far East) is at risk of losing investor faith as a viable money-making asset class.
5) <u>That great quadrennial circus that has become the U.S. Presidential Election will dominate news headlines, billboards and television airwaves</u> (is there still such a thing as a TV airwave, or should that now be co-axial or satellite waves? Doesn't have the same ring…). The U.S. electorate will once again be made multiple empty promises (that in honesty if followed through on would cost the U.S. taxpayers TRILLIONS of dollars that the government doesn't yet have) by career politicians. Hope and faith should once again be dashed upon the rocks of a dysfunctional Washington, D.C. Do we need another Clinton or Bush? The Donald anyone? Ugh.
6) <u>The prices of oil and gas should find a bottom sometime in 2016.</u> Just as the cure for high prices was high prices, the cure for low oil prices will be…low oil prices. Eschew the Volt, Tesla, solar panel or wind farm, have

you seen your gas bill lately? Nothing to worry about…right? So far, the savings to the consumer from low energy prices haven't been spent, as evidenced by the surge in the U.S. personal savings rate (up roughly 1% over the past 2 years). However, we Americans like to shop and many feel it's just a matter of time before energy-related savings are pumped back into the economy, which should prove beneficial to overall U.S. growth.

7) So-called "alternative income" vehicles such as REITs, MLPs, utilities, and high-dividend stocks will likely begin mean-reverting in terms of yield. Investors starving for income these past few years have piled into these sub-asset classes, which offer yields 300 to 500 basis points over Treasuries. As the yields on more traditional bonds normalize, investors should gravitate back to the safety and predictability that many of these securities offer.
8) The geopolitical risk premium will rise in 2016. This is unfortunate as it implies a rise in terrorism related activity in many investable markets, including here in the U.S. Investors are capricious animals and stark video images of carnage and destruction can be enough to deter investment dollars from being placed in various regions and markets. When considering the list of things that could increase market volatility, this will be near the top.
9) Fiscal drag will become fiscal stimulus in 2016. Government spending the past few years has actually detracted from national GDP, given sequestration-related cutbacks in federal spending and belt-tightening at the state and local levels. As we approach election time, the more recent détente between Republicans and Democrats being forged by new House Speaker Paul Ryan will lead to higher spending. We're already starting to see government spending increase at the state and local level and this trend should continue in the years ahead. Budget deficits notwithstanding, this is a good thing for the economy and could actually add .5-1.0% to annual GDP.
10) So-called "alpha" trades will likely comprise more of an investor's total return in 2016 than "beta", or the market return. Per guess #3 above, assuming broad markets like the S&P 500 don't meaningfully move in 2016, it will be incumbent upon asset managers (i.e. US!) to figure out ways to add incremental return. Shorter-term sector, style or country-specific trades will be needed to generate return. Although easier said than done, spikes in volatility have historically created good money-making opportunities for those paying attention and Nottingham will continue to do the hard analytical work in order to ferret out those trades.

We'll have a more comprehensive review after the first of the year, discussing in more detail our hits (there were a few) and misses (unfortunately, I feel an equal number as hits this year) and where we see things heading across asset classes in 2016. For now, rest assured our work isn't done. Despite relatively decent performance across our strategies this year, we feel things could be better; especially in our Global Income strategy, which saw greater volatility than in past years and didn't perform up to our standards.

On behalf of everyone here at Nottingham, thank you for your business. We wish you all a peace-filled holiday season and a joyous and prosperous New Year.

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