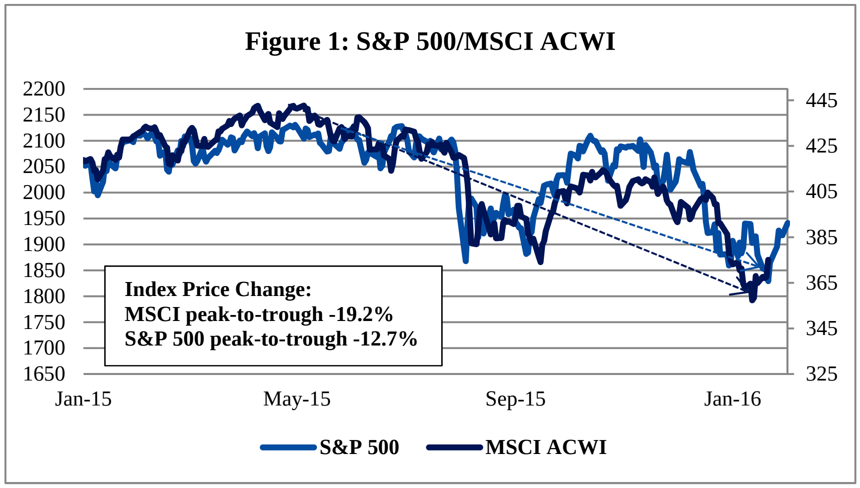
The 2016 Rollercoaster Ride

January Overview:

January was the worst start to a year in a decade for the U.S. and for some markets the worst on record. The recent market volatility reflects souring investor sentiment over global growth, collapsing commodity prices and divergent central bank policy. Equity markets suffered with global stocks (MSCI ACWI) down by 6% and domestic stocks (S&P500) down by 5% through the end of January (Figure 1). Global stocks fell into a bear market 20 days into the New Year, with a decline since early last year of more than 20%. Commodity markets continued their selloff in January as oil sank to a 12-year low below $30 a barrel.

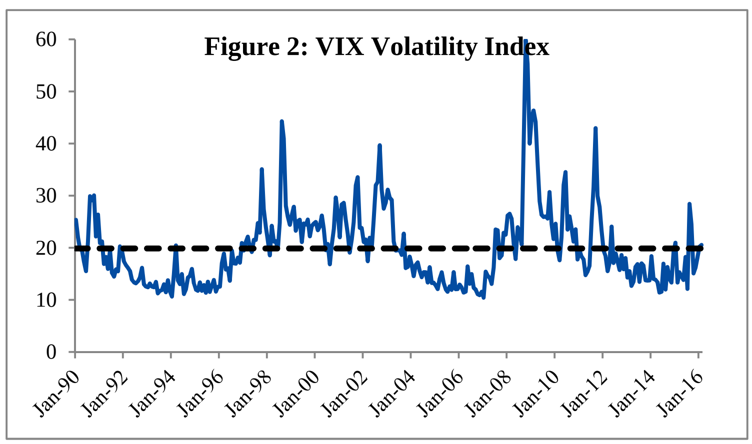


The outlook for markets in 2016 does not look compelling, but January's volatility may not be an accurate reflection of the overall health of the global economy. While serious challenges remain, specifically the risk of deflation, economic disappointments and divergent central bank policies, these were known risks and it is unlikely that January's market declines were the result of independent, objective analysis of the impacts of each event on each company. Rather, the sudden declines show to what extent markets can be affected by investor sentiment, irrespective of the intrinsic value of the underlying assets.

The resulting volatility is unsettling in the short-run. However, for investors with long investment horizons and a well-reasoned investment process in place, volatility should not be an impetus for drastic portfolio changes but a chance to rebalance portfolios and look for new opportunities.

Historic Volatility and Portfolio Opportunities:

Market volatility, or the measure of potential variability from mean returns (as measured by the VIX index), has averaged 20% a year for U.S. stocks (Figure 2). In layman's terms, the market has lost at least 10% about one out of every five years and over the last 114 years there have been eleven instances where the stock market has lost at least 20%, the most recent being the 2008 financial crisis when annual volatility spiked to 60%. Throughout history there have been periods of low as well as elevated volatility, but it eventually reverts to the mean. Volatility is the norm, not the exception and currently we are right around the historic average of 20%.



At Windrose Advisors, we have long anticipated a move into a higher volatility environment, which we believe will eventually reward active strategies and a diversified portfolio approach.

Specific market dislocations may arise occasionally from increased volatility, presenting opportunities, but each one merits a measured and detailed approach before allocating capital. We, as always, meet with managers across all asset classes to understand both immediate and long-term opportunities. Current market conditions are leading us to spend additional time with active managers focused on Master Limited Partnership (MLPs), Exploration and Production (E&P) energy companies, distressed debt/equity and trend following strategies.

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