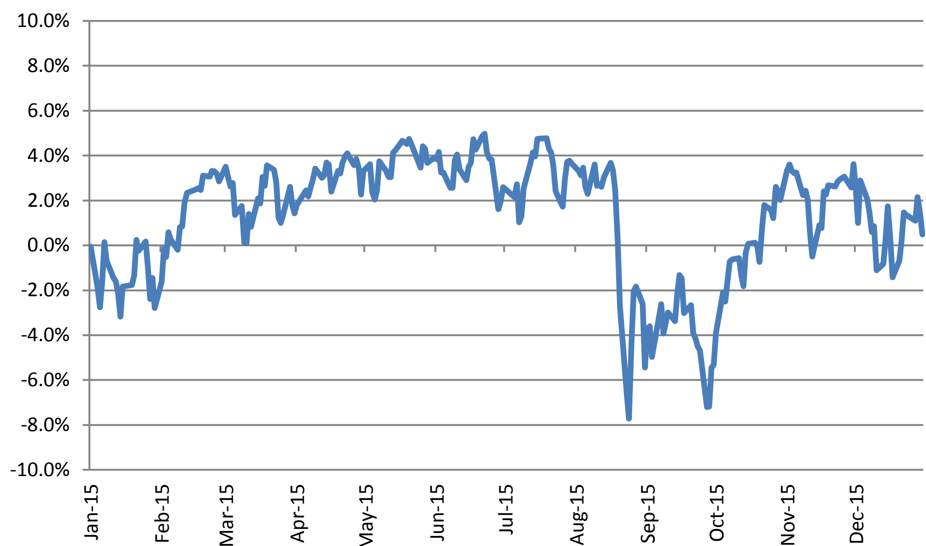
Kai W. Hong, CFA
Managing Partner,
Chief Investment Strategist

2015 Year in Review

The first half of 2015 largely continued the choppiness of the prior year as many markets remained somewhat rangebound. Markets were fairly narrow with a handful of larger cap, growth-oriented names with the so-called "FANGs" – Facebook, Amazon, Netflix, and Google leading the way. Sector dispersion was broad with Health Care and Consumer Staples leading and commodity areas such as Energy and Materials lagging significantly. Despite a severe correction in global equity markets in August, central bank accommodation helped facilitate the recovery of the majority of the decline by the end of the year.

US equities as represented by the Russell 3000 Index finished with a +0.5% return. Outside of the US, MSCI World ex US Index returned -3.0%, and the MSCI Emerging Markets Index returned -14.9%.

Figure 1. Russell 3000 Index Returns



[Source: Bivium, eVestment Alliance]

Q1

The year started with alternating periods of rally and reversal as the markets struggled for direction. Strong returns in the prior quarter left valuations at less attractive levels and mixed economic data left plenty of ammo for both bulls and bears to act upon. By February, the price of oil stabilized, and things were generally more sanguine on the macro front. Although US GDP growth for Q4 2014 fell short of expectations, growth

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for the overall year was still the highest in four years. A surge of M&A activity in the pharmaceuticals space also helped to stoke investor sentiment, and February turned out to be an exceptionally strong month for most equity markets. Despite the inception of QE by the ECB, volatility returned in March as mixed economic data was perceived as either good (decreasing the likelihood of a Fed rate hike) or bad (slower long-term growth less supportive of robust valuations) for the markets.

Q2

Early in the quarter, the absence of any significant macro news saw the performance of markets appear to reflect relative assessments over absolute fundamentals. Of note was the continuation of the recovery in the price of oil from its March lows to an intermediate plateau of $60/barrel. Economic news was somewhat mixed (capped by a negative reading for Q1 US GDP), but a standoff between Greece and its international creditors – marked by oddly different assessments from the negotiators of where the negotiations stood – re-emerged as a source of global macro uncertainty. The major policy discussion was still the timing of Fed "lift-off" as a strengthening US labor market came against the backdrop of muted inflation data and lower growth expectations. Interestingly, external parties such as the IMF and World Bank have been quite vocal in their calls for a delay. Volatility returned towards the end of the quarter as a dramatic collapse in the Chinese equity market was met with heavy (and somewhat ineffective) government interventions and default, bank closures, and the announcement of an economic referendum threw the Greek debt crisis into uncharted territory. With valuations for many asset classes at fair or full levels and the end of central bank accommodation becoming incrementally more real than academic, it feels that we are in a period of unstable equilibrium which is resulting in increased market volatility.

Q3

The quarter started inauspiciously enough with news of Greece's default on a payment due to the IMF and the subsequent rejection of bailout terms by Greek voters in a snap referendum. While somewhat expected, the actual events still had the effect of unnerving investors in a period when good macro news was hard to come by. This left markets mostly range-bound. However, the main event was to come in the month of August as the surprise devaluation of the Chinese Yuan catalyzed a dramatic decline in global equity markets, capped by the greater than 10%

decline in many equity markets in the six trading days from the 18th to the 25th. All of this volatility further complicated the picture surrounding the timing of the Fed's lift-off in interest rates, whereby global volatility and China were actually referenced by the Fed in their September decision to not increase the Fed Funds rate. While the markets attempted to recover in early September, concerns over weak economic data globally, and in China in particular, left the quarter to end on a down note.

Q4

At the start of the quarter, although there were few meaningfully positive developments in the markets, the lack of "bad" news was enough to give buyers confidence that the recent sharp declines in the market were overdone. Economic data was mixed, and most growth forecast revisions continued to be down with the IMF lowering its forecast for global growth from 3.3% to 3.1% on weakness in emerging markets. At the corporate level, M&A activity remained robust with 2015 on track for a record. By the time the calendar rolled into November, the momentum from the market rally of the prior month was already tapering off. Fed comments pointed strongly towards a mid-December increase in interest rates which served to further dampen risk appetites. A terrorist attack in Paris mid-month shook the geopolitical status quo, but it was unclear what, if any, significant changes in approach that would drive. Volatility continued into December with the Fed's somewhat controversial decision to raise rates ending an unprecedented period of monetary stimulus. Weak data and financial market volatility in China remained on investors' minds as events highlighted the limits of the Chinese government's control of the equity markets. On the commodity-side, oil prices resumed their descent from an intermediate plateau of $45/barrel towards the mid-$30s/barrel, making the Energy sector the worst performing segment of the market (by far) for the second year in a row.

Outlook

While most valuation metrics improved slightly, modest prospects for growth and the potential beginning of an interest rate tightening cycle continue to lead us to believe that market returns may again be somewhat below their medians over the last 10 years. Volatility can be found everywhere, and uncertainty is the norm. The markets are particularly hard to gauge as sentiment, value, and non-economic trading (e.g. SWF selling to fund fiscal needs) collide in unpredictable ways. Good risk management and an awareness of exposures will be critical throughout this time.

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