C Y P R E S S

ASSET MANAGEMENT, INC.

MARKET COMMENTARY **January, 2016**

Q4 Market Overview

The S&P 500 is already down 8% in the first half of January, its worst start in history, and down 10 % from late December 2015.

The fundamental issue is a weak global economy. China is the current focus, and it is transitioning from an export and investment driven to more consumer-driven economy. But emerging markets are struggling generally, from Latin America to the Middle East. The major industrial nations of Europe and Japan struggle to generate any sustainable growth. The U.S. remains the best house in a tough neighborhood, but investors worry how long we can withstand the competitive challenges of a strong dollar and slowing international markets. Heightened geopolitical risks only add to the uncertainty and investor fears.

Sentiment is very negative toward stocks; investors have actually pulled $122 billion out of equity funds (mutual funds and ETFs) in the past 12 months, which is more than even 2008. Individual investors continue to lack confidence in the equity market, even after a long period of slow growth and decent market returns. We have not seen the overvaluation and optimism that typically marks the end of a bull market or a market top. The market has been in a yearlong consolidation process, and is not expensive at roughly 16 times estimated 2016 earnings. Nor is it clearly cheap, and given the current global growth scare and high levels of uncertainty and risk, we are not likely to see multiple expansion until fears abate and some confidence restored.

Our outlook is for more of the same in 2016: slow economic growth, low oil, gas and commodity prices, low interest rates and inflation all look likely to continue for some time to come. This is not all bad, low growth is preferable to recession and is more sustainable than an economic boom; and low rates should eventually mean a higher multiple for stocks.

2015 Equity Market Returns*	%
United States S&P 500	**1.4**
Dow	0.2
Nasdaq	7.1
MSCI World Index**	**-1.8**
MSCI Emerging Markets**	**-14.6**
MSCI World Ex U.S.**	**-5.3**
Bond & Currency Index Returns	**%**
U.S. Dollar Index (DXY)	**8.3**
Long Term Treasury	**-1.3**
U.S. Corporate Investment Grade	**-0.6**

*Index returns include dividend reinvestment

** Local Currency

Commodities	Units	12/31/2014	12/31/2015	% Change
NYMEX Crude	$/Bbl	53.17	36.97	-16.5%
Brent Crude	$/Bbl	55.73	36.61	-17.3%
Nat Gas	$/Mmbtu	2.99	2.332	-15.2%
Gold	$/troy oz	1184.1	1060	-10.3%
Copper	$/lb	282.4	213.45	-20.3%

Global Growth Scare

If we avoid a global recession - and we think modest growth levels can be maintained– the market could see mid-single digit gains in 2016. We are inclined to agree with Abby Joseph Cohen, strategist at Goldman Sachs when she says, “We don’t see a recession coming in the United States. We see economic growth whether it’s 2 ¼ per cent or 2 ½ percent.” While the markets may wrestle with the size and degree of growth, the U.S. economy is in decent shape and a recession in 2016 is an unlikely scenario.

According to Leon Cooperman at Omega Advisors, the stock market appears to be going through a “growth scare”. Cooperman does not see the traditional signs of an impending bear market, and cites four indicators of an impending bear market:

-***Oncoming recession***. Again, we believe the US economy continues to produce slow but positive growth.

-***Euphoric market***. The remaining pockets of euphoria (faster growth, mega cap technology companies; parts of biotechnology; overpriced and hyped IPOs) were largely purged over the past year, and the remnants of euphoria have been replaced with fear. As we write this letter, the S&P 500 is off to the worst start to any investment year on record. No euphoria here.

-***Geopolitical events***. No one can predict geopolitical events, but there are numerous hot spots and regional turmoil across the globe. But there is no clear overarching geopolitical event indicative of an ensuing recession.

-***The Fed becomes restrictive and removes the punch bowl.*** Clearly the Fed is still accommodative and engaged in an effort to foster and sustain economic vitality. The Fed has made clear that its rate policy remains “data dependent.” It is trying to move to a more normal level of between .5% and 1% on the fed funds rate, based on the economic data, hardly a restrictive policy.

A Challenging Environment but All is Not Lost

Here at the beginning of 2016, the market appears to see all inputs as negative. Moreover, the media and nonstop news flow tend to emphasize the most awful and dire scenarios rather than the most likely outcomes. Investors by nature also are typically emotional and prone to undue optimism or pessimism. And it appears that trend will continue for a while because it will take time for greater clarity to emerge about the global economy. But we remind you that we are all of 15 days into the New Year, not all is lost.

Growth is challenged in the post financial crisis world, and so is confidence. Still, we need to remember that the consumer is still almost 70% of the U.S. economy, and he is in good shape. The American consumer is benefitting from low energy costs and low gas prices, even as the energy and industrial sectors are struggling as are the more resource and commodity price dependent emerging market economies like Russia, Latin America, and the Middle East. U.S. stocks continue to look like the best alternative in a challenging low growth, low interest rate, and low return environment.

Treasury bills yield nothing, ten year government bonds yield only 2% and about half of the stocks in the S&P 500 now have a yield greater than government bonds. In fact, many of our favorite investments have become much more reasonably valued and carry very desirable, growing yields for the long term investor. We have taken note that Warren Buffet has been adding to positions in this downdraft.

We continue to believe in the long term investment strategy that emphasizes a well-diversified and high quality equity portfolio, and pays a good and sustainable dividend as we work through this soft economic patch and period of market consolidation. At some point, overwhelmingly negative sentiment and mounting liquidity on the sidelines should provide support to stocks, and some upside when confidence improves.

GDP Growth Forecasts versus S&P Earnings	**2013**	**2014**	**2015e**	**2016e**
Global Real GDP Growth (y/y rate)	3.3%	3.3%	3.1%	3.4%
U.S.	2.2	2.4	2.5	2.5
Euro Area	-0.4	0.8	1.5	1.7
Japan	1.5	0.2	0.7	1.2
Developing Asia	6.6	6.1	6.0	6.1
China	*7.7*	*7.3*	*6.9*	6.6
Latin America	2.5	0.8	-0.4	-0.2
Emerging Market & Developing Economies	4.7	4.4	4.1	4.4
S&P 500 Aggregate EPS*	109	118	120	124
Earnings (y/y rate)	12.6%	8.3%	1.7%	3.3%
PE Ratio (January 2016 price 2,000)		16.9	16.7	16.1

Sources: IMF, ISI Group, BAML, Capital IQ