

Wealth Management

Ameritas Investment Partners

Market Commentary

October 30, 2015

Navigating Rough Waters – v. 2.0

“When the tide goes out you can see who has been swimming naked.”
– Warren Buffett

Last year's third quarter market commentary was titled “Navigating Rough Waters” due to the market turbulence in the last half of September. This year, the markets got rough again in the third quarter – with August experiencing the sharpest and almost universal declines in both stocks and bonds. Stocks experienced their worst quarter since the third quarter of 2011 with the Standard & Poor's 500 Index losing 6.4% and the MSCI EAFE Index losing 10.2%, respectively.

Stock market performance - Third quarter 2015 (total returns)

	July	August	Sept	3Q 2015	YTD	Year ended	
						2014	2013
Standard & Poor's 500 Index	2.09%	-6.03%	-2.47%	-6.44%	-5.29%	13.69%	32.39%
Standard & Poor's 500 “Value” Index	0.38%	-5.98%	-2.79%	-8.25%	-8.66%	12.36%	31.99%
Standard & Poor's 500 “Growth” Index	3.62%	-6.08%	-2.20%	-4.83%	-2.17%	14.89%	32.75%
Standard & Poor's 400 Midcap Index	0.14%	-5.58%	-3.22%	-8.50%	-4.66%	9.77%	33.50%
Russell 2000 Index	-1.16%	-6.28%	-4.91%	-11.91%	-7.73%	4.90%	38.82%
MSCI US REIT Index	5.64%	-6.23%	3.03%	2.06%	-4.26%	30.38%	2.47%
Dow Jones Industrial Average	0.52%	-6.20%	-1.35%	-6.98%	-6.95%	10.04%	29.65%
NASDAQ Composite Index	2.88%	-6.70%	-3.21%	-7.09%	-1.61%	14.74%	40.12%
MSCI EAFE Index	2.08%	-7.36%	-5.08%	-10.23%	-5.28%	-4.90%	22.78%
MSCI Emerging Markets Index	-6.93%	-9.04%	-3.01%	-17.90%	-15.47%	-2.19%	-2.60%

Source: Bloomberg, Interactive Data

Indices are unmanaged, do not incur fees or expenses and cannot be invested into directly. Past performance is not indicative of future results.

The Fed blinks

The September meeting of the Federal Reserve Open Market Committee (Fed) was eagerly anticipated by analysts, economists and short-term investors because there was the real possibility that central bankers would finally boost the federal funds rate for the first time in almost 10 years. In case you missed it, the Fed chose not to raise rates in September, but left open the possibility we might see an October or December move.

While the meeting gave the financial press something to talk about (and talk about and talk about), let's take a longer-term perspective. We can argue that the current economic environment is reasonably stable, and a fed funds rate that is stuck at zero is no longer needed.

At the press conference following the Fed's decision, Chair Janet Yellen said the economy "has been performing well and impressing us by the pace at which it is creating jobs..." Still, that wasn't quite enough for the Fed to pull the trigger. Instead, worries about what's happening in China and emerging markets were the primary reason the Fed chose to stay on hold. As Yellen noted at her quarterly press conference, "We focused particularly on China and emerging markets."

Post meeting, Reuters reported that more than one Fed official acknowledged the decision was a close call, and in a speech a week after the meeting, Yellen said she expects that a rate hike this year is "likely" followed by "gradual" increases.

Perspective

In other words, let's put the last Fed meeting into perspective. Will it really matter one year, or five years, or 10 years from now whether the Fed chose to raise or not raise interest rates at the September 2015 meeting? It won't. It's the long-term that really matters, not the day-to-day or month-to-month gyrations in the market. While rollercoaster rides can be fun for some (think the short-term or day trader) and unsettling for others, a more mundane approach is usually the best. As the influential economist Paul Samuelson once said, "Investing should be more like watching paint dry or watching grass grow. If you want excitement, take \$800 and go to Las Vegas."

At the end of the third quarter, the ten year U.S. Treasury Note yield was 2.04% and the S&P 500 dividend yield was 2.25%. Given low interest rates and the concern about how bond prices decline when rates rise, many investors understandably don't find bonds an attractive option.

Bond market performance – Third quarter 2015 (total returns)

	July	August	Sept	3Q 2015	YTD	Year ended	
						2014	2013
Barclays U.S. Aggregate Index	0.70%	-0.14%	0.68%	1.23%	1.13%	5.97%	-2.02%
Barclays Intermediate Credit Index	0.29%	-0.31%	0.56%	0.54%	1.36%	4.16%	-0.17%
Barclays Intermediate Government Index	0.40%	0.06%	0.75%	1.21%	2.03%	2.52%	-1.25%
Barclays U.S. TIPS Index	0.21%	-0.76%	-0.59%	-1.14%	-0.80%	3.64%	-8.60%
Barclays U.S. High Yield Index	-0.58%	-1.74%	-2.60%	-4.86%	-2.45%	2.45%	7.45%
Barclays Municipal Bond Index	0.72%	0.20%	0.72%	1.65%	1.77%	9.05%	-2.55%
BOA / Merrill Lynch US T Bill 3 Month	0.00%	0.01%	0.00%	0.01%	0.02%	0.03%	0.07%

Sources: Bloomberg, Barclay's, Interactive Data

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Bottom Line

Tommy Armour, who was one of the greatest golfers of the early 20th century, once said, "The way to win is by making fewer bad shots."

Diversification is a major step in the direction of taking fewer bad shots, and it is a key strategy in long-term investing success. Moreover, Benjamin Graham, known as the "Father of Value Investing" and a favorite of Warren Buffett, once quipped, "Individuals who cannot master their emotions are ill-suited to profit from the

investment process.” Diversification, along with an investment roadmap in the form of well-defined objectives and policies, takes the emotions out of the investment equation and typically has been the surest path to financial success. While it’s easy to adhere to the investment plan when times are good, some investors find it difficult to stay on the path when the road gets a bit rocky. It’s during times like these that detours tempt investors. However, wandering off can take you into unfamiliar neighborhoods, and delays will cost you precious time.

Our basic message still remains unchanged from the past several years. We continue to advise an above-average equity weight. Markets rise and markets fall, but unless there have been changes in your circumstances or you’ve hit milestones in your life, such as retirement, stay with the plan.

For clients with an allocation to bonds, we continue to see value in U.S. Agency bonds with periodic “step-ups” in coupon rates and higher quality corporate and municipal issuers generally with maturities of 10 years or less. We also have been seeing some value in Certificates of Deposit for clients with shorter-term investment horizons.

We hope you’ve found this review to be educational and helpful. As always, we thank you for your support and welcome your comments.



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