



GLOBAL PERSPECTIVES

December 21, 2015



Gene Tannuzzo
Senior Portfolio Manager

POSITIONING PORTFOLIOS AFTER FED RATE LIFTOFF

- With a positive backdrop for credit risk, we favor investment-grade corporate bonds and MBS, while some areas of high yield also present opportunities.
- We believe a modest but positive duration stance remains appropriate, with 2016 likely to provide additional opportunities to buy longer dated bonds.
- Currency risk presents some opportunity, but it is no longer as simple as expecting the U.S. dollar to appreciate versus all other currencies.
- Inflation risk will likely increase next year as commodity prices ultimately bottom and wages perk up. At current prices, increasing exposure to inflation-protected bonds makes sense to us.

The Federal Reserve ceremoniously raised short-term interest rates on December 16 for the first time in over nine years. The move was generally well received in financial markets and was reinforced by an almost uncharacteristically upbeat tone from Fed Chair Janet Yellen in her subsequent press conference. Despite modest upward pressure to government bond yields, equity and credit markets performed strongly, and currency swings were fairly modest overall. For us, this move confirms two important elements. First, the Fed hiked for the right reasons. Labor markets have continued to improve, and the outlook for consumption remains firm. Second, the move was not a market surprise, something the Fed poured much effort into achieving. In light of these conditions, the overarching conclusion should be that bond investors should stay invested.

Peering into 2016, the Fed's policy outlook will remain in focus. To that end, we provide our expectation for how investors should position bond portfolios (We Said) given the groundwork laid out by Janet Yellen (She Said).

IN THIS ISSUE

- Positioning portfolios after Fed rate liftoff
- Is it time to buy industrial stocks?
- Weekly Market Summary

She Said	We Said
The Federal Open Market Committee raised its target interest rate by 0.25%, citing "further improvement" in the labor market along with "solid rates" of household spending and business investment. The committee's decision was unanimous, with no members voting to keep rates at zero.	The Fed is raising rates for good reason. The economy has improved and no longer requires emergency policy. This reinforces a positive backdrop for credit risk broadly, but also supports bonds more sensitive to the U.S. consumer. Investment-grade corporate bonds and MBS are most compelling here while some areas of high yield also present opportunities (outside of energy, metals and mining).

GLOBAL PERSPECTIVES

She Said	We Said
In the economic projections provided by the Federal Reserve Board, the Fed's median forecast for the fed fund's rate is 1.4% at the end of 2016 and 2.4% at the end of 2017. In the statement and press conference, the Fed continues to point to a gradual move higher in rates.	This is the first rate hike cycle the Fed has embarked upon while providing a forecast on where it will go. At this juncture, the Fed's rate projections take on a new and heightened significance. With rates moving higher at a pace of 1% per year, duration risk is likely to produce lackluster returns overall. We believe a modest but positive duration stance remains appropriate, with 2016 likely to provide additional opportunities to buy longer dated bonds.
Regarding headwinds preventing the U.S. economy from accelerating, Chair Yellen referred to international effects including slower growth abroad as well as the strength of the dollar. However, she continues to believe the strength of the dollar will prove transitory.	The muted reaction in the currency market today reinforces our view that most meaningful part of the U.S. dollar rally is behind us. Currency risk does present some opportunity, but it is no longer as simple as expecting the dollar to appreciate versus all other currencies. We think the U.S. dollar has the most room to strengthen against Asian currencies, including those of Australia, New Zealand and Korea. Meanwhile, our outlook for other currencies is more positive, such as those in Mexico and Poland.
Chair Yellen described inflation as "well below" the committee's 2% objective, but mostly due to transitory factors. In particular, she discussed a preference to look past declines in energy and commodity prices, and expects core measures of inflation to continue to rise. Her reference to "incipient signs of wage growth" supports the committee's confidence in rising prices in the future.	With crude oil trading near decade lows, inflation concerns may seem premature. However, inflation risk will likely increase next year as commodity prices ultimately bottom and wages perk up. At current prices, increasing exposure to inflation-protected bonds makes sense to us.

GLOBAL PERSPECTIVES



Charles Mann

Analyst

IS IT TIME TO BUY INDUSTRIAL STOCKS?

- We expect industrial stocks to continue to be priced at a discount to the broader market, after trading at a premium during the two prior business cycles.
- Although a rebound in 2016 is possible, a marked pickup is unlikely due to lower spending on capital equipment and weaker pricing.
- Slower profit and cash flow growth, weaker business metrics, and an extended business cycle will pressure valuation for most industrials.

The steep decline in oil prices decimated sales and profit as the shale boom has increased energy exposure to record levels. Plus, the strong U.S. dollar and slower global growth weakened overseas demand for U.S. goods. As a result, industrials are priced at a discount to the broader market, after trading at a premium during the two prior business cycles.

- **Inventories are high.** Weaker sales growth suggests that destocking will limit industrial production. For example, inventory-to-sales for industrial distributors has reached a multi-year high, and days of inventory at U.S. multi-industrials are at the highest level in over a decade.
- **Utilization is declining.** Capacity utilization has weakened in the United States and remains well below prior cycle peaks. While Europe has improved modestly, utilization in China has dropped from 95% to 55% over the last four years.
- **Pricing is weaker.** With lower utilization and greater supply, pricing has softened across most industries. With utilization in the United States at 78% – below the 81% level generally needed for PPI inflation – stronger price increases are unlikely.
- **Companies are negative.** Preliminary guidance from industrial bellwethers such as Cummins, Caterpillar, and Emerson Electric has disappointed, as sales will shrink for a second year. But many hope that the 2015 carnage will create a favorable setup for sales and earnings growth in late 2016.

Although a rebound in 2016 is possible, a marked pickup is unlikely due to lower spending on capital equipment and weaker pricing, which will lead to slower profit and cash flow growth. Further, weaker business metrics and an extended business cycle will pressure valuation for most industrials, and the discount to the broader market will persist.



GLOBAL PERSPECTIVES

Weekly Market Summary as of 12/18/15									
	Last	Week Ago		Month Ago		YTD		Year Ago	
Bonds	Yield	Yield	Chg	Yield	Chg	Yield	Chg	Yield	Chg
U.S. 2-year	0.95	0.88	0.08	0.88	0.08	0.66	0.29	0.63	0.32
U.S. 10-year	2.20	2.13	0.08	2.27	-0.07	2.17	0.03	2.21	0.00
U.S. 10-year Breakeven (TIPS)	1.50	1.48	0.02	1.59	-0.09	1.68	-0.18	1.65	-0.15
Barclays U.S. Aggregate	2.54	2.47	0.07	2.50	0.04	2.25	0.29	2.28	0.26
Barclays U.S. Agg Corporate	3.61	3.49	0.12	3.52	0.09	3.11	0.50	3.15	0.46
BofA Merrill Lynch High Yield Master II Index	7.10	7.10	0.00	7.10	0.00	6.61	0.49	6.77	0.33
AAA Muni 10-year	2.29	2.28	0.01	2.37	-0.08	2.31	-0.02	2.32	-0.03
Equity Indices	Price	Price	TR Chg	Price	TR Chg	Price	TR Chg	Price	TR Chg
S&P 500 Index	2,005.6	2,012.4	-0.3%	2,083.6	-3.6%	2,058.9	-0.6%	2,061.2	-0.6%
Russell 1000 Growth Index	983.5	987.3	-0.4%	1,016.0	-3.1%	961.3	3.9%	962.8	3.7%
Russell 1000 Value Index	944.4	947.4	-0.3%	989.6	-4.4%	1,028.3	-5.9%	1,026.4	-5.7%
Russell 2000 Growth Index	698.8	700.6	-0.2%	726.5	-3.7%	722.1	-2.6%	716.6	-1.8%
Russell 2000 Value Index	1,361.1	1,364.0	-0.2%	1,430.5	-4.7%	1,523.4	-8.9%	1,503.3	-7.6%
MSCI EAFE Index	1,687.2	1,690.2	-0.2%	1,731.1	-2.5%	1,774.9	-2.2%	1,767.3	-1.7%
MSCI EM Index	789.7	773.6	2.1%	822.8	-3.9%	956.3	-15.4%	935.1	-13.2%
Commodities	Price	Price	% Chg	Price	% Chg	Price	% Chg	Price	% Chg
Gold	1,066.2	1,074.7	-0.8%	1,070.7	-0.4%	1,184.9	-10.0%	1,198.7	-11.1%
Crude Oil	34.7	35.6	-2.5%	40.8	-14.8%	53.3	-34.8%	54.1	-35.8%
U.S. Dollar	Price	Price	% Chg	Price	% Chg	Price	% Chg	Price	% Chg
U.S. Dollar Index	98.7	97.6	1.2%	99.7	-1.0%	90.3	9.3%	89.2	10.6%

Source: Columbia Management Investment Advisers, LLC

Past performance does not guarantee future results. It is not possible to invest directly in an index.

DESCRIPTION OF INDICES

The **Barclays U.S. Aggregate Bond Index** is a market value-weighted index that tracks the daily price, coupon, pay-downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and non-convertible investment grade debt issues with at least \$250 million par amount outstanding and with at least one year to final maturity.

The **Barclays U.S. Corporate Investment Grade Index** is an unmanaged index consisting of publicly issued U.S. Corporate and specified foreign debentures and secured notes that are rated investment grade (Baa3/BBB- or higher) by at least two ratings agencies, have at least one year to final maturity and have at least \$250 million par amount outstanding. To qualify, bonds must be SEC-registered.

The **BofA Merrill Lynch High-Yield Bond Master II Index** is an unmanaged index that tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The **Standard & Poor's (S&P) 500 Index** tracks the performance of 500 widely held, large-capitalization U.S. stocks.

The **Russell 1000 Growth Index** measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The **Russell 1000 Value Index** measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The **Russell 2000 Growth Index** measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The **Russell 2000 Value Index** tracks the performance of those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The **MSCI EAFE Index** is a capitalization-weighted index that tracks the total return of common stocks in 21 developed-market countries within Europe, Australia and the Far East.

The **MSCI EM Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

Investment products are not federally or FDIC-insured, are not deposits or obligations of, or guaranteed by any financial institution, and involve investment risks including possible loss of principal and fluctuation in value.

Securities products offered through Columbia Management Investment Distributors, Inc., member FINRA. Advisory services provided by Columbia Management Investment Advisers, LLC.

Columbia Threadneedle Investments (Columbia Threadneedle) is the global brand name of the Columbia and Threadneedle group of companies.

Columbia Management Investment Distributors, Inc., 225 Franklin Street, Boston, MA 02110-2804.

© 2015 Columbia Management Investment Advisers, LLC. All rights reserved.

columbiathreadneedle.com/us