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# MARKETS IN FOCUS: JANUARY 2016 - WHAT THE HECK?!

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January was a very unusual month in the global markets. And the first days of February resumed those declines in equities, and surging Treasury prices.

Equity markets around the world ended January down substantially, and the declines in the major U.S. stock indices, in the first week and as well as the first two weeks of the year, were the worst in over 100 years. (The month as a whole was the worst January since 2009.)

So far, the "technical" indicators do not indicate panic or capitulation, and the final week of the month ended with a pause or consolidation after the downtrend of the first three weeks, at least in the U.S. stock market.

Treasury yields fell significantly during January, and that continues into early February, despite the Fed's bump in December and promises of more to come.

High yield corporate bonds (HYCBs) resumed their 18-month downtrend after a consolidation during the second half of 2015, then rose a bit during the final part of January.

Municipal bonds were off to an unusually strong start in January, before leveling off.

Both of Sierra's portfolios have substantial allocations to municipal bonds, which helped us achieve positive returns in the face of an unproductive environment for most portfolio managers, and with most mutual funds that compete with us in the non-traditional bond space.

The U.S. economy's first report for the fourth quarter of 2015 (the initial report is typically subject to substantial revisions) showed overall GDP growth of only +0.7%. (In our view, any growth rate that is lower than the growth of the labor force shows that output per capita declined, which we believe is a better definition of "recession" than the simplistic idea that growth must be negative in absolute terms, after inflation, to qualify.) Manufacturing led the decline in the U.S.

Revenue and profit numbers reported in January for many U.S. companies have been disappointing, and many companies and analysts continue to lower expectations going forward. Reuters reports that at least 62 companies referred to the potential of recession ahead.

One headwind is that the U.S. dollar rose over 22% in the second half of 2014, and during 2015 traded in a relatively broad range, but certainly no reversal. The impact of such a sustained higher dollar is that many large U.S. companies (including most of those large enough to be included in the S&P 500) have had their overseas sales and profits significantly hurt. And this is likely to continue in the coming months.

Geopolitical events and the U.S. Presidential race of course remained in the headlines during January, but also such economic and capital markets events as last week's decision by the Bank of Japan to actually set one benchmark rate at a negative level: Banks that make certain deposits with the Bank of Japan going forward will actually have to pay the BOJ a small rate of interest, and the BOJ announced that it will increase the negative rate if current economic conditions persist.

Europe continues to struggle with hoards of refugees from the Middle East, with Germany alone agreeing to host 200,000 refugees. There is increasing conflict between the refugee policies of different developed countries in Europe, as well as conflicts over which country allows refugees to flow freely into the next.

Overall, the major economies of Europe are flat or slightly down according to the most recent reports. Outright deflation is also being reported in some European countries.

In summary, the global picture is not a positive one for equity markets and other risk assets, including high yield corporate bonds, commodities, and emerging market stocks and bonds.

We believe that our diversified portfolios are positioned well for the months ahead, in this environment: We hold large positions in municipal bonds and we also hold significant positions in high-grade U.S. and foreign bonds.

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