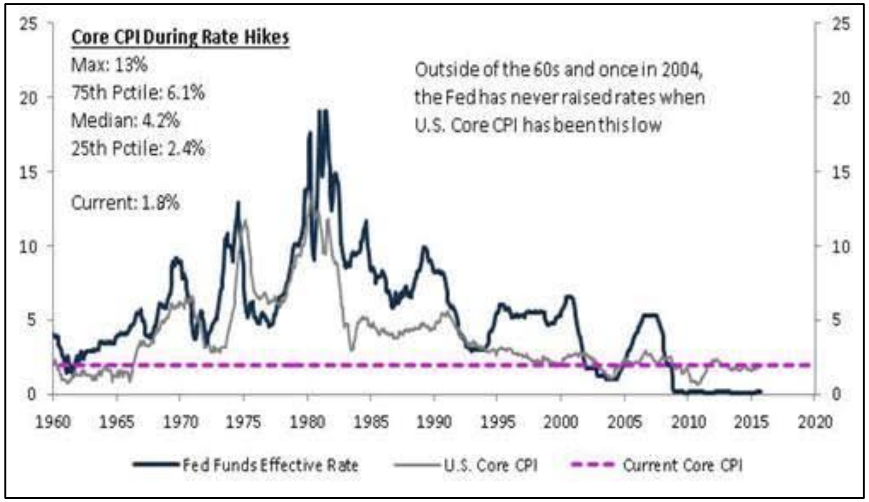
Market Recap

Raising Interest Rates With Low Inflation



Source: Evercore ISI

High Yield Bonds Spreads Widen

Source: Bloomberg, Bank of America, Haver, Goldman Sachs, JP Morgan

With the Fed raising rates on Wednesday for the first time in a decade, we can look back at historical data to see what differentiates this particular rate hike from those in past tightening cycles. The Fed generally raises rates in periods of strong economic growth AND higher inflation. Only once (2004) since the 1960s has the Fed raised interest rates when core inflation has been this low (1.9% YoY currently). Weak inflation makes company revenue and earnings growth more difficult to achieve, and is thus a headwind for many sectors that have outperformed during rate hike cycles over the past 25 years. In the past, Industrials, Materials, Financials, IT and Energy names have the strongest correlations to changing interest rates. Intuitively, this makes sense--Financial institutions are able to derive greater profit margins as interest rates rise, while the other aforementioned sectors all benefit from inflationary pressures (Materials and Energy are impacted by commodity prices, while Tech and Industrials benefit from increased capital expenditure) associated with a strong economy.

The multi-year rally in high yield bonds may soon be coming to an end. The spread, or difference in yield that investors demand for holding U.S. high yield debt over comparable U.S. Treasuries, is at a multi-year high. This has led to a greater than 5% decline in the ML High Yield index for 2015. This negative return is largely due to exposure to the energy and commodity sectors which have come under significant pressure in 2015. In addition, high yield bonds are less liquid as banks have paired down their balance sheets following the last recession. Unfortunately, many analysts are predicting defaults will accelerate in 2016. However, unlike prior instances in which higher spreads preceded recessions, there is little to indicate that a recession may follow this time as U.S. economic conditions continue to improve and equity markets are less impacted by these factors.

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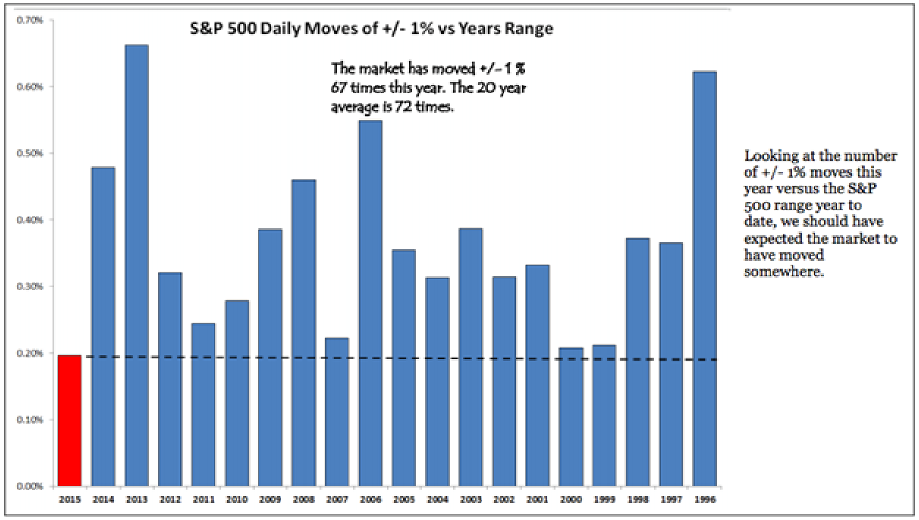
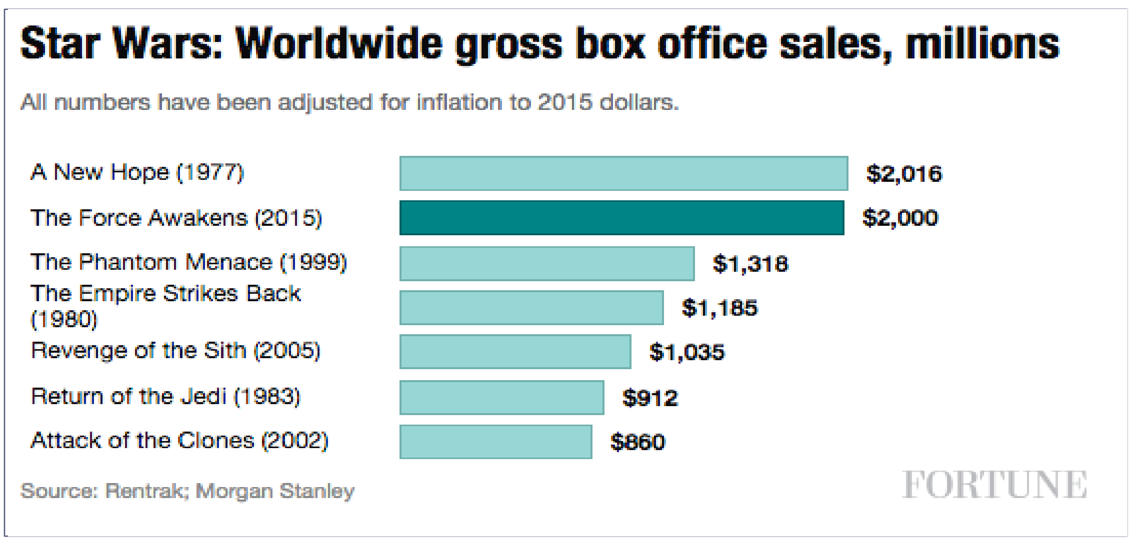
Market Volatility With Little To Show



Source: FBN

Star Wars Revenues Expected to Enter Hyperdrive



Source: Fortune

At the highest level, 2015 has been a relatively flat year for the S&P 500. The index opened the year at a level of 2058.90 and, through 12/16/15, closed at 2075 for a marginal YTD increase of 0.82%. Looking deeper into the details, the market has seen fairly significant moves and frequent volatility during portions of the year. On average, the S&P 500 records 72 days each year during which the index moves up or down by 1% or more. This year will be average or better, reaching this 72-day level by mid-December. On an even more granular level, however, the market has seen a significantly lower ratio of gaining to losing stocks on days recording a market increase. A small number of stocks leveraging impressive gains have driven the market into slightly positive territory, while the vast majority of stocks have performed poorly this year. Quoting JC O'Hara at FBN Securities, "If we take [the number of 1% moves] and put it in context of a market's trading range for that year, we conclude that the S&P 500 has traveled 'extremely fast to go nowhere.'"

This week brought about two things that we have not seen in nearly a decade: a Fed rate hike, and a new *Star Wars* film – both of which bode well for the economy. Before its release on Thursday, *The Force Awakens* already had amassed over $100 million in ticket presales, quadrupling the previous record of $25 million (*The Dark Knight Rises*). This pace is expected to continue, with ticket sales projected to reach $2 billion, falling just short of the 1977 original (adjusted for inflation). The franchise is expected to gross $9.6 billion in its first year (including $5 billion in merchandise). Given that Disney bought the rights to *Star Wars* for $4 billion in 2012, the studio is poised to recoup their investment from merchandise sales alone – not to mention the three more *Star Wars* episodes already set for production. After a series of disappointing *Star Wars* films, *The Force Awakens* certainly appears to be "A New Hope" for the franchise and its fans.

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