OLD NORTH STATE TRUST, LLC

ANNUAL MARKET REVIEW 2015

Overview

Volatility may best describe the equity markets for the majority of 2015, as they were impacted by economic stress in China and Greece, coupled with underwhelming corporate earnings reports, falling oil prices, and terrorist attacks here and abroad. While some economic sectors, such as housing and labor, offered favorable news, others, including exports and wages, showed little in the way of positive movement. Nevertheless, despite inflation running below the Fed's target rate of 2.0%, there were enough signs of overall economic growth to prompt the Federal Open Market Committee to raise interest rates in December for the first time since 2006.

Of the indexes listed here, only the Nasdaq posted a year-on-year gain. Not even a fourth quarter rally could bring the other indexes into positive territory for the year. Nevertheless, the fourth quarter saw gains in large caps as the S&P 500 finished up 6.45%, while the Dow closed the quarter up 7.0%. Even the Global Dow gained a little over 4.0% for the quarter.

U.S. Treasuries saw prices fall during the fourth quarter as the yield on 10-year Treasury bonds jumped 22 basis points for the quarter. Oil prices (WTI) continued to fall, dropping from $46.36 per barrel at the end of the third quarter to $37.07 per barrel at the end of the fourth quarter. Gold, meanwhile, also felt the effects of the global economy, finishing the fourth quarter at roughly $1,060.50 an ounce compared to $1,114.50 an ounce at the end of the prior quarter. Finally, not all falling values are necessarily bad, as the average retail price of a gallon of regular gasoline fell $0.29 to $2.034 at the end of the quarter.

Snapshot 2015

The Markets

- **Equities:** It was a roller coaster ride in the equities markets in 2015. After a lackluster start, domestic equities spent much of the year riding a wave of peaks and valleys, to ultimately close the year short of where they started. Anticipation of a federal interest rate hike influenced the markets, as did global economies, particularly in China and Greece. Favorable labor and unemployment figures pushed the markets higher, only to see them recede with news of poor exports, stagnant inflation, mediocre earnings reports, and falling oil prices. While the close of 2014 saw several of the major indexes listed here post double-digit returns, 2015 found only the Nasdaq finishing ahead of its 2014 close--up 5.73%. The Dow lost 2.2% (the first time it posted negative annual returns since 2008), while the S&P 500 fell 0.7% following three straight years of double-digit gains. The Russell 2000 and the Global Dow took the biggest year-on-year hits, finishing down 5.71% and 6.60%, respectively.

- **Bonds:** Long-term bond yields ticked up only moderately at the close of 2015, confounding those who expected the yield on 10-year Treasuries to rise toward 3.0% by the end of the year, especially with the interest rate increase announced by the Fed early in December. Instead, the yield on 10-year Treasuries closed 2015 at 2.26% compared to the 2014 closing yield of 2.17%. A strong dollar, continued uncertainty surrounding the global economy, and low inflation made Treasury debt an appealing investment choice, keeping bond prices up and yields down.

- **Oil:** As oil producing countries flooded the market, oil prices remained below $40 a barrel. While falling energy stocks had an effect on the stock market, the plunge in oil prices helped fatten consumers' wallets, with prices at the pump hovering around $2 a gallon for regular gasoline.

- **Currencies:** Falling oil prices coupled, with the expectation of higher interest rates, helped boost the U.S. dollar, which continued to rise over the course of the year. The U.S. Dollar Index, a measure of the dollar relative to the currencies of most U.S. major trading partners, gained about 9% over its December 31, 2014, closing value. The dollar also benefitted from interest rates abroad, some of which were even lower than those for Treasuries. The strong dollar raised new concerns that countries and foreign corporations hurt by lower oil prices might have trouble repaying debt in currencies that were substantially weaker against the U.S. dollar.

- **Gold:** With inflation hovering below 2.0%, gold, historically seen as a hedge against inflation, saw its value drop throughout the year, posting its third consecutive annual loss. The precious metal ended the year at roughly $1,060.50--about $120 below its value at the close of 2014.

The Economy

- **Employment:** Improvement in the U.S. job market was slow but steady. The unemployment rate ended the year at 5.0%, lower than the 5.6% rate at the close of 2014. According to the Bureau of Labor Statistics, over the past 12 months the unemployment rate and the number of unemployed persons were down by 0.8% and 1.1 million, respectively. Over the prior 12 months, total nonfarm payroll employment averaged a monthly gain of 237,000, adding 2.3 million jobs. Over the year, average hourly earnings have risen by 2.3% to about $25.25 per hour.
- **GDP:** Challenging weather, a strengthening dollar, and lower oil prices slowed growth in the first quarter of 2015 to 0.6%. Economic growth in the second quarter expanded at an annual rate of 3.9% on the strength of increased personal spending. However, the latest figures for the third quarter show growth is once again slowing down to an annual rate of 2.0%, as consumer and business spending figures were revised downward.
- **Inflation:** Inflation remained below the Fed's stated target rate of 2.0%, but indications are that it is expanding, albeit at a very slow pace. The Bureau of Labor Statistics reported that the all items index rose 0.5% from November 2014 to November 2015--the largest 12-month increase since the 12-month period ended December 2014. The food index rose 1.3% over the span, while the energy index declined 14.7%. The index for all items less food and energy rose 2.0%--its largest 12-month increase since the 12 months ended May 2014. The core personal consumption expenditures price index, relied upon by the Fed as an important indicator of inflationary trends, sat at 1.3% for the year, giving no clear indication that it will approach the Fed's 2.0% target rate.
- **Housing:** The housing market had been relatively strong for much of the year. However, the latest figures from the National Association of Realtors® show that sales of existing homes fell in November by 10.5% compared to October, and the year-on-year rate of existing home sales is -3.8%--the first such decrease since September 2014. The median price for existing homes in November was $220,300, which is 6.3% above November 2014. The number of new home sales in November 2015 increased 9.1% compared to the number of sales in November 2014. The median sales price of new houses sold in November 2015 was $305,000 and the average sales price was $374,900, compared to $302,700 and $358,800, respectively, in November 2014.
- **Manufacturing:** Manufacturing and industrial production have not been consistently strong sectors this year. The Federal Reserve's monthly index of industrial production was down 1.2% from November 2014 to November 2015. In addition, the latest report from the Census Bureau shows orders for all durable goods in the first 11 months of 2015 fell 3.7% on the year.
- **Imports and exports:** For the year, the goods and services deficit increased $22.2 billion, or 5.3%, from the same period in 2014. Exports decreased $84.7 billion, or 4.3%. Imports decreased $62.5 billion, or 2.6%. Low prices for oil held down imports, while the continued strength of the dollar was a key factor in the year's sluggish exports sector leading to weak demand abroad.
- **International markets:** For most of 2015, economic problems overseas impacted the United States and contributed to the Fed's caution with raising interest rates. Though the European Central Bank extended its program of buying bonds, cut a key interest rate to -0.2%, and passed measures intended to pressure banks to lend more, the Eurozone economy grew at an annual rate of just 1.2%, with unemployment sitting at 10.7% and inflation at an annual rate of only 0.1%. Greece began the year electing an anti-austerity prime minister, saw its economy contract to the point where its banks and stock markets were forced to shut down, then agreed to more intense austerity measures to help support its economy. China had experienced an average annual growth rate of 10%. However, 2015 saw China's economy grow at a much slower rate of about 7%, prompting several government-backed measures intended to support growth.

Eye on the Year Ahead

As the year came to a close, the Fed finally raised interest rates based on some favorable economic news, particularly on the labor front and, to a somewhat lesser extent, in the housing market. The Fed is expected to consider three to four more rate increases during 2016. However, falling oil prices, inflationary trends that have been less than robust, poor manufacturing and production numbers, and a glaring weakness in exports could impact whether additional rate hikes are in the offing for 2016.

ONST Views on the Markets

- The market declines of the first two weeks of 2016 marked the worst start to the year that has ever been recorded. Since January 1st, we have experienced large intra-day and inter-day swings in the market. Volatility seems to be the buzzword of the year. The word volatility tends to evoke a negative sentiment, however volatility in the markets means downward as well as upward fluctuations. One benefit to volatility is that it enables investors with a long-term outlook to take advantage of the dips and buy securities that are “on sale”. While we are not market timers, in such times we do look to buy on the dips.
- The ONST Investment Team maintains a long-range perspective when positioning client’s portfolios and we periodically use tactical strategies to make short-term adjustments we believe will be additive to the overall portfolio.
- We believe the right approach during all kinds of markets is to be realistic, have a plan, stick with it and strike a comfortable balance between risk and return.

- In these uncertain and volatile times, we would like to share some words to ponder…

"Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities they should try to be fearful when others are greedy and greedy when others are fearful."--Warren Buffett

"Most of the time common stocks are subject to irrational and excessive price fluctuations in both directions as the consequence of the ingrained tendency of most people to speculate or gamble ... to give way to hope, fear and greed." --Benjamin Graham

"In this business if you're good, you're right six times out of ten. You're never going to be right nine times out of ten." --Peter Lynch