CITY OF DICKINSON

FY2015-2016
QUARTERLY INVESTMENT AND FINANCIAL REPORT
PERIOD ENDING DECEMBER 31, 2015

City of Dickinson
Investment Report
For the Period Ended December 31, 2015

The City invests cash that is not immediately needed for operations in Certificates of Deposit, TexPool, and Securities issued by Agencies of the Federal Government as allowed by the Public Funds Investment Act and the City's Investment Policy.

As of December 31, 2015, the City's cash and investments were as follows:

Investment Category	Book Value	Percentage	Weighted Average Maturity (Days)
Cash in Demand Accounts	$7,790,478	86.53%	1.00
Government Pools	$1,212,447	13.47%	1.00
Certificates of Deposit	$516,170	0.00%	0.00
TOTAL	**$ 9,002,925**	**100.00%**	**1.00**

The portfolio is highly liquid with $7,790,478 or 86.53% available immediately.

Interest rates on investments range from 0.03% to 0.35%. These rates are historic lows leading to a recommendation to keep the portfolio liquid for the coming 3 months. This strategy is being implemented by moving money to the City's new depository bank, Capital One, which currently has the greatest return rates. Additionally, staff continues a review of accounts to evaluate the distribution of accounts and types of accounts being held by the City.

Compliance: The City requires its depository banks to provide collateral for all deposits in excess of Federal Deposit Insurance. As of December 31, 2015, the market value of collateral pledged to the City by Capital One through the Bank of New York Mellon was $7,994,290.58.

Market Value: The City currently holds no investments in which the book value differs from the market value. For all holdings, the book value is equal to the market value.

FY2016 First Quarter Investment Report
Period Ended December 31, 2015

G/L Account	Description	Book Value	Current Interest Rate	Yield to Maturity	Maturity Date	Days to Maturity	Beginning Market Value for Period	Changes to Market Value	Ending Market Value for Period	Interest Paid YTD
Cash in Demand Accounts										
99-1120	Capital 1 - Operating Acct	$ 3,298,931	0.35%	0.00%	Demand	1	$ 4,194,160	$ (895,229)	$ 3,298,931	$ 2,589
01-1121	Capital 1 - Supplemental Acct	$ 2,271,287	0.35%	0.00%	Demand	1	$ 19,039	$ 2,252,249	$ 2,271,287	$ -
15-1120	Capital 1 - PID#1 Acct	$ 24,115	0.35%	0.00%	Demand	1	$ 355,552	$ (331,437)	$ 24,115	$ 55
02-1270	Capital 1 - Debt Service	$ 33,513	0.35%	0.00%	Demand	1	$ 1,710	$ 31,803	$ 33,513	$ 43
03-1255	Capital 1 - State Narcotics	$ 7,647	0.35%	0.00%	Demand	1	$ 9,472	$ (1,824)	$ 7,647	$ -
03-1256	Capital 1 - Awarded Fed. Seized	$ 147,749	0.35%	0.00%	Demand	1	$ 155,665	$ (7,917)	$ 147,749	$ 66
03-1258	Capital 1- Awarded State Seized	$ 13,411	0.35%	0.00%	Demand	1	$ 13,411	$ -	$ 13,411	$ -
01-1288	Capital 1 - Employee Ben. Trust	$ 2,145	0.35%	0.00%	Demand	1	$ 2,145	$ -	$ 2,145	$ -
08-1120	Capital 1 - Street Maintenance	$ 1,760,114	0.00%	0.00%	Demand	1	$ 1,991,924	$ (231,811)	$ 1,760,114	$ 1,570
01-1271	Regions - Money Market Acct	$ 200,807	0.15%	0.15%	Demand	1	$ 200,817	$ (10)	$ 200,807	$ 25
N/A	Regions - RWB Account	$ 30,760	0.15%	0.15%	Demand	1	$ 45,545	$ (14,785)	$ 30,760	$ -
01-1269	AMOCO Federal Credit Union	$ -	0.00%	0.00%	Demand	1	$ 833	$ (833)	$ -	$ -
Total Cash in Demand Accounts		**$ 7,790,478**					**$ 6,990,272**	**$ 800,206**	**$ 7,790,478**	**$ 4,348**
Invested in Government Pools										
01-1259	TexPool - General Fund	$ 1,212,447	0.03%	0.03%	Demand	1	$ 1,212,045	$ 401	$ 1,212,447	$ 401
Total Invested in Government Pools		**$ 1,212,447**					**$ 1,212,045**	**$ 401**	**$ 1,212,447**	**$ 401**
Invested in Certificates of Deposit										
01-1269	AMOCO Federal Credit Union	$ -	0.00%	0.00%	Matured	0	$ 258,333	$ (258,333)	$ -	$ 3
01-1264	Texas First Bank	$ -	0.00%	0.00%	Matured	0	$ 258,043	$ (258,043)	$ -	$ 203
Total Invested in Certificates of Deposit		**$ -**					**$ 516,376**	**$ (516,376)**	**$ -**	**$ 206**
TOTAL ALL INVESTMENTS		**$ 9,002,925**					**$ 8,718,694**	**$ 284,231**	**$ 9,002,925**	**$ 4,955**

Investment Category	Book Value	Percentage	Weighted Average Maturity (Days)
Cash in Demand Accounts	$ 7,790,478	86.53%	1.00
Government Pools	$ 1,212,447	13.47%	1.00
Certificates of Deposit	$ -	0.00%	0.00
TOTAL	**$ 9,002,925**	**100.00%**	**1.00**

Investment schedules presented per the provisions of the Texas Code Chapter 2256 (Public Funds Investment Act) and the City of Dickinson Investment Policy

The City requires its depository banks to provide collateral for all deposits in excess of Federal Deposit Insurance. As of December 31, 2015, the market value of collateral pledged to the City was $7,994,290.58 pledged by Capital One.

Unrealized gain/loss is the difference between the market value of the City's securities and what it paid for them. Gains and losses are realized only when a security is sold prior to maturity. Since it is the City's practice to hold all securities to maturity, it is unlikely that unrealized gains and losses will be realized. As of December 31, 2015, the City had no unrealized gains or losses.

In view of historically low interest rates, the recommended investment strategy for the next fiscal quarter is to invest primarily in shorter term Certificates, Bonds and Investment Pools. The recommended strategy is currently being implemented.

Stephanie Russell

Prepared by: Stephanie Russell, Administrative Services Manager

Julie M. Robinson, City Administrator and Investment Officer

CITY OF DICKINSON
STATEMENT OF NET REVENUES - GENERAL FUND
FY 2016 FIRST QUARTER - PERIOD ENDING DECEMBER 31, 2015

	FY 2016 Original Budget	FY 2016 Actuals As Of 12/31/15*	FY 2016 Q1 Over/(Under) Budget	FY 2016 Q1 % Realized
REVENUES				
Sales Tax	5,734,800	1,561,233	(4,173,567)	27.2%
Ad Valorem (Property) Tax	2,939,036	1,508,882	(1,430,154)	51.3%
Other Taxes	40,000	11,390	(28,610)	28.5%
Franchise Fees	1,020,200	149,127	(871,073)	14.6%
Licenses & Permits	335,748	67,626	(268,122)	20.1%
Court Fines & Fees	751,000	173,275	(577,725)	23.1%
Charges for Service	390,000	64,856	(325,144)	16.6%
Miscellaneous Income	38,300	11,780	(26,520)	30.8%
Intergovernmental Income				
Federal E.M.P.G. Grant	-	-	-	0.0%
Contract for Jail Services	10,000	960	(9,040)	9.6%
CDBG Reimb - Personnel	12,500	-	(12,500)	0.0%
Ambulance DHS Football	2,250	1,800	(450)	80.0%
Transfer From DEDC	195,231	48,808	(146,423)	25.0%
Transfer From DMD #1	537,382	30,092	(507,290)	5.6%
Reg. DWI Task Force Grant	4,518	-	(4,518)	0.0%
Emergency Service Co. Fee	126,000	31,500	(94,500)	25.0%
Transfers & Other Sources				
Transfer From PID#1	15,000	-	(15,000)	0.0%
TOTAL REVENUES	**12,151,964**	**3,661,328**	**(8,490,636)**	**30.1%**
EXPENDITURES				
Administration	524,390	117,297	(407,093)	22.4%
Finance	217,613	48,889	(168,725)	22.5%
Community Development	430,441	83,423	(347,018)	19.4%
Municipal Court	316,459	69,649	(246,810)	22.0%
Police Department	3,943,080	918,598	(3,024,482)	23.3%
Fire Marshal	197,526	46,996	(150,530)	23.8%
Emergency Management	91,359	26,226	(65,133)	28.7%
Public Works	616,711	137,017	(479,694)	22.2%
Information Technology	294,709	80,456	(214,253)	27.3%
Library	398,011	76,732	(321,278)	19.3%
Tourism	103,227	24,864	(78,363)	24.1%
EMS	935,264	235,304	(699,960)	25.2%
City-Wide Services				
380 Grant Payments	3,268,836	877,325	(2,391,511)	26.8%
Other Contractual Payments	665,529	151,353	(514,176)	22.7%
TOTAL EXPENDITURES	**12,003,155**	**2,894,130**	**(9,109,025)**	**24.1%**
REVENUE-EXPENDITURES	**148,809**	**767,198**	**618,389**	

**Unaudited values, subject to change.*

CITY OF DICKINSON
STATEMENT OF NET REVENUES - OTHER FUNDS
FY 2016 FIRST QUARTER - PERIOD ENDING DECEMBER 31, 2015

	FY 2016 Original Budget	FY 2016 Actuals As Of 12/31/15*	FY 2016 Q1 Over/(Under) Budget	FY 2016 Q1 % Realized
DEBT SERVICE FUND				
REVENUES				
Property Tax	701,880	360,340	(341,540)	51.3%
Interest Income	-	43	43	0.0%
Transfers & Other Contributions				
Transfer from GF Reserve	20,941	-	(20,941)	0.0%
DEDC	62,705	-	(62,705)	0.0%
WCID #1 Contribution	86,965	86,964	(1)	100.0%
TOTAL REVENUES	**$ 872,491**	**$ 447,347**	**$ (425,144)**	**51.3%**
EXPENDITURES				
Issue Cost & Continuing Disclosure	5,300	-	(5,300)	0.0%
Principal				
2009 GO Refund	120,000	-	(120,000)	0.0%
2014 GO Refund	465,000	-	(465,000)	0.0%
Interest				
2009 GO Refund	75,320	-	(75,320)	0.0%
2009 CO Refund	50,695	-	(50,695)	0.0%
2014 GO Refund	156,175	-	(156,175)	0.0%
TOTAL EXPENDITURES	**872,490**	**-**	**(872,490)**	**0.0%**
NET REVENUES	**$ 1**	**$ 447,347**	**$ 447,346**	
MUNICIPAL DRAINAGE UTILITY FUND				
REVENUES				
Resident Drainage	281,000	2,920	(278,080)	1.0%
Commercial Drainage	24,000	156	(23,844)	0.7%
Multi-Family/Mobile Home	59,000	300	(58,700)	0.5%
TOTAL REVENUES	**$ 364,000**	**$ 3,376**	**$ (360,624)**	**0.9%**
EXPENDITURES				
Salaries & Benefits	218,120	57,257	(160,863)	26.3%
Other Operating Expenses	142,103	9,637	(132,466)	6.8%
2016 Projects:				
Moore's Addition	28,000	-	(28,000)	0.0%
Church Street	8,000	-	(8,000)	0.0%
Green Lee	10,000	-	(10,000)	0.0%
TOTAL EXPENDITURES	**$ 406,223**	**$ 66,894**	**$ (339,329)**	**16.5%**
NET REVENUES	**$ (42,223)**	**$ (63,518)**	**$ (21,295)**	

**Unaudited values, subject to change.*

CITY OF DICKINSON
STATEMENT OF NET REVENUES - OTHER FUNDS
FY 2016 FIRST QUARTER - PERIOD ENDING DECEMBER 31, 2015

	FY 2016 Original Budget	FY 2016 Actuals As Of 12/31/15*	FY 2016 Q1 Over/(Under) Budget	FY 2016 Q1 % Realized
STREET MAINTENANCE FUND				
REVENUES				
Street Maintenance Sales Tax	1,433,700	390,308	(1,043,392)	27.2%
Interest Income	500	1,570	1,070	314.1%
TOTAL REVENUES	**$ 1,434,200**	**$ 391,879**	**$ (1,042,321)**	**27.3%**
EXPENDITURES				
Street Repair/Patch	100,000	4,326	(95,674)	4.3%
Legal Notices	1,000	-	(1,000)	0.0%
Projects				
Avenue L	-	2,028	2,028	0.0%
Dakota	-	302,509	302,509	0.0%
48th Street (E of HWY 3)	-	1,008	1,008	0.0%
33rd Street	-	1,008	1,008	0.0%
28th Street (W of HWY 3)	-	1,008	1,008	0.0%
Leonetti	-	1,008	1,008	0.0%
Oleander (Palm tO Bridge)	-	1,008	1,008	0.0%
Greenbriar Street	-	1,008	1,008	0.0%
35th (E. of Kansas)	419,796	13,962	(405,834)	3.3%
Nebraska	116,897	13,962	(102,935)	11.9%
Hollywood	226,044	13,962	(212,082)	6.2%
Gill Road	217,971	13,962	(204,009)	6.4%
Johnson Street	96,876	13,962	(82,914)	14.4%
Mariner's	96,876	13,962	(82,914)	14.4%
Pine Oak Circle	90,418	13,962	(76,456)	15.4%
TOTAL EXPENDITURES	**$ 1,365,878**	**$ 412,641**	**$ (953,237)**	**30.2%**
NET REVENUES	**$ 68,322**	**$ (20,762)**	**$ (89,084)**	

CITY OF DICKINSON
STATEMENT OF NET REVENUES - OTHER FUNDS
FY 2016 FIRST QUARTER - PERIOD ENDING DECEMBER 31, 2015

	FY 2016 Original Budget	FY 2016 Actuals As Of 12/31/15*	FY 2016 Q1 Over/(Under) Budget	FY 2016 Q1 % Realized
BAYOU LAKES PUBLIC IMPROVEMENT DISTRICT NO. 1				
REVENUES				
Pentalty & Interest	4,000	-	(4,000)	0.0%
Assessments	203,000	125,829	(77,171)	62.0%
Attorney Fees	810	-	(810)	0.0%
Refunds	18,310	-	(18,310)	0.0%
Interest Income	95	55	(40)	57.8%
TOTAL REVENUES	**$ 226,215**	**$ 125,884**	**$ (100,331)**	**55.6%**
EXPENDITURES				
Audit & CAFR	3,600	-	(3,600)	0.0%
Collection Fees	3,950	-	(3,950)	0.0%
Developer Reimbursement	204,239	-	(204,239)	0.0%
Tax Refunds to Homeowners	300	-	(300)	0.0%
Transfer to General Fund	15,000	-	(15,000)	0.0%
TOTAL EXPENDITURES	**$ 227,089**	**$ -**	**$ (227,089)**	**0.0%**
NET REVENUES	**$ (874)**	**$ 125,884**	**$ 126,758**	
VEHICLE EQUIPMENT RECPLACEMENT FUND				
REVENUES				
Transfer in from DMD #1	245,400	245,400	-	100.0%
Transfer from General Fund	-	-	-	0.0%
Misc. Revenues	-	-	-	0.0%
Auction Proceeds	-	-	-	0.0%
TOTAL REVENUES	**$ 245,400**	**$ 245,400**	**$ -**	**100.0%**
EXPENDITURES				
Furniture & Equipment				
Law Enforcement	-	45,334	45,334	0.0%
City-Wide	-	39,513	39,513	0.0%
Vehicle Acquisition				
Law Enforcement	204,400	114,473	(89,927)	56.0%
Fire Marshal	41,000	41,435	435	101.1%
Drainage	45,000	-	(45,000)	0.0%
TOTAL EXPENDITURES	**$ 290,400**	**$ 240,755**	**$ (49,645)**	**82.9%**
NET REVENUES	**$ (45,000)**	**$ 4,645**	**$ (94,645)**	

**Unaudited values, subject to change.*

CITY OF DICKINSON
STATEMENT OF NET REVENUES - OTHER FUNDS
FY 2016 FIRST QUARTER - PERIOD ENDING DECEMBER 31, 2015

	FY 2016 Original Budget	FY 2016 Actuals As Of 12/31/15*	FY 2016 Q1 Over/(Under) Budget	FY 2016 Q1 % Realized
BUILDING MAINTENANCE FUND				
REVENUES				
Transfer from General Fund	-	-	-	0.0%
TOTAL REVENUES	**$ -**	**$ -**	**$ -**	**0.0%**
EXPENDITURES				
Public Safety Building Repairs	-	3,079	3,079	0.0%
TOTAL EXPENDITURES	**$ -**	**$ 3,079**	**$ 3,079**	**0.0%**
NET REVENUES	**$ -**	**$ (3,079)**	**$ (3,079)**	
SPECIAL REVENUE FUNDS				
REVENUES				
Other Taxes	30,000	7,551	(22,449)	25.2%
Court Fines & Fees	33,123	7,272	(25,851)	22.0%
Miscellaneous Income	-	65	65	0.0%
Intergovernmental Income	67,844	21,518	(46,326)	31.7%
Transfers & Other Sources	133,260	2,779	(130,481)	2.1%
TOTAL REVENUES	**$ 264,227**	**$ 39,185**	**$ (225,042)**	**14.8%**
EXPENDITURES				
Miscellaneous Grants	-	-	-	0.0%
Child Safety	7,793	947	(6,846)	12.1%
Court Efficiency	5,096	150	(4,946)	2.9%
Court Security	11,541	1,904	(9,637)	16.5%
Court Technology	6,150	8,301	2,151	135.0%
Federal Seized	50,700	17,512	(33,188)	34.5%
State Seized	-	2,195	2,195	0.0%
State Narcotics	-	-	-	0.0%
Library Grant Fund	14,910	1,426	(13,484)	9.6%
Library Trust Fund	-	-	-	0.0%
VOCA Grant	66,642	13,895	(52,747)	20.8%
COPS Grant	119,551	28,545	(91,006)	23.9%
Hotel/Motel Tax Fund	20,042	3,793	(16,250)	18.9%
TOTAL EXPENDITURES	**$ 302,425**	**$ 78,666**	**$ (223,759)**	**26.0%**
NET REVENUES	**$ (38,198)**	**$ (39,481)**	**$ (1,283)**	

**Unaudited values, subject to change.*

Asset Management Economic Summary — 4th Quarter 2015

"So, the much anticipated liftoff finally came, but the headwinds going forward are likely to hinder the Fed's ability to maintain a steadfast course."

		Fed Funds	3 mo T-bill	6 mo T-bill	2 yr T-note	5 yr T-note	10 yr T-note
Last	9/30/15	0.00%	-0.01%	0.07%	0.63%	1.36%	2.85%
High		0.25%	0.27%	0.55%	1.09%	1.79%	3.12%
Low		0.00%	-0.02%	0.04%	0.55%	1.27%	2.83%
End	12/31/15	0.25%	0.16%	0.48%	1.05%	1.76%	3.01%

The economic numbers generally weakened, but the attention of market participants during the final three months of the year was squarely focused on the Fed. Janet Yellen and other prominent Central Bank members took every opportunity during the quarter to hint that a rate hike was on the way. The *data didn't always cooperate*. Gross Domestic Product (GDP) slowed from a +3.9% annualized rate in the second quarter to +2.1% in the third quarter. Early fourth quarter projections indicate further slowing. Although business inventories distorted the true growth picture, the Fed had never initiated a tightening cycle when GDP was so sluggish. The ISM factory index, after posting sickly 50.2 and 50.1 readings in September and October, unexpectedly dropped to 48.6 in November. *This was the first "contraction" since 2012 and the lowest reading since June 2009.* The housing market cooled and equities couldn't hold onto gains for the year. Only auto sales and employment shined, but that was enough for the Fed.

After seven long years of zero interest rate policy, a small move toward normalization of monetary policy seemed long overdue. The doubters pointed to a struggling global economy, a lack of inflationary pressure both domestically and overseas, and only moderate U.S. economic growth despite seven years of extreme accommodation. The first rate increase since 2006 had been repeatedly postponed. In June, it was Greece, China and Puerto Rico that spoiled the party. In September, the culprit was a surprisingly weak August employment report. But in December, there was little question Fed officials would hold their breath and pull the trigger. Market yields on the short end of the curve crept higher throughout the quarter. By the day of the meeting, the expected move was fully priced in. The bigger question concerned the pace and magnitude of future rate increases.

In the past, Fed officials have been overly optimistic in their projected path to rate normalization. This time is no exception. FOMC members still expect the overnight target rate to hit 1.375% by the end of 2016, but reduced their projections for the end of 2017 from 2.625% to 2.375%. The long range forecast remains at 3.5%. Of course, in order for the Fed to raise rates this dramatically, the inflation rate will have to increase. The December meeting revealed even the committee itself doesn't expect this to happen anytime soon. The median projected inflation rate according to FOMC members is +1.6% by the end of 2016 and +1.9% by the end of 2017. The +2.0% target isn't expected to be reached until 2018. And in fact, the series of projected rate hikes *are more likely to push inflation lower* as the dollar strengthens.

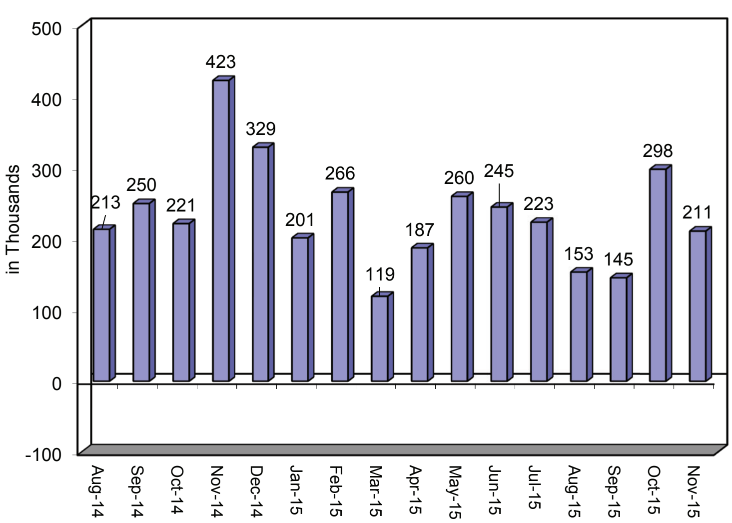
Higher U.S. interest rates relative to trade partners suggest a stronger dollar, and this generally happened during the quarter. The U.S. dollar rose to a 12½-year high according to a St. Louis Fed Index tracking the dollar against the major trading partners. The appreciation in U.S. currency makes exports more expensive while making imports cheaper. Lower priced goods entering the U.S. mean domestic producers have to trim expenses (often reducing labor costs) and lower shelf prices to compete. The United States imports quite a bit more than it exports, so the notion of "importing deflation" will be the more pressing concern for the Fed. Exports represent only about 13% of GDP, with 40% going to NAFTA trade partners Canada and Mexico. Since both are significant net exporters of oil (which was another big story in the fourth quarter), the Canadian and Mexican economies are struggling to stay out of recession. With the EU and Japan also teetering on the edge and China's growth rate now nearly half of what it was in 2007, the U.S. can't count on a boost from the global economy in 2016.

During the summer of 2008 when crude oil peaked above $140 per barrel, Goldman Sachs predicted that crude could reach $200 per barrel. With crude now trading below $40, Goldman believes $20 is a possibility later in 2016, and there's plenty of reasons supporting this. In early December, OPEC abandoned its production ceiling, effectively allowing its members to pump unlimited amounts to defend market share. A sanction free Iran is set to ramp up production by as much as a million barrels a day. Storage capacity is already strained. In the U.S. stockpiles are at the highest levels in eight decades. In response, the U.S. voted to lift a self-imposed 40-year ban on oil exports, although the positive effect of this measure could take years to unfold. In the meantime, the International Energy Agency announced inventories are expected to rise by 300 million barrels in 2016 and global onshore storage capacity is expected to be exhausted by the end of the first quarter. Bloated supply and declining global demand point to price declines.

Lower energy prices were expected to be a boon for consumers. The fact that they haven't yet is a bit of a mystery. The average nationwide price for a gallon of regular unleaded was $2.00 as of December 29th. Less than 18 months ago, the average pump price was hovering around $3.50. Analysts had predicted a year ago that the consumer was poised to spend the savings windfall which would then bolster economic growth. Gasoline prices have actually fallen another 15% since last year at this time and the effects have yet to materialize. Instead, nervous Americans are choosing to save. The personal savings rate rose to a three-year high in October.

EMPLOYMENT

NONFARM PAYROLLS
Total Change in Thousands



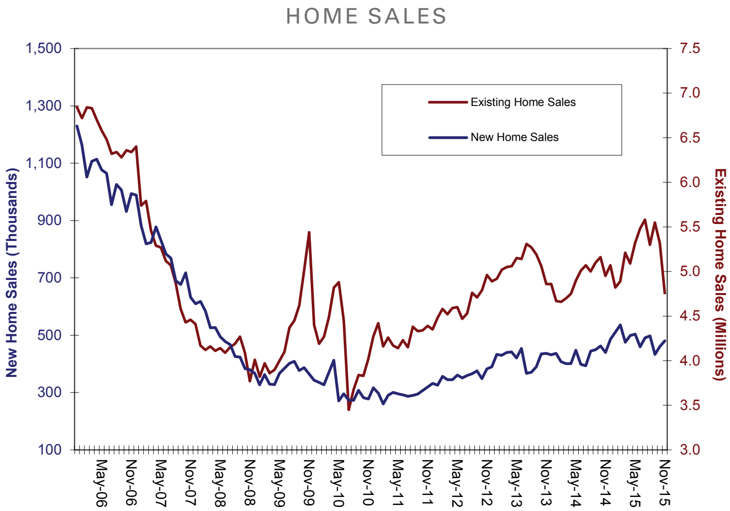
The FOMC decision to finally begin tightening in December was based to a large degree on "considerable improvement in labor conditions." This widely held belief made the November labor report, released less than two weeks before the meeting, extremely important. *The Fed needed good numbers*. Analysts had suggested payroll growth below +150k could derail the expected rate hike. *This didn't happen*. The Bureau of Labor Statistics announced that +211k new jobs were added to company payrolls in November, while October payrolls were revised upward from +291k to +298k. The sector breakdown didn't matter. The Fed got all it needed to begin rate hikes in the headline.

The official unemployment rate, calculated from a separate household survey, held steady at a 7½-year low of 5.0%, while the broader U6 measure, which includes *involuntary* part-time workers and people who would like to work but haven't actively searched in the past 30 days, drifted upward from 9.8% to 9.9%. Average hourly earnings increased by +0.2% in November, while October's satisfying +0.4% earnings rise was unrevised. On a year-over-year basis, average hourly earnings slipped a bit from +2.5% to +2.3%, but continued to show an acceptable amount of wage pressure. In viewing the labor picture as decidedly positive, the Fed was choosing the glass half-full view. In the past 5 years, the U.S. economy had added over 12 million jobs. The half-empty view is that at one point in 2010, there were 15 million Americans unemployed and actively seeking work. The reason for throwing cold water on one of few solid economic series is that much of the recent growth was catch-up. Any subsequent economic downturn jeopardizes future job growth. Without the job creation, the Fed loses its primary reason to continue tightening policy.

CONSUMER SPENDING

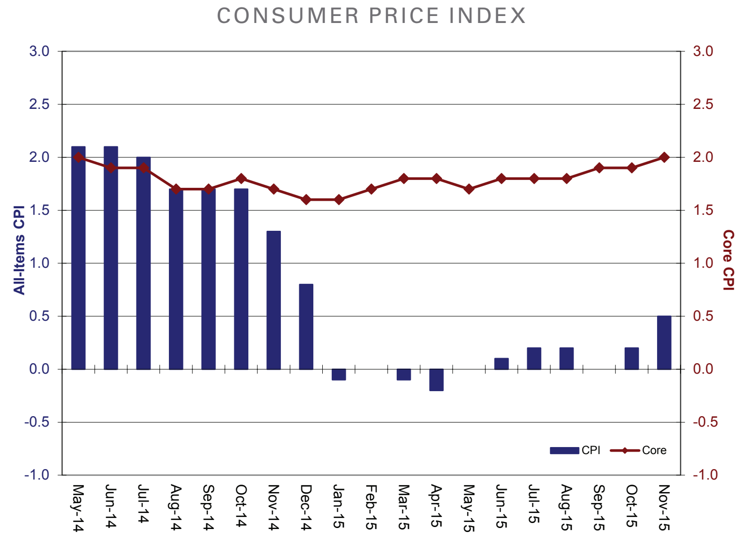
Americans are spending, but not in enough volume to drive the economy at its accustomed pace. November retail sales rose +0.2%. Although this was slightly below forecast, it was the strongest consumption rate in four (admittedly weak) months. On a year-over-year basis, sales growth had slowed to a mediocre +1.4%. Unless the December spending tally surprises to the upside, it looks like Q4 consumer spending will be lower than in the previous quarter. One bright spot has been auto sales. Purchases of cars and trucks were absolutely booming in the fall with a record three straight months above the 18 million unit annual pace. Although the record high average age of cars and trucks on the road (11½ years) has played a role in the ballooning purchases, so have unusually liberal credit and financing terms that some believe have fueled a bubble. Experian Automotive reported that the average credit score for new car purchases in Q3 2015 was 710, down from 733 in Q3 2010, while the average used car credit score during the same period fell from 661 to 650. The dollar amount of total auto loans outstanding was $968 billion in Q3 2015, up from $784 billion two years earlier, while a record 86.6% of all new car purchases are financed. The bottom line for the auto sector going forward is that economic growth will have to cooperate in order for the brisk vehicle sales to continue. Borrowing is already stretched.

HOUSING



So far, mortgage borrowing costs have shown little effect from the change in Fed policy. Since the December Fed move won't directly affect longer rates, it isn't necessarily a sure thing that the cost of mortgages will rise in 2016. But if long rates gradually increase, they'll still remain favorable from a historical perspective. The average 30-year fixed rate loan according to Freddie Mac ended the year at 4.01%. Although this is slightly above the 3.95% average for November and December, it's still below the 4.17% average for all of 2014 and significantly below the 4.86% average over the last 10 years. Existing home sales fell by -10.5% to a 4.76 million unit annual pace in November, the lowest in nearly two years, while October sales were revised downward to a 5.32 million unit annual rate. Although the November plunge might suggest that impending Fed action had a negative impact, new mortgage industry regulation was the more likely culprit. New rules implemented in November apparently slowed closings and restrained sales, and are likely to hamper lending efforts going forward. Slowing sales pushed the available supply up from 4.8 to 5.1 months, although the nationwide median sales price for an existing home rose +6.3% year-over-year to $220,300. By contrast, new home sales (which represent a significantly smaller portion of the market) enjoyed a better month. New home sales rose by +4.3% in November to a 490k pace. Available supply fell from 5.8 to 5.7 months and the median home price increased by +6.3% during the year to $305,000. The still relatively lean home inventory levels, combined with unseasonably favorable weather boosted both housing starts and building permits in November. Starts jumped +10.5% to a 1,173k annualized pace, while building permits (an indicator of future starts) soared by +11% to a 1,289k pace, the second highest reading in the post-recession period.

INFLATION



According to the Labor Department, import prices have fallen by -9.4% over the past year as the strong dollar and depressed global demand continue to exert downward pressure on imported goods. Unfortunately, the case for global resurgence and a weakening dollar in 2016 is a tough one to make. The headline consumer price index (CPI) was *unchanged* in November, exactly matching the median forecast and up +0.5% on a year-over-year basis. *That's not good.* On the other hand, core CPI, which excludes food and energy prices, rose +0.2% in November and is now increasing at a reasonable +2.0% pace. The reason for the broad difference is that medical and housing costs are included in the core and are moving higher, while commodities prices (including oil and gas) are falling and are not included in core CPI. The Fed usually doesn't pay too much attention to CPI, but they needed support for their rate hike, so the +2.0% year-over-year core advance was a convenient winner. Its preferred inflation gauge – the core Personal Consumption Expenditure (PCE) Index is rising at a lesser +1.3% pace and has fallen below target for nearly four years. The Fed, as mentioned earlier, isn't expecting inflation to rise in the foreseeable future. If price pressures were to ease further in 2016, they'll have a hard time justifying additional hikes.

U.S. EQUITY MARKETS

	DOW	S&P 500	NASDAQ
9/30/15	16,285	1,920	4,620
12/31/15	17,425	2,044	5,007
% Change for Q4-2015	+7.0%	+6.5%	+8.4%

The DOW moved up or down by 1% or more on 73 trading days in 2015, more than twice the occurrence in 2014. The volatility, which reflects investor anxiety over impending Fed tightening and a series of high profile global market problems hasn't been this severe since 2011. The quarter was surprisingly solid, although gains couldn't recoup losses on the year. The DOW gained +7% over the three month period, but ultimately shed -2.2% for all of 2015. Likewise, the S&P climbed by +6.5% during the final quarter and lost a fractional -0.7% for the year. The NASDAQ won the year as its +8.4% quarterly advance boosted its year-to-date gain to +5.7%. The effect of Fed rate hikes on stocks is debatable. Conventional thinking is that rate hikes are not positive for equities, but in nine of the past 12 tightening cycles, stocks have actually moved higher in the year following liftoff.

ECONOMIC AND INTEREST RATE OUTLOOK

It's important to realize December's rate move was intended to *get off of zero*, and to a large degree for the Fed to save face, not to combat phantom inflation or slow an overheating economy. As such, it makes little sense to expect this to be followed by the typical *series* of hikes. Vining Sparks pointed out that the Fed has hiked interest rates 119 times since 1948 and on 116 of those occasions, nominal GDP was running above 5.0%. One of the three times they boosted rates with GDP below 5% was in December. If GDP slows down further, there really isn't historical precedence for tightening.

According to the Wall Street Journal, there have been five Fed tightening cycles in the last 32 years. During each of these, economic growth either accelerated or held steady as interest rates moved higher. Since the Fed was preemptively raising rates to cool economies threatening to overheat, established positive momentum was able to sustain itself. *This time is different; there is no momentum*. Following +3.9% and +2.1% GDP growth in the previous two quarters, the Atlanta Fed's "GDP Nowcast" showed Q4 economic growth tracking at a +0.7% rate, while both the Morgan Stanley and RBC tracking models indicate +0.5% growth in the final quarter of the year.

The prevailing thought is that the FOMC will raise the overnight funds rate at every other meeting this year. This suggests they'll skip late January and target mid-March 2016. But, as Yellen said at the December press conference, future rate increases are not on a preset path; the economic data will determine the timing and magnitude of any subsequent hikes. Of course, future data strength will wax and wane, and much can happen on the way to the seemingly optimistic 3.5% terminal funds rate the Fed is forecasting for three to four years down the line. In fact, a recent WSJ survey showed that 58% of economists believe short-term rates *could return to zero*, while 37% believe another round of quantitative easing could occur and 16% believe negative interest rates are a possibility, *all within the next five years*. Recessions aren't the result of policy mistakes, but rather part of a natural economic cycle. Eventually, another recession will happen and the Fed will again ease short-term interest rates to jumpstart growth.

Long-term rates are another story altogether. Historically, increases in the overnight rate target have pushed yields out all along the yield curve, but yet again, this time is different. There's little inflation, so there is virtually no inflation premium built into the long end. Global yields are already painfully low and massive Central Bank asset purchase programs in Europe and Japan ensure that low rates will continue through 2016. Closely related to this is a severe lack of bond supply on the long end. Although yields on U.S. bonds with longer maturities could certainly rise in the coming months, there will be an unusual amount of pressure holding them down. This curve flattening is ideal from the Fed's perspective. Market forces will keep a lid on consumer borrowing rates while the Fed claws back enough ammunition on the short end to combat any recession that might be looming in the future. As many have written over the past decade, we are in uncharted territory. Even the welcomed relief of the December liftoff creates as many questions as it answered. *So, the much anticipated liftoff finally came, but the headwinds going forward are likely to hinder the Fed's ability to maintain a steadfast course.*

Scott McIntyre, CFA
Senior Portfolio Manager
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