KEIM ASSET MANAGEMENT, LLC
Preserving Your Lifestyle

January 6, 2016

Dear Investor:

LIFTOFF

Much has happened since my last letter, but the most significant would have to be the interest rate increase by the Federal Reserve. Rates have been at zero for the last seven years, since December 2008. The market has waited a long time for the Fed to take that first step. Most investors were in agreement and expecting it to happen. The actual monetary effect of a small rise off the zero bound will be minimal. It's the start of the long road back to "normal" that is important. The Fed's main thinking on this is that the total amount of progress made on the economy is sufficient to move forward. This appears to be the case as we have had several years of slow and steady growth. Unemployment has come down from 10% to 5%, a very notable amount. Around 2.5 million jobs were created in 2015 alone. We still have a long way to go, but by moving forward slowly, the Fed is lowering the odds of having to make more abrupt moves if things were to accelerate.

2015 was not an easy year for investors. There's not a lot to feel good about. For starters, the market made basically no progress on average. The S&P 500 finished up 1.38% for the year and only got into the black when we include the dividends. The Dow Jones Industrials were down over 2% for the year. We have collected our dividends on many positions, and that is always helpful as it's real money. However, for the most part, capital gains were hard to come by. The strong dollar was a substantial headwind as the big multinational companies experienced negative currency adjustments to their earnings. We also started the year with a fairly expensive market, and it stayed high most of the year. We had a sharp correction in August and September which I discussed at that time. The market recovered from that and ended the year close to where it started.

Things were not much better in bonds as the Barclays Aggregate Index, which tracks investment grade bonds with a large tilt toward US Government paper, finished up at 0.55%. Some of our managed bond funds were up and others were down. The world bond category suffered as the rising dollar was just too much for them in 2015. However, it's a good time to note that many of the writers and the experts that you saw on TV early in the year predicted that you would be "wiped out", in so many words, if you held on to your bond positions. This was certainly not the case and it's not likely to be the case this year either. Bonds play many roles in your portfolio, but one of the most important is to dampen the volatility of the stock market. There are very few investors out there who can live with the large price swings that can come with a portfolio of all stocks. It's important to stay diversified if we want to be successful in investing.

The economy was running at a +2.2% pace thru the end of the third quarter. Things seemed to be moving pretty good, but now the forecasts for the fourth quarter have come down, apparently due to inventories and exports. This is not a total surprise as the manufacturing sector has been struggling all year and has turned negative the last two months. We are also very familiar with the situation in the energy patch, and I've talked about it a lot this year. Right now there seems to be no end in sight to that

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story. Saudi Arabia has made it clear that they do not intend to back down. They are currently running a budget deficit and are planning spending cuts to help control the situation. They may even sell shares in their state owned oil company to raise money. You read forecasts every day, but no one really knows how long this will go on, or how low the price of oil will go. Ed Morse of Citigroup says that the oversupply is only 2% of the total market of 95 million barrels per day. It would only take a small change for the market to balance. Boone Pickens is saying the same thing. The relevance to us right now is the huge cutbacks in the energy industry are definitely being felt, and we know the earnings and the stock prices in that sector are way down. Over 35 North American energy producers have filed for bankruptcy this year, and there will likely be more in 2016. When things finally stabilize, I expect it to be a significant positive for the overall market.

Looking forward, all eyes are on the Fed. In a way it's unfortunate that this is what things have come to. We have become totally dependent on every word that comes out of the Fed. Now that we finally have the first interest rate increase behind us, what happens next? According to the Fed dot plots, they expect to raise rates as many as four times in 2016. The market is already discounting this by a wide margin with many players looking for one, or at the most, two increases. Everything will depend on the actual performance of the economy. The Fed insists that they are "data dependent" and it's true. They have their PhD's and their economic forecasts, but they don't know the future. They make their judgments and decisions by weighing the information at hand, as we all do. If the US economy continues to advance, I think we will see at least one or two rate increases. I welcome this as it's important to get away from the "zero bound", if possible. Things are not that strong, so it's hard to see rates rising a lot. There's a little more room for short rates to go up before longer term rates will begin to move. If longer rates start to go up, you begin to impact the mortgage market. At that point we really confront reality. It's taken a lot of work to get things going in housing again. If the Fed sees that rates are slowing the sale of homes, they will likely be forced to pause or back down. I don't think they will risk a slowdown in that sector of the economy.

Although we have seen a lot of selling in the first days of 2016, we plan to stick with our strategies. Most of the data in the US is still solid. I'm expecting the recovery to continue at the same slow pace we've seen in recent years. We live in difficult times and nothing seems to come easy these days. I'm convinced that long term investors with properly diversified portfolios can still expect to see decent results over time. Please feel free to contact me anytime to discuss your portfolio.

Best Regards,

David E Keim

Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past Performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index.

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The Barclays Capital Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Barclays Capital government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities.

The S&P 500 is a broad –based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks.

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