



# COMMENCEMENT FINANCIAL PLANNING LLC

Q3

Quarterly Market Review

Third Quarter 2015

# Quarterly Market Review

Third Quarter 2015

This report features world capital market performance and a timeline of events for the past quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios and features quarterly topics.

## Overview:

Market Summary

World Stock Market Performance

World Asset Classes

US Stocks

International Developed Stocks

Emerging Markets Stocks

Select Country Performance

Real Estate Investment Trusts (REITs)

Fixed Income

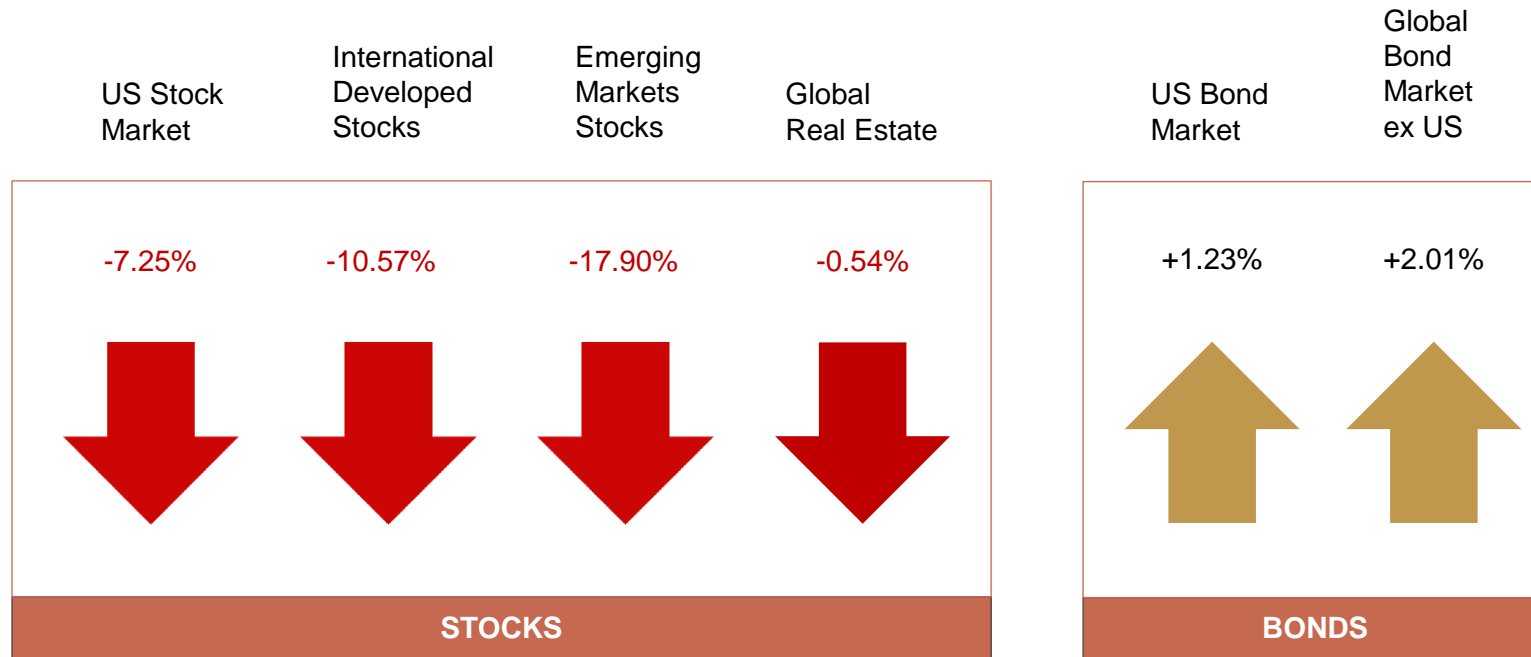
Global Diversification

## Quarterly Topics:

- Diversification Can Make a Difference
- Unhealthy Attachments
- Should Investors Sell after a “Correction”?

# Market Summary

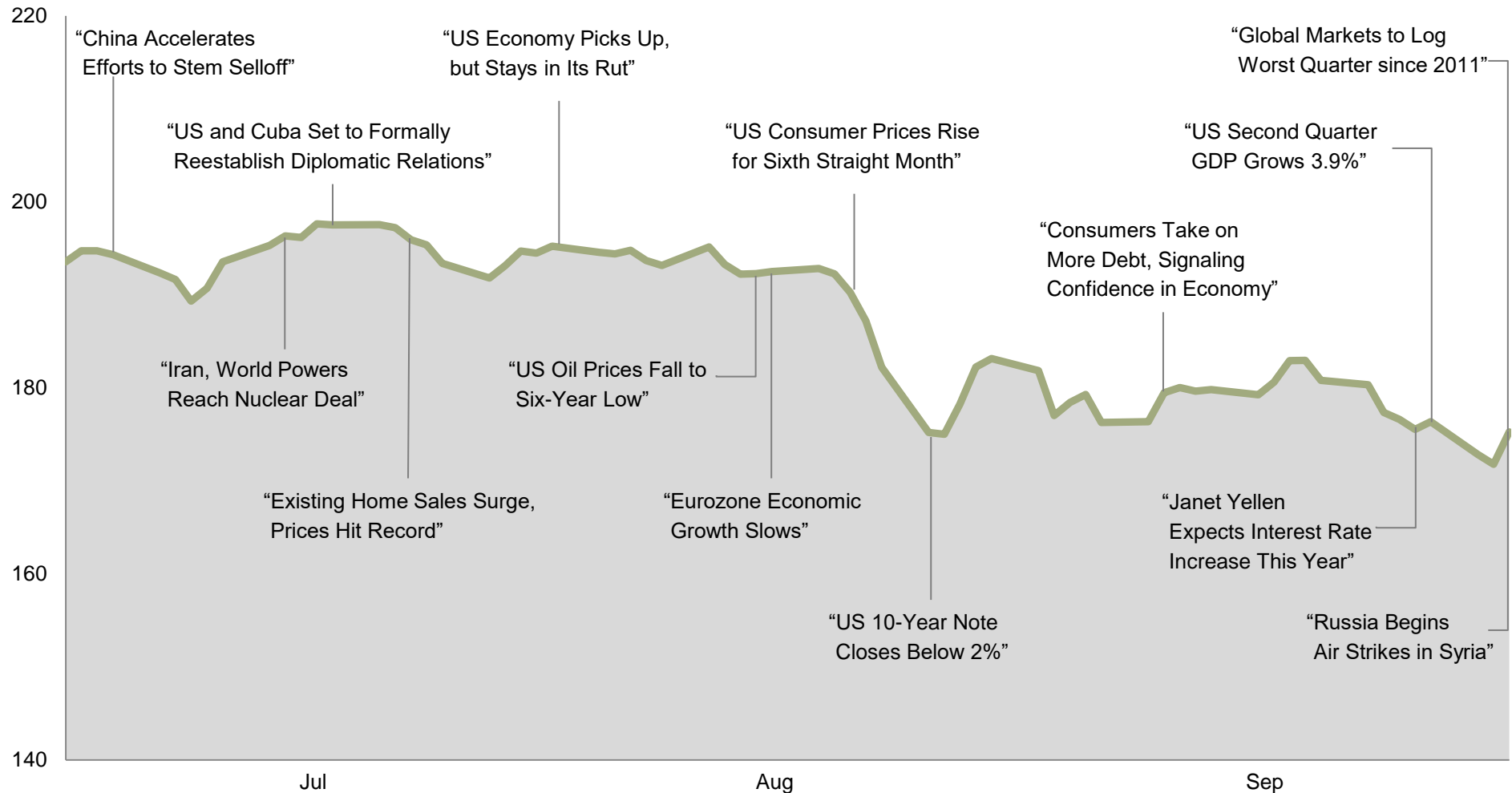
Third Quarter 2015 Index Returns



**Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citigroup WGBI ex USA 1-30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Russell data © Russell Investment Group 1995-2015, all rights reserved. MSCI data © MSCI 2015, all rights reserved. Barclays data provided by Barclays Bank PLC. Citigroup bond indices © 2014 by Citigroup.

# World Stock Market Performance

MSCI All Country World Index with selected headlines from Q3 2015



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index. MSCI data © MSCI 2015, all rights reserved.

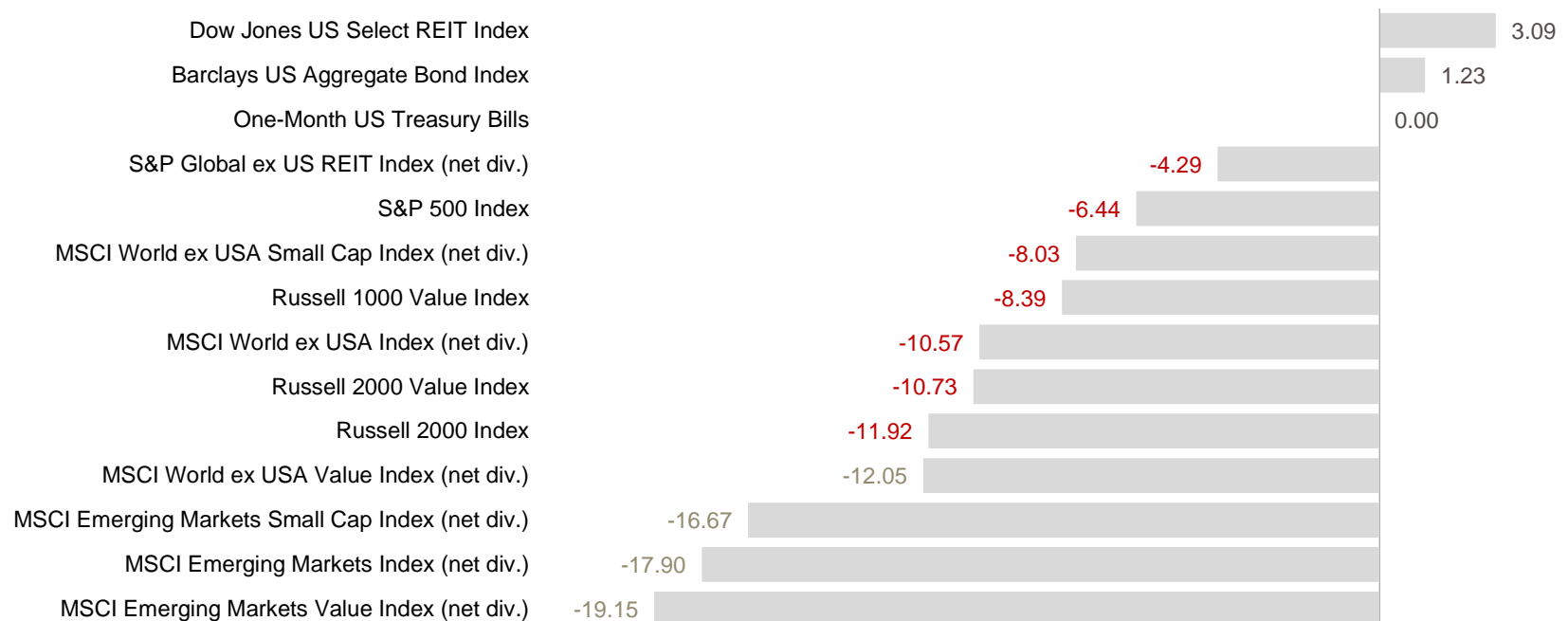
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

# World Asset Classes

## Third Quarter 2015 Index Returns

Looking at broad market indices, the US equity market outperformed both developed ex US and emerging markets during the third quarter. US REITs recorded the highest returns, outperforming equity markets.

The value effect was negative in the US, developed ex US, and emerging markets. Small caps outperformed large caps in the non-US and emerging markets but underperformed in the US. The US dollar appreciated against most currencies.



# US Stocks

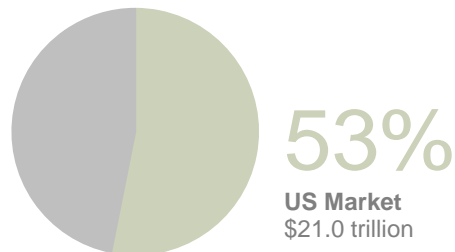
## Third Quarter 2015 Index Returns

The US equity market recorded negative performance for the third quarter.

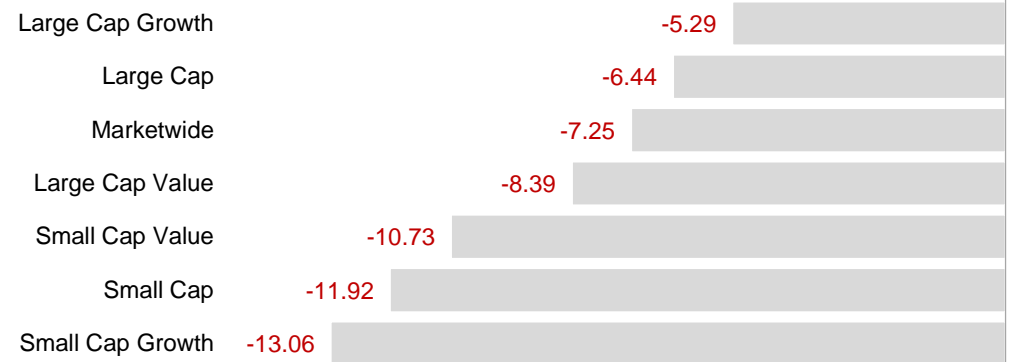
Small caps underperformed large caps.

Value stocks underperformed growth stocks among marketwide indices. However, in small caps, the effect was reversed with small cap value outperforming small cap growth.

### World Market Capitalization—US



### Ranked Returns for the Quarter (%)



### Period Returns (%)

Asset Class	YTD	1 Year	* Annualized		
			3 Years*	5 Years*	10 Years*
Marketwide	-5.45	-0.05	12.53	13.28	6.92
Large Cap	-5.29	-0.61	12.40	13.34	6.80
Large Cap Value	-8.96	-4.42	11.59	12.29	5.71
Large Cap Growth	-1.54	3.17	13.61	14.47	8.09
Small Cap	-7.73	1.25	11.02	11.73	6.55
Small Cap Value	-10.06	-1.60	9.18	10.17	5.35
Small Cap Growth	-5.47	4.04	12.85	13.26	7.67

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (S&P 500 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. Russell 3000 Index is used as the proxy for the US market. Russell data © Russell Investment Group 1995–2015, all rights reserved. The S&P data are provided by Standard & Poor's Index Services Group.

# International Developed Stocks

## Third Quarter 2015 Index Returns

Developed markets outside the US underperformed the US equity market but outperformed emerging markets indices in US dollar terms.

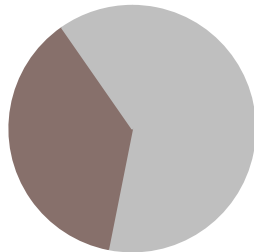
Small caps outperformed large caps.

Value underperformed growth indices across all size ranges.

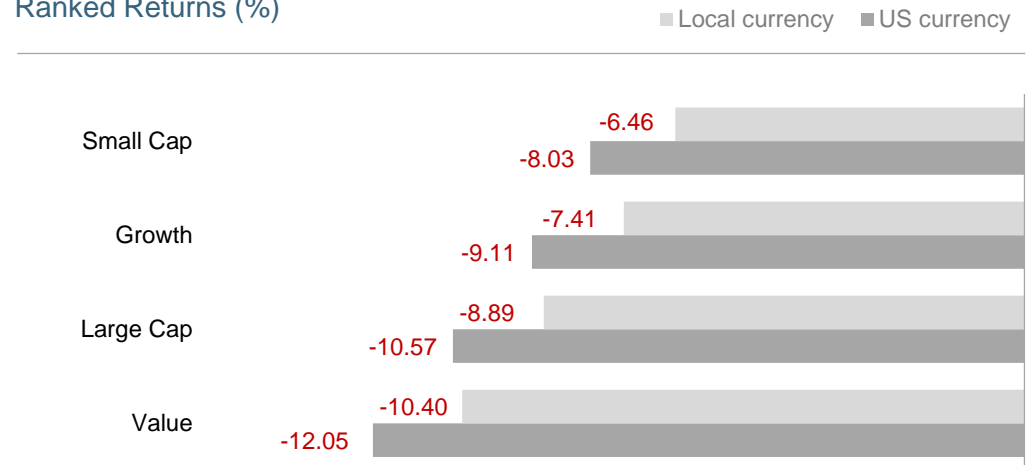
### World Market Capitalization—International Developed

# 37%

International  
Developed  
Market  
\$14.7 trillion



### Ranked Returns (%)



### Period Returns (%)

Asset Class	YTD	1 Year	* Annualized		
			3 Years*	5 Years*	10 Years*
Large Cap	-6.69	-10.14	4.60	3.42	2.92
Small Cap	-0.34	-3.71	7.48	5.74	4.23
Value	-9.65	-14.32	3.56	2.61	2.12
Growth	-3.75	-5.88	5.59	4.18	3.65

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Large Cap (MSCI World ex USA Index), Small Cap (MSCI World ex USA Small Cap Index), Value (MSCI World ex USA Value Index), and Growth (MSCI World ex USA Growth). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI World ex USA IMI Index used as the proxy for the International Developed market. MSCI data © MSCI 2015, all rights reserved.

# Emerging Markets Stocks

## Third Quarter 2015 Index Returns

Emerging markets indices underperformed developed markets indices (including the US) in US dollar terms during the third quarter.

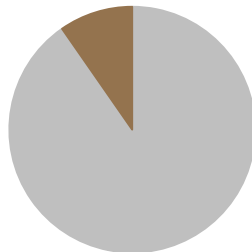
Small cap indices outperformed large cap indices.

Value underperformed growth indices across all size ranges.

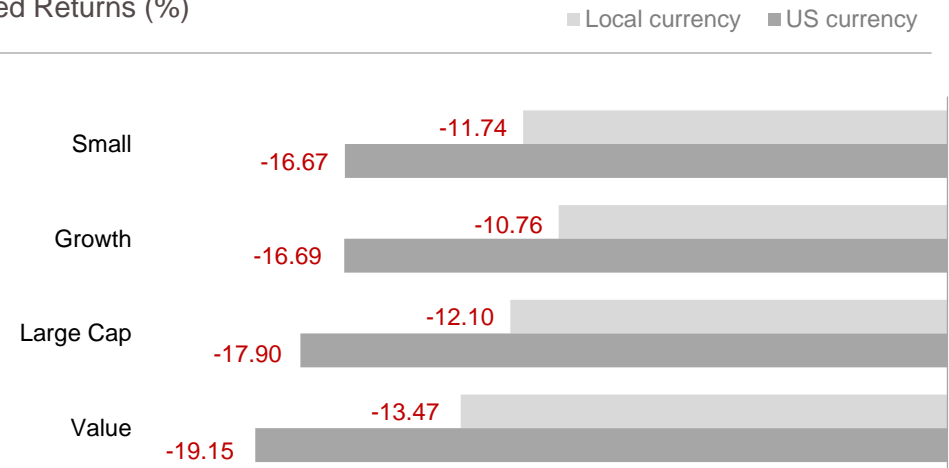
### World Market Capitalization—Emerging Markets

# 10%

Emerging Markets  
\$3.8 trillion



### Ranked Returns (%)



### Period Returns (%)

Asset Class	YTD	1 Year	* Annualized		
			3 Years*	5 Years*	10 Years*
Large Cap	-15.48	-19.28	-5.27	-3.58	4.27
Small Cap	-9.80	-15.23	-1.09	-2.43	6.72
Value	-17.38	-22.70	-7.66	-5.09	4.12
Growth	-13.63	-15.89	-2.95	-2.12	4.35

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), and Growth (MSCI Emerging Markets Growth Index). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI Emerging Markets IMI Index used as the proxy for the emerging market portion of the market. MSCI data © MSCI 2015, all rights reserved.

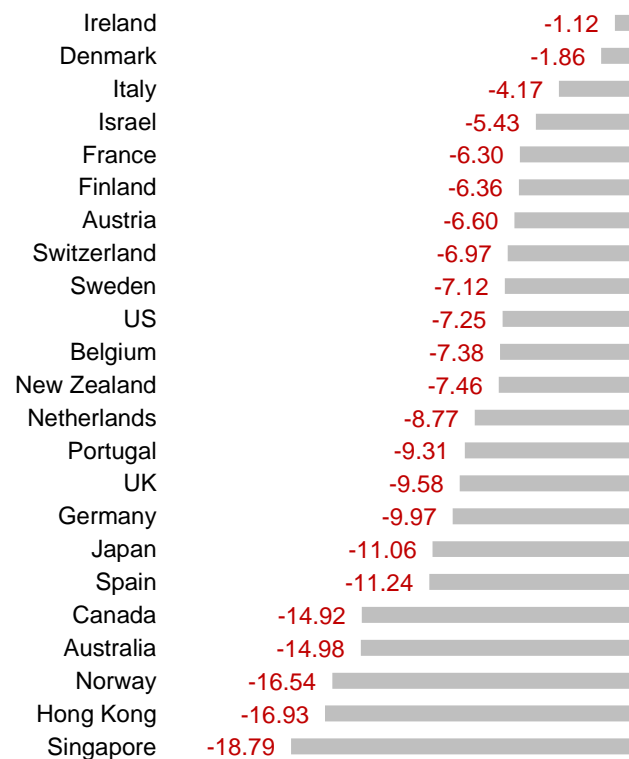


# Select Country Performance

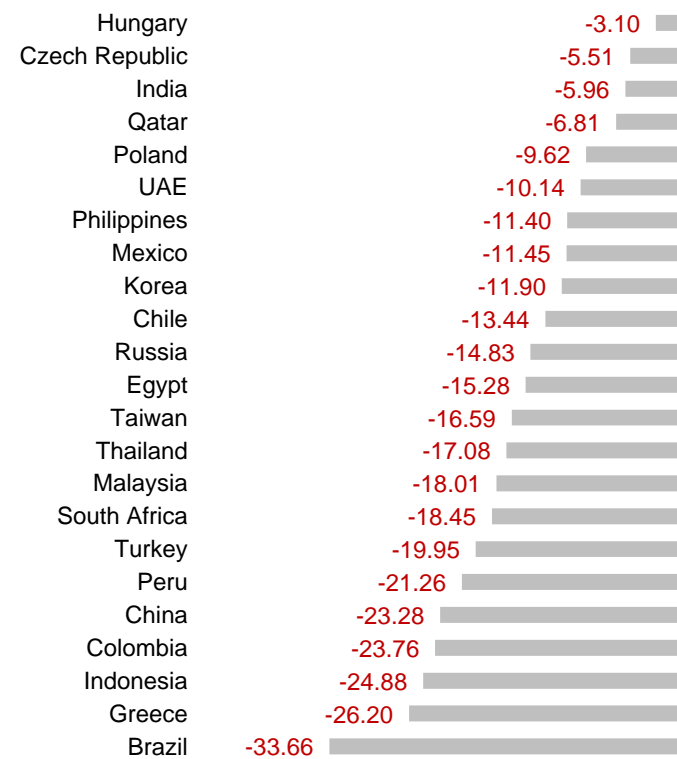
## Third Quarter 2015 Index Returns

Ireland again recorded the highest country performance in developed markets and Singapore and Hong Kong the lowest for the third quarter. In emerging markets, Hungary and the Czech Republic posted the highest returns, while China's equity performance dominated news headlines as its market recorded one of the lowest country returns.

### Ranked Developed Markets Returns (%)



### Ranked Emerging Markets Returns (%)



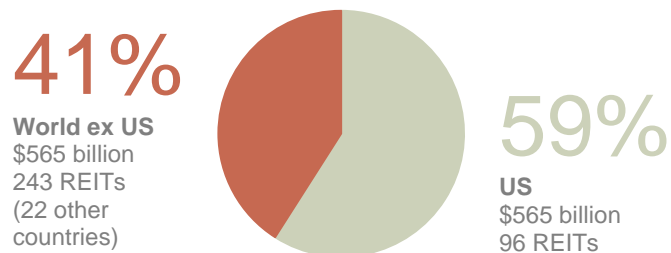
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Country performance based on respective indices in the MSCI World ex US IMI Index (for developed markets), Russell 3000 Index (for US), and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends. MSCI data © MSCI 2015, all rights reserved. Russell data © Russell Investment Group 1995–2015, all rights reserved. UAE and Qatar have been reclassified as emerging markets by MSCI, effective May 2014.

# Real Estate Investment Trusts (REITs)

## Third Quarter 2015 Index Returns

US REITs were one of the best-performing asset classes during the third quarter, outperforming equities. Although REITs outside the US produced negative absolute returns, global REITs outside the US outperformed broad market equity indices.

### Total Value of REIT Stocks



### Ranked Returns (%)



### Period Returns (%)

Asset Class	YTD	1 Year	* Annualized		
			3 Years*	5 Years*	10 Years*
US REITs	-2.84	11.82	9.92	12.31	6.69
Global REITs (ex US)	-5.30	-2.47	4.53	6.64	3.11

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.

Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's Index Services Group © 2014.

# Fixed Income

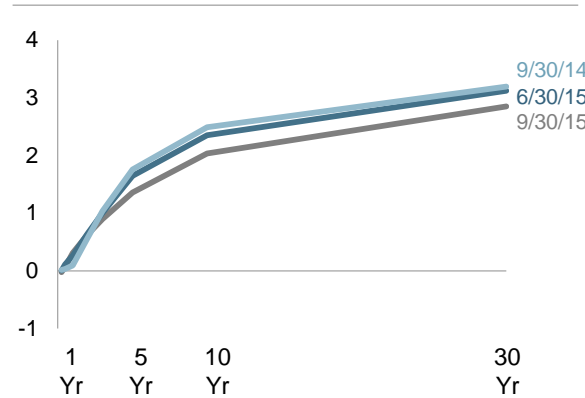
## Third Quarter 2015 Index Returns

Interest rates across the US fixed income markets generally decreased during the third quarter. The yield on the 5-year Treasury note dropped 25 basis points to end the period at 1.38%. The yield on the 10-year Treasury note decreased 27 basis points to end the quarter at 2.06%. The 30-year Treasury bond fell 22 basis points to finish with a yield of 2.88%. Yields on the short end of the curve were relatively unchanged.

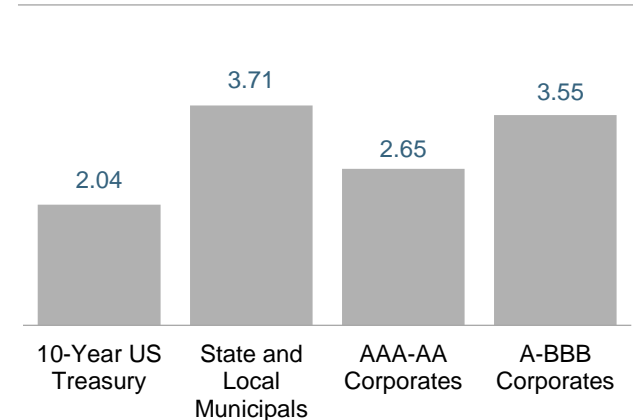
Short-term corporate bonds returned 0.30%, while intermediate-term corporate bonds returned 0.71%.

Short-term municipal bonds returned 0.74%, while intermediate-term municipal bonds returned 1.68%. Municipal general obligation and revenue bonds experienced similar returns.

### US Treasury Yield Curve



### Bond Yields across Issuers



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	* Annualized	
				5 Years*	10 Years*
BofA Merrill Lynch Three-Month US Treasury Bill Index	0.02	0.02	0.06	0.08	1.33
BofA Merrill Lynch 1-Year US Treasury Note Index	0.32	0.25	0.27	0.33	1.88
Citigroup WGBI 1-5 Years (hedged to USD)	1.09	1.57	1.34	1.50	2.97
Barclays Long US Government Bond Index	0.22	8.62	2.78	6.18	6.92
Barclays US Aggregate Bond Index	1.13	2.94	1.71	3.10	4.64
Barclays US Corporate High Yield Index	-2.45	-3.43	3.51	6.15	7.25
Barclays Municipal Bond Index	1.77	3.16	2.88	4.14	4.64
Barclays US TIPS Index	-0.80	-0.83	-1.83	2.55	4.02

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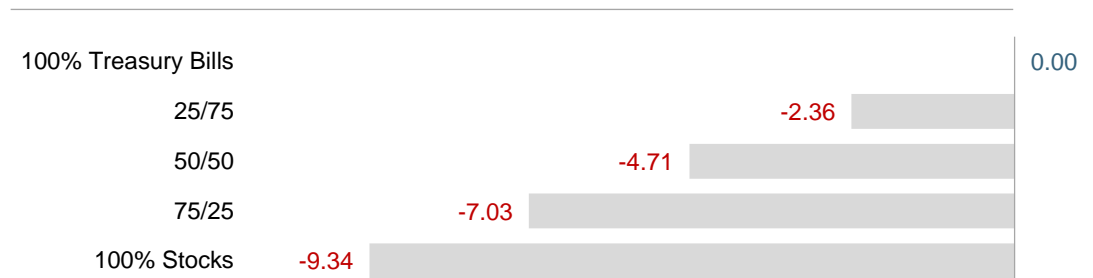
# Global Diversification

## Third Quarter 2015 Index Returns

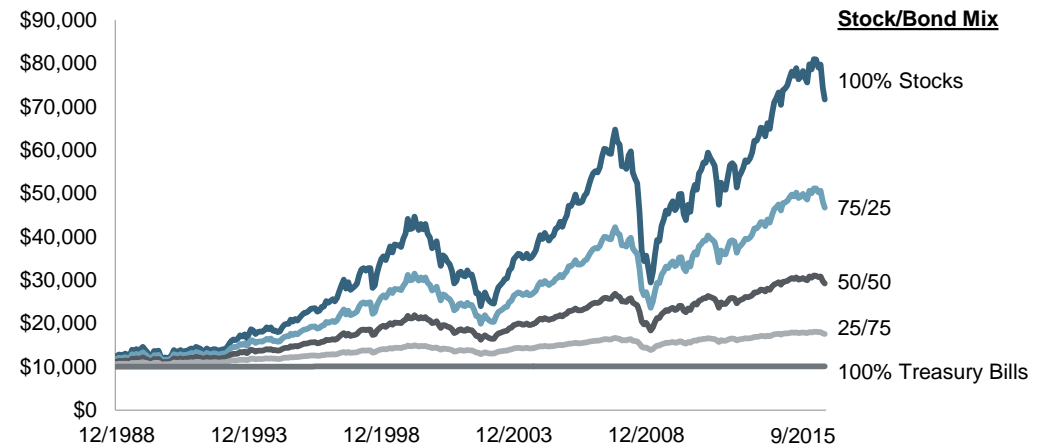
These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Period Returns (%)		* Annualized				
Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	
100% Stocks	-6.65	-6.16	7.52	7.39	5.14	
75/25	-4.93	-4.55	5.69	5.67	4.12	
50/50	-3.24	-2.98	3.82	3.85	2.92	
25/75	-1.60	-1.47	1.93	1.96	1.54	
100% Treasury Bills	0.00	0.00	0.00	0.00	0.01	

### Ranked Returns (%)



### Growth of Wealth: The Relationship between Risk and Return



Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio.** Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2015, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

# Diversification Can Make A Difference

Third Quarter 2015

**A portfolio allocated differently than the S&P500 will behave differently than the S&P500; sometimes by a lot.**

Every few years the S&P500 outperforms all most or all other major asset classes. During these periods we'll see articles such as [this](#) and [this](#) supporting 100% S&P500 as the stock component of portfolios. At other times you'll see articles like [this](#) that will have you believing stock investing might not be worth it based solely on how the S&P500 (or worse, the Dow) has performed even though [other asset classes](#) may have performed well over the same time period.

In the investment world I admire no one more than I admire Warren Buffett and John Bogle, but I believe their level of wealth provides them with the luxury of being able to ride out a decade or more of subpar S&P500 returns. Most of us simply do not have that luxury.

As an example<sup>1</sup>, let's look at what would have happened to three hypothetical retirees; each having portfolios worth \$2.1 million at retirement, but each retires in different years: beginning of 1998, 2000, & 2002. Let's further assume that each retiree withdraws \$100,000 from their portfolio at the beginning of each year. For simplicity we will ignore taxes, fees, and transaction costs.

If each of the retirees' portfolios were invested 100% in the S&P500, the following hypothetical balances would have resulted on December 31, 2014:

	Hypothetical December 31, 2014 Balance	
1998 Retiree	\$	2,598,089
2000 Retiree		935,065
2002 Retiree		2,301,685

The first thing that should jump out is the big wealth gap between the 2000 Retiree and the other two. What's not apparent is that the low point for each hypothetical portfolio was in 2008.; the lowest being \$776,988 for the 2000 Retiree.

Now, keeping the assumptions above, let's instead assume that each Retiree portfolio was invested: 25% S&P500, 25% Dimensional US Small Cap Value, 25% MSCI EAFE (Foreign Developed Markets), and 25% Barclays US Aggregate Bond. Let's further assume that each portfolio is rebalanced back to 25/25/25/25 at the end of each year. In this case, the following hypothetical balances would have resulted on December 31, 2014:

	Hypothetical December 31, 2014 Balance	
1998 Retiree	\$	4,118,208
2000 Retiree		3,089,947
2002 Retiree		3,493,362

The first thing you may notice is the higher balances overall, but perhaps more importantly, there isn't as great of disparity across the three retirees. I find this important because we won't know which retiree we'd be beforehand, so we should appropriately diversify across markets. Also, each of the portfolios saw their low points in 2002; and all were at the highest in 2014. As investors, this is the sort of result we'd hope for over time.

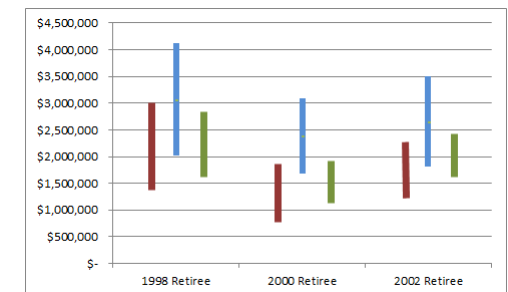
Finally, to get a more "apples-to-apples", we should examine a hypothetical portfolio of 75% S&P500 and 25% Barclays US Aggregate Bond; rebalanced back to 75/25 at the end of each year. In this case, the following hypothetical balances would have resulted on December 31, 2014:

Hypothetical  
December 31, 2014  
Balance

1998 Retiree	\$	2,885,686
2000 Retiree		1,540,007
2002 Retiree		2,484,057

You'll notice better results than the 100% S&P500 portfolios, but there's still great disparity. Further, though two investors had their highest portfolio values in 2014, the 2000 Retiree saw his highest balance in 2000. That investor would likely not be encouraged by this.

Finally, the chart below reflects the range of results for each hypothetical Retiree portfolio. The 'red' lines represent the 100% S&P500 Retiree portfolios, the 'blue' the 25/25/25/25, and the 'green' the 75/25.



At the time of this writing, roughly 48% of the world's stock available for public investment exists outside the United States. Diversifying into those markets as well as into "factors" with higher expected return can help when US Large Cap stocks underperform, especially over long periods of time.

*"Diversification is Your Buddy" ~ Nobel Laureate Merton Miller*

<sup>1</sup> Source of return data: DFA Matrix Book 2015. Actual investor results would have been different due to taxes, management fees, transaction fees, etc. Diversification does not eliminate the risk of market loss. There is no guarantee investing strategies will be successful. Past performance is no guarantee of future results. All expressions of opinion are subject to change. This article is distributed for informational purposes, and it is not to be construed as an offer, solicitation, recommendation, or endorsement of any particular security, products, or services. Commencement Financial Planning LLC is a Registered Investment Advisor registered with the Securities and Exchange Commission and the State of Washington.

# Unhealthy Attachments

Third Quarter 2015

**Have you ever made yourself suffer through a bad movie because, having paid for the ticket, you felt you had to get your money's worth?**

Some people treat investment the same way.

Behavioral economists have a name for this tendency of people and organizations to stick with a losing strategy purely on the basis that they have put so much time and money into it already. It's called the "sunk cost fallacy."

Let's say a couple buy a property next to a freeway, believing that planting trees and double-glazing will block out the noise. Thousands of dollars later the place is still unlivable, but they won't sell because "that would be a waste of money".

This is an example of a sunk cost. Despite the strong likelihood that you'll never get your money back, regardless of outcomes, you are reluctant to cut your losses and sell because that would involve an admission of defeat.

It works like this in the equity market too. People will often speculate on a particular stock on the basis of newspaper articles about prospects for the company or industry. When those forecasts don't come to pass, they hold on regardless.

It might be a mining stock that is hyped based on bullish projections for a new tenement. Later, when it becomes clear the prospect is not what its promoters claimed,

some investors will still hold on, based on the erroneous view that they can make their money back.

The motivations behind the sunk cost fallacy are understandable. We want our investments to do well and we don't want to believe our efforts have been in vain. But there are ways of dealing with this challenge. Here are seven simple rules:

1. Accept that not every investment will be a winner. Stocks rise and fall based on news and on the markets' collective view of their prospects. That there is risk around outcomes is why there is the prospect of a return.
2. While risk and return are related, not every risk is worth taking. Taking big bets on individual stocks or industries leaves you open to idiosyncratic influences like changing technology.
3. Diversification can help wash away these individual influences. Over time, we know there is a capital market rate of return. But it is not divided equally among stocks or uniformly across time. So spread your risk.
4. Understand how markets work. If you hear on the news about the great prospects for a particular company or sector, the chances are the market already knows that and has priced the security accordingly.
5. Look to the future, not to the past. The financial news is interesting, but it is about what has already

happened and there is nothing much you can do about that. Investment is about what happens next.

6. Don't fall in love with your investments. People often go wrong by sinking emotional capital into a losing stock that they just can't let go. It's easier to maintain discipline if you maintain a little distance from your portfolio.
7. Rebalance regularly. This is another way of staying disciplined. If the equity part of your portfolio has risen in value, you might sell down the winners and put the money into bonds to maintain your desired allocation.

These are simple rules. But they are all practical ways of taking your ego out of the investment process and avoiding the sunk cost fallacy.

There is no single perfect portfolio, by the way. There are in fact an infinite number of possibilities, but based on the needs and risk profile of each individual, not on "hot tips" or the views of high-profile financial commentators.

This approach may not be as interesting. But by keeping an emotional distance between yourself and your portfolio, you can avoid some unhealthy attachments.

# Should Investors Sell After a "Correction"?

Third Quarter 2015

Stock prices in markets around the world fluctuated dramatically for the week ended August 27. On Monday, August 24, the Dow Jones Industrial Average fell 1,089 points—

a larger loss than the “Flash Crash” in May 2010—before rallying to close down 588. Prices fell further on Tuesday before recovering sharply on Wednesday, Thursday, and Friday. Although the S&P 500 and Dow Jones Industrial Average rose 0.9% and 1.1%, respectively, for the week, many investors found the dramatic day-to-day fluctuations unsettling.

Based on closing prices, the S&P 500 Index declined 12.35% from its record high of 2130.82 on May 21 through August 24. Financial professionals generally describe any decline of 10% or more from a previous peak as a “correction,” although it is unclear what investors should do with this information. Should they seek to protect themselves from further declines by selling, or should they consider it an opportunity to purchase stocks at more favorable prices?

Based on S&P 500 data, stock prices have declined 10% or more on 28 occasions between January 1926 and June 2015. Obviously, every decline of 20% or 30% or 40% began with a decline of 10%. As a result, some investors believe that avoiding large losses can

be accomplished easily by eliminating equity exposure entirely once the 10% threshold has been breached.

Market timing is a seductive strategy. If we could sell stocks prior to a substantial decline and hold cash instead, our long-run returns could be exponentially higher. But successful market timing is a two-step process: determining when to sell stocks and when to buy them back. Avoiding short-term losses runs the risk of avoiding even larger long-term gains. Regardless of whether stock prices have advanced 10% or declined 10% from a previous level, they always reflect (1) the collective assessment of the future by millions of market participants and (2) the expectation that equities in both the US and markets around the world have positive expected returns.

Our research shows that US stocks have typically delivered above-average returns over one, three, and five years following consecutive negative return days resulting in a 10% or more decline. Results from non-US markets are similar.

Contrary to the beliefs of some investors, dramatic changes in security prices are not a sign that the financial system is broken but rather what we would expect to see if markets

are working properly.

The world is an uncertain place. The role of securities markets is to reflect new developments—both positive and negative—in security prices as quickly as possible. Investors who accept dramatic price fluctuations as a characteristic of liquid markets may have a distinct advantage over those who are easily frightened or confused by day-to-day events and may be more likely to achieve long-run investing success.

## References

“Wild Ride Leaves Investors Grasping,” Wall Street Journal, August 25, 2015.

“Investors Scramble as Stocks Swing,” Wall Street Journal, August 25, 2015.