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HC FINANCIAL ADVISORS, INC.
2015 Stock Market Review and Outlook for 2016

Although the fourth quarter was relatively strong and helped offset a very poor third quarter, 2015 proved to be a challenging year for investors. Many asset classes were down on the year, and others provided such a minimal return that they were negative on a "real" or inflation adjusted basis. Commodities were the big losers as the Bloomberg Commodity index closed down 25% for the year, highlighted by weakness in energy markets. Other commodities also participated in the rout, with gold down 10% and industrial metals falling the most since 2008. Emerging markets were another very weak area, losing close to 15% for the year as a whole. Yet there were wide disparities between individual countries within this index, leading to a wide range of returns.

The S&P 500 was slightly positive for the year if we include dividends; however, most stocks in the index were down. Without contributions from a handful of stocks that are heavily weighted in the index, the S&P 500 would have closed the year in negative territory. This also helped explain the large disparity between growth and value stocks as the large-cap Russell 1000 Growth index returned a positive 5.7% for the year, versus a negative return of 3.8% for the Russell 1000 Value index, as growth outperformed value by 9.5%. Other stocks, including smaller U.S. companies and international equities, finished the year in negative territory after several years of strong performance.

The Federal Reserve finally raised interest rates, putting pressure on bond markets during the quarter. Most bond indexes were negative for the fourth quarter, depressing full year returns for investment grade bonds. Municipal bonds were an exception, posting good returns as supply and demand fundamentals outweighed the headwind from rising rates. This held true even in the high yield municipal bond market which also posted positive returns in the 1.8% range for the quarter and full year. High yield corporate bonds on the other hand priced in the possibility of a recession, lifting yields to the 9% range and pushing overall returns down 5%.

Major Stock & Bond Indexes (Total Return)			*Lipper Mutual Fund Peer Averages (Total Return)*		
	4Q15	2015		4Q15	2015
S&P 500 Index	7.0%	1.4%	Large-Cap Core Funds	6.0%	-0.6%
Dow Jones Industrial	7.7%	0.2%	Large-Cap Growth Funds	7.5%	5.3%
Russell Midcap Index	3.6%	-2.4%	Large-Cap Value Funds	4.9%	-4.2%
Russell 2000	3.6%	-4.4%	Mid-Cap Core Funds	2.4%	-4.3%
MSCI EAFE (USD Gross)	4.8%	-0.4%	Small-Cap Core Funds	2.5%	-5.1%
MSCI EM (USD Gross)	0.7%	-14.9%	International Large-Cap Core	2.9%	-3.4%
NAREIT U.S. Real Estate Ind.	7.7%	2.8%	Emerging Markets	0.5%	-14.1%
Barclays US Agg. Bond (3-5yr)	-0.7%	1.6%	Core Bond	-0.6%	-0.1%
Bloomberg Commodity	-10.5%	-24.7%	High Yield	-1.9%	-4.1%

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FINANCIAL MARKETS:

U.S. stocks as defined by the most commonly used benchmark, the S&P 500, finished 2015 in slightly positive territory. However, this is not what most stock market investors experienced. In this case, the headline return number did not accurately portray the underlying health of the stock market. Stock market technicians use a term called "breadth" of the market to define the overall direction of the market. Breadth is the ratio of advancing stocks to declining stocks and gives insight into the true health of a stock market. For the full year 2015, roughly 40% of stocks included in the S&P 500 were up, compared to 60% of the stocks finishing the year down. Digging deeper shows that five very large companies comprising close to 10% of the index i.e., Microsoft, General Electric, Facebook, Google/Alphabet, and Amazon, were up 21%, 23%, 36%, 48%, and 122% respectively. These five stocks added over 4% to the total return of the S&P, without which, the index would have closed down about 2.5% for the year. Unless an investor owned at least a few of these, results were quite disappointing. While the devaluation in China may have prompted some of the decline in stock prices, full year results were more likely a result of disappointing revenue growth and falling earnings.

Bond markets were equally challenged in the face of rising interest rates and concerns over credit quality. The one standout was municipal bonds which posted a good year on increased demand by individuals facing higher taxes as well as reduced supply as municipalities watched their budgets. Although U.S. Treasury bonds and some very high quality corporate bonds did feel some pressure from rising interest rates, they still finished the year in positive territory as most of the pressure from a rising Fed funds rate was felt in very short-term instruments. The damage to bonds was done from the most credit sensitive segments of the market. Credit risk, or the risk that the bond issuer fails to pay interest or principal, is measured by the excess premium in the interest rate paid over a Treasury bond that has no credit risk. When the economic outlook is good, this premium is very small. At the end of 2013, investors were demanding a little more than 3% to hold the riskiest of debt, known as non-investment grade bonds or junk bonds. Today, that premium also called "the spread", is over 5%, bringing high yield bonds to an average annual yield over 9%. This increased spread indicates that bond market investors are expecting a recession in the near future and are requiring greater compensation for the added credit risk since bond defaults increase during a recession. The current premium between Treasury and high yield bonds is the highest it has ever been outside of a recession.

THE U.S. ECONOMY:

Although economic growth was sluggish, the U.S. economy continued to create jobs at a steady clip, reducing the unemployment rate to 5.0% by November's end. Reports of strong job creation gave the Fed sufficient confidence to raise interest rates, despite weaker readings in other parts of the economy. However, several economic headwinds persisted throughout the year. Strength in the U.S. dollar against major trading partners raised the price of U.S. exports to foreign buyers, impeding U.S. economic growth. Additionally, falling oil prices reduced profits and employment in the growing domestic energy industry and the expected bounce to consumer spending never fully materialized.

We enter 2016 with more uncertainty over economic growth than we have seen in several years. Continued strength in the dollar would be a major drag on growth and could potentially tilt us into negative territory. Another area of concern is employment growth. Growing the workforce and improving productivity, along with capital investment by

businesses, are the ingredients for growth. With unemployment down to 5.0%, there are limited opportunities for growth in the workforce. Typically, the Fed would start raising rates at a much higher unemployment rate, thus slowing the drive to full employment and extending the business cycle. At the current trajectory, we should reach unemployment in the low 4% range (typically considered full employment) sometime in 2016. Although there are a number of new developments that may improve worker productivity in the future, it will be more difficult to surpass the advances in computer and internet technology we have experienced over the past two decades. This means research and development spending will not have the same dramatic impact as in the past. Without growth in the workforce, it is more difficult to see economic expansion much beyond 2016.

Labor force participation is at multi year lows and could help add to the workforce; however, it is not clear how many non-participants have the ability or desire to rejoin the workforce. Before the financial crisis in 2008, labor force participation was 66.0% and has now fallen to 62.5% as of the latest November 2015 measurement. With about 2% of this drop due to retirement and another 1% due to disability, this leaves only about 1% available to rejoin the workforce if they can attain the requisite skills.

BOND LIQUIDITY:

Liquidity risks in the bond market received a lot of press during the fourth quarter. Liquidity for investors is the ability to quickly buy or sell an asset at a fair price. In the wake of the financial crisis, a number of new regulations were enacted to help ensure the safety of banks by limiting their ability to increase leverage and participate in other business activities. One of these regulations is known as the “Volker Rule” named after former Fed Chairman Paul Volker who proposed the rule. This rule prohibits banks from conducting certain investment activities in their own accounts; known as proprietary trading, this trading allowed banks to trade with their own capital to earn a profit. With the Volker Rule in place and the elimination of proprietary trading, this rule also eliminated the market making activities of banks that have traditionally held bonds in inventory in order to facilitate an orderly market. With a bank as a market maker, bond market participants had a place with readily available inventory to buy or sell bonds without substantially moving prices away from fair value. Without a market maker and this inventory in place, the bond seller now needs to find a buyer that wants to own the bond as an investment. This could be well below the current market value, especially in times of distressed markets.

We do believe that liquidity is a source of risk to bond markets and we have taken several measures to protect against this risk. Whenever possible we buy individual bonds and hold them to maturity. This allows us to lock in the return when the bond is purchased and eliminate the need to sell on the open market where prices can fluctuate. In the case of bond funds, the manager has several other avenues of liquidity that prevent the forced sale of less liquid bonds. One example is with bank loan funds where a line of credit is required and can be used to fund redemptions rather than the forced sale of loans. In the case of high yield funds, we like to see other high grade assets in the fund that can be sold to create redemptions as necessary. Liquidity risk for Treasury bonds is much lower as this is one of the most liquid markets in the world.

MARKET OUTLOOK:

One of the biggest factors for the continued health of the U.S. economy is the value of the dollar, a value that is very difficult to predict. Strength of the dollar in the early part of

2015 was responsible for much of the weakness in corporate revenue and profit growth for the year. Certainly companies in the technology, industrial, and consumer staples sectors felt a significant headwind from the strong dollar. Following an almost record rise from 2011 to March 2015, the value of the dollar seems to have stabilized against our major trading partners and many economists believe that the majority of the dollar's rise is now completed. This would bode well for U.S. multinational companies that sell goods globally and in foreign currencies.

With this increased economic uncertainty on the horizon, we became more defensive during the middle of 2015 and still feel this positioning is warranted. During the year, we significantly reduced exposure to more credit sensitive segments of the bond market, such as high yield corporate bonds and bank loans. Within stocks, we reduced exposure to sectors of the market that are more sensitive to global economic conditions, such as industrials and energy, and moved much of these funds into healthcare. We also reduced exposure in emerging market stocks. Despite strong employment numbers, there are still indications for concern. Earnings projections for S&P 500 companies fell by 12% for 2015 and by 15% for 2016. Moreover, an increasing number of companies have issued negative earnings guidance, meaning they are now expecting to earn less than originally forecasted. During the fourth quarter, 85 companies in the S&P 500 issued negative guidance compared to only 26 companies issuing positive guidance. Although some of this is related to weakness in the energy sector, we could be seeing early signs of wage growth that may surpass a company's ability to raise prices, thus putting pressure on corporate profits.

While we still agree with most economists who expect GDP growth in the United States to be somewhere in the 2% to 3% range, there is an increased risk of a downturn in the next 24 months. Under this low, but positive growth scenario, high yield bonds could be one of the best performing asset classes for 2016. Although quality bonds would continue to face pressure from rising interest rates, the difference between interest rates in high quality bonds and high yield bonds will narrow, bringing yields down and prices up. Most likely, U.S. stocks will show lackluster, but still positive returns in the single digit range as earnings begin to recover. There does appear to be more opportunity in international stocks as developed foreign markets, particularly in Europe, have lower valuations and are earlier in the economic cycle than the U.S.

COMMUNICATIONS FROM HC FINANCIAL ADVISORS, INC.

We are required by the SEC to offer a copy of our updated ADV Part 2 on an annual basis. By the end of April, we will send a summary of material changes to last year's filing. You may request a full copy of the ADV Part 2 at that time. The information in both Part 1 and Part 2 for the ADV is also available online at the SEC website, www.adviserinfo.sec.gov.

We want to meet with you at least once a year to review and update any changes in your goals and objectives, cash requirements or allocation targets. If we don't hear from you, we will be calling to schedule a meeting. We want you to understand the decisions we are making on your behalf and be comfortable with your asset allocation. Please call us with your questions or concerns.

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