In September, the Fed postponed raising interest rates, citing concerns with the economy, inflation, and worldwide market volatility. The central bank raised its benchmark rate by a quarter point in December—its first rate hike since 2006—and stated that it would continue on a gradual course of monetary tightening as long as inflation and economic growth allowed. The impact on the US financial markets was negligible, as rates had already begun to increase in anticipation of the move. Even as the US central bank began monetary tightening, most banking authorities across the globe were taking measures to ease their country's monetary policy in response to signs of an economic slowdown. The ECB implemented a major stimulus program throughout the year, and in December announced new quantitative easing measures along with Japan. More than 40 central banks across the globe eased monetary policy in 2015.

China's Rising Influence

Markets closely followed the news about China's declining economic growth and the severe downturn over the summer, when the Chinese equity market declined more than 40% from its peak. Attempts by the Chinese authorities to support stock prices and the Bank of China's surprise devaluation of the yuan raised questions about China's impact on the economies of trading partners. The events also pointed to the stresses the government faces in implementing additional free-market reforms and transitioning its economic model from heavy industry and exports to one based more on consumer spending.

2015 Investment Overview

Market Summary

In the US equity markets, most major indices logged negative performance, despite a strong rebound during Q4. For the year, the S&P 500 Index returned 1.38%; the Russell 3000 Index 0.48%; and the Russell 2000 Index –4.41%.

US market volatility, measured by the Chicago Board Options Exchange Market Volatility Index (VIX), declined steadily for the first half of 2015, but jumped to its highest level in six years in late August, following the US market decline. During Q4, the index dropped then rose again to close slightly higher for the year.

Non-US developed stock markets experienced mixed performance across almost all major indices (returns in

Major World Indices
As of December 31, 2015

Index	Three Months	One Year	Three Years*
US Equity Returns (%)			
Russell 3000 Index	6.27	0.48	14.74
Russell 2500 Index	3.28	–2.90	12.46
Russell 2000 Index	3.59	–4.41	11.65
Russell 2000 Value Index	2.88	–7.47	9.06
Russell 2000 Growth Index	4.32	–1.38	14.28
Russell 1000 Index	6.50	0.92	15.01
Russell 1000 Value Index	5.64	–3.83	13.08
Russell 1000 Growth Index	7.32	5.67	16.83
S&P 500 Index	7.04	1.38	15.13
Non-US Equity Returns (net div.) (%)			
MSCI World ex USA Small Cap	5.82	5.46	7.82
MSCI World ex USA	3.91	–3.04	3.93
MSCI World ex USA Value	2.17	–7.68	1.99
MSCI World ex USA Growth	5.61	1.65	5.83
MSCI Emerging Markets	0.66	–14.92	–6.76
MSCI Emerging Markets Small Cap	3.27	–6.85	–1.67
MSCI Emerging Markets Value	–1.45	–18.57	–9.50
Fixed Income Returns (%)			
BofA Merrill Lynch Three-Month US Treasury Bill	0.03	0.05	0.05
BofA Merrill Lynch 1-Year US Treasury Note	–0.17	0.15	0.20
Citigroup World Government Bond Index 1–3 Years (hedged)	–0.05	0.71	0.81
Barclays US Government Bond	–0.91	0.86	1.01
BofA Merrill Lynch 1–5 Year US Treasury and Agency	–0.65	0.97	0.68
Citigroup World Government Bond Index 1–5 Years (hedged)	–0.08	1.00	1.17
Barclays US TIPS	–0.64	–1.44	–2.27
Other Returns (%)			
Dow Jones US Select REIT	7.54	4.48	11.76
S&P Global ex US REIT (net div.)	1.86	–3.54	3.08
Bloomberg Commodity Total Return	–10.52	–24.66	–17.29

*Annualized

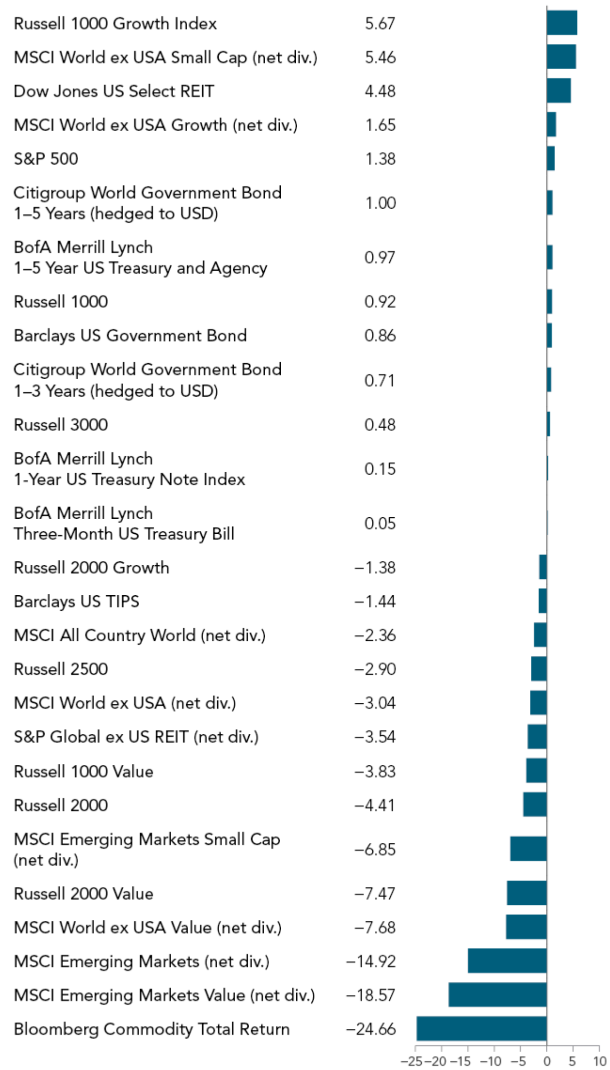
Past performance is not a guarantee of future results. In US dollars. Indices are not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.

USD, net dividends). The MSCI World ex USA Index, a benchmark for large cap stocks in developed markets outside the US, returned –3.04%. Small cap and value stock returns were mixed: The MSCI World ex USA Small Cap Index returned 5.46% and MSCI World ex USA Value Index returned –7.68%. The MSCI World ex USA Growth Index was positive at 1.65%. Emerging markets were among the worst global performers: The MSCI Emerging Markets Index returned –14.92%; the small cap subindex returned –6.85%; the value subindex returned –18.57%.

Among the equity markets tracked by MSCI, nearly half of the countries in the non-US developed markets index had negative total returns (in USD) and the range of returns was broad. The top three return countries were Denmark (23.43%), Ireland (16.49%), and Belgium (12.10%). Countries with the lowest returns were Canada (–24.16%), Singapore (–17.71%), and Spain (–15.64%).

In emerging markets, 21 of 23 countries tracked by MSCI logged negative total returns (in USD) and the dispersion of returns was broader than in the developed countries. Hungary (36.31%), Russia (4.21%), and India (–6.12%) were the top-performing countries in the index. The lowest returns in the index came from Greece (–61.33%), Colombia (–41.80%), and Brazil (–41.37%).
Returns of major fixed income indices were slightly positive. One-year US Treasury notes returned 0.15%, Barclays US Government US Bond Index 0.86%, Citigroup World Government Bond Index (1–5 years, USD hedged) 1.00%, and Barclays US TIPS index returned –1.44%. The Barclays Global Aggregate Corporate Bond Index 1–5 Years (hedged to USD) returned 1.21%.

Major World Indices Ranked by One-Year Performance (%)
As of December 31, 2015



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US and global real estate securities had mixed performance: The Dow Jones US Select REIT Index returned 4.48%, and the S&P Global ex US REIT Index returned –3.54%. Commodities were negative for the fifth year in a row, with the Bloomberg Commodity Total Return Index returning –24.66%. Among the composite indices, petroleum returned –39.42% and industrial metals –26.88%. Among the single commodity indices, Brent crude (–45.57%) and West Texas intermediate crude (–44.35%) were the worst performers. Natural gas returned –39.95%. Gold was down for the third year in a row at –10.88%; silver prices returned –12.72%. Cotton was the only commodity in the index to post a positive return (2.97%).

Currency Impact
The US dollar rose against most major currencies, including the euro, pound, and yen. The dollar's strength had a negative impact on returns for US investors with holdings in unhedged non-US assets. For example, in 2015,

the dollar's rise relative to the euro hurt the returns of US investors in European markets. The MSCI Europe Index (net dividends) returned 8.22% in euro but −2.84% in US dollars. This was the case in other regions where the dollar outperformed local currencies. Examples: The MSCI United Kingdom Index (net dividends) returned −2.21% in pounds and −7.56% in USD. The MSCI Australia Index returned 1.29% in Australian dollars but −9.95% in USD.

Performance of Size and Value Premiums

Based on the respective total returns of the Russell indices[1] within the size dimension, US small cap stocks underperformed US large cap stocks by −5.33% (−4.41% vs. 0.92%). Within the relative price dimension, US value underperformed US growth by −9.22% (−4.13% vs. 5.09%). Among US small cap stocks, small value underperformed small growth by −6.09% (−7.47% vs. −1.38%); among US large cap stocks, large value underperformed large growth by −9.49% (−3.83% vs. 5.67%).

As in most years, diverging performance of various subindices in 2015 underscores the fact that the premium within a particular dimension (e.g., size or value) does not always move in the same direction across the global markets. For example, although the size premium was negative in the US, it was positive in both the developed non-US and emerging markets for the year. The MSCI World ex USA Small Cap Index outperformed the MSCI World ex USA Index by 8.50% (all returns in USD, net dividends). The MSCI Emerging Markets Small Cap Index outperformed the MSCI Emerging Markets Index by 8.07%. Value premiums outside the US were generally negative. The MSCI World ex USA Value Index underperformed its growth counterpart by −9.33%; the MSCI Emerging Markets Value Index underperformed the MSCI Emerging Markets Growth Index by −7.24%.

Annual underperformance of the size and value premiums is not unusual from a historical standpoint. Although small cap and value stocks have offered higher expected long-term returns relative to their large cap and growth counterparts, these return premiums do not appear each year.[1] For example, since 1979, US small caps have outperformed large caps in 19 of the 37 calendar years—or 51% of the time. Results are similar for the relative price dimension. Since 1979, US value has outperformed growth in 20 of 37 calendar years—or 54% of the time. Small cap value has outperformed small cap growth in 57% of the calendar years.

History also has produced multiyear periods in which US small cap and value stocks did not outperform large caps and growth. The most recent example is three-year underperformance of small cap value vs. small cap growth (2013–2015). Small value has also underperformed in three straight years (2009–2011 and 1989–1991). Other multiyear examples include small caps underperforming large caps (1984–1987 and 1994–1998) and value underperforming growth (1989–1991 and 2009–2011). Yet, despite even extended negative-premium periods, small cap and value stocks have outperformed their counterparts over time, and when the premiums reversed, they often did so strongly and for multiple years.

[1] US small cap is represented by the Russell 2000 Index; US large cap is the Russell 1000 Index; US value (marketwide) is the Russell 3000 Value Index; and US growth (marketwide) is the Russell 3000 Growth Index. US large value is the Russell 1000 Value Index; US large growth is the Russell 1000 Growth Index. Russell data © Russell Investment Group 1995–2016, all rights reserved.

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Investing risks include loss of principal and fluctuating value. Small cap securities are subject to greater volatility than those in other asset categories. International investing involves special risks such as currency fluctuation and political instability. Investing in emerging markets may accentuate these risks. Sector-specific investments can also increase these risks.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, and other factors. REIT risks include changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and creditworthiness of the issuer.

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