21st Century
Equity Advisors Corporation

Market Commentary
Year-end 2015
Prepared January 5, 2016

Dear Clients and Friends

Following is a summary of the performance of major market averages during 2015:

Market Index	2015 Index Close	2015 Change	Date All-Time High	All-Time High Index Close	% Off All-Time High
Dow Jones Industrial Average	17,425	-2.2%	5/20/15	18,312	-4.8%
S&P 500	2,044	-.7%	5/22/15	2,131	-4.1%
New York Stock Exchange Index	10,143	-6.4%	5/22/15	11,240	-9.8%
Dow Jones Transportation Index	7,509	-17.9%	12/30/14	9,217	-18.5%
Russell 2000 (Small Cap)	1,135	-5.7%	6/24/15	1,296	-12.2%
NASDAQ	5,007	+5.7%	7/2015	5,219	-4.1%
Dow Jones Utility	578	-6.4%	1/30/15	652	-11.3%

The Stock Market for 2015. All-time and bull market highs were registered in both the Dow Jones Industrial Average and the S&P 500 index during May: the DJIA closed at 18,312 on May 20, 2015 and the S&P 500 closed at 2,131 on May 22nd. The broader based New York Stock Exchange Index, off 6.4% in 2015, is down 9.8% off its all-time high, indicative of broader market weakness not reflected in the DJIA and S&P 500. I make special note of the Dow Jones transportation average which closed 18.5% off its all-time high, a classic “Dow Theory” confirmation of bearish market behavior.

Bull/Bear Market Scorecard. The primary trend of the stock market is down as of the end of 2015. A new bear market began on May 22nd. As of the end of 2015, the bear cycle is more than 7 months old, just past infancy.

TECHNICAL, SENTIMENT AND TIMING CHARACTERISTICS
OF TYPICAL BULL OR BEAR MARKETS/ CURRENT STATUS

Price. The overriding piece of evidence, of course, is price direction. Since both the DJIA and the S&P 500 closed 2015 more than 4% off the May highs, then a statement of the obvious is that the price trend is down as of year-end. Other indices registered larger declines, indicative of a market that is broadening out to the downside. **CONCLUSION: BEARISH**

On that beautiful spring day of May 22nd it would have been difficult to predict the end of a bull market, especially one of such persistence and longevity. After all, a new high was just registered and why would one not expect that another new high would be registered in the days ahead? But that new high never came, and after that day, bearish evidence began to pile up in favor of the emergence of a new downtrend.

Narrowing Leadership: Characteristic of late bull/early bear market behavior is for the market averages to be held up by fewer and fewer stocks. Advance/decline lines of all major stock market indices topped many months ago.

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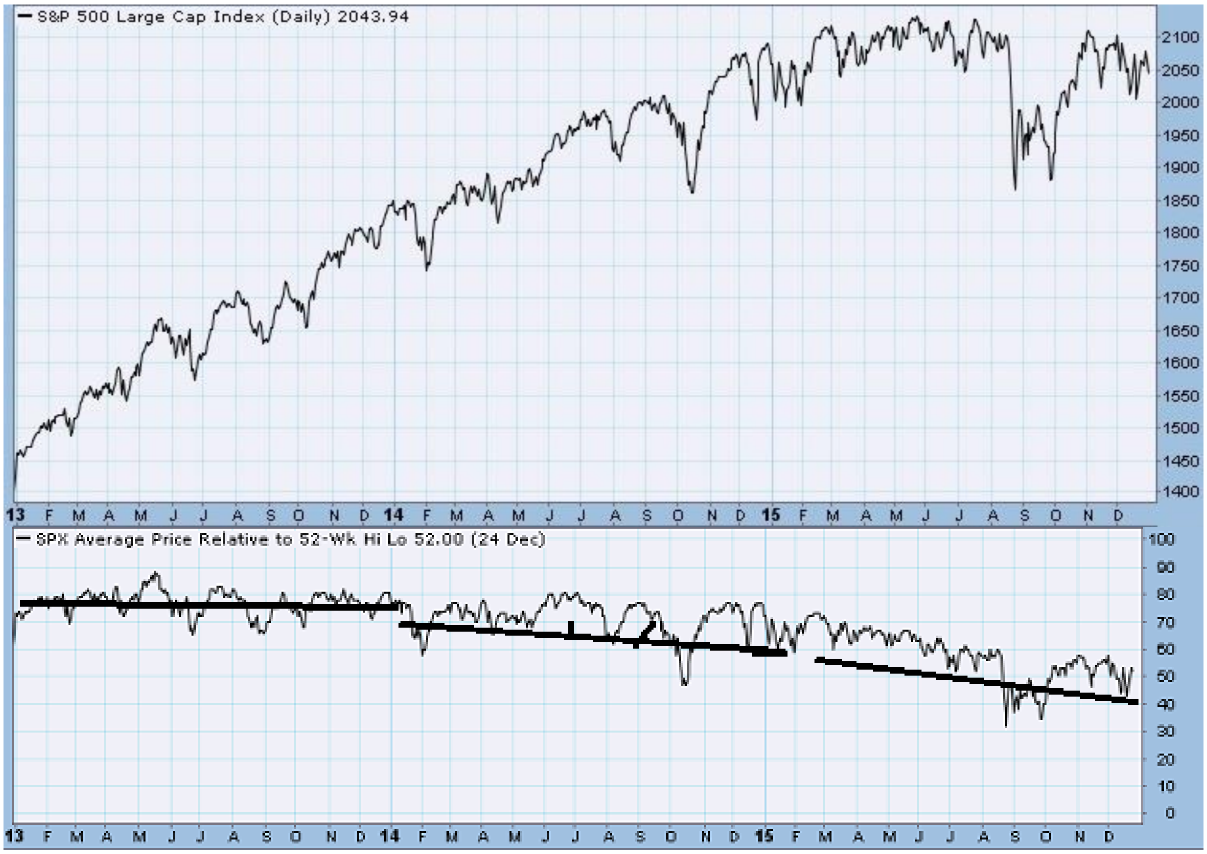
In other words, more and more stocks have fallen out of their previous uptrends. The chart below is an illustration of the gradual narrowing of participation since the middle of 2014.

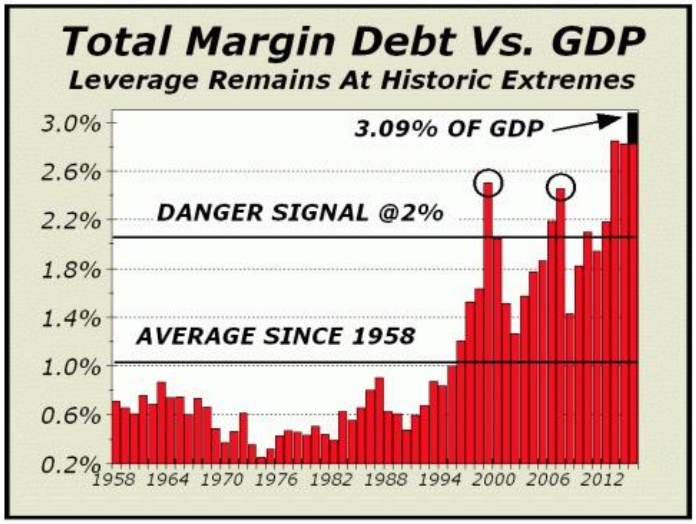


This chart tracks the average of each stock in the S&P 500 and determines the location of the current price of each index component in relation to the 52-wk high and the 52-wk low. A relationship of the components using a scale of 0 (at the 52-wk low) to 100 (at the 52-wk high) is expressed. Components in the middle of the range get a value of 50. The higher over 50 the better (note in 2013 this indicator fell within the range of 70-80). Below 50 and trending downward shows that more and more stocks are "dropping" out of participating in the uptrend. In spite of a rising S&P 500 index, the 2014 trendline began to deteriorate as compared to 2013, and then accelerated deterioration is apparent in 2015.

<u>**New 52-week Highs/ New 52-week Lows**</u>: New 52-week lows began to occasionally exceed 52-week highs during June and then began to consistently exceed new highs in succeeding months, sometimes by wide margins. August 24th, the day of the "mini" crash, the Dow Jones Industrial Average fell by 1,000 points at the open of trading. New lows spiked to 1,335, more than 1/3rd of NYSE issues traded, an extreme negative reading, which marked a short-term oversold bottom in the market. But, as the market recovered from that extreme down-day, new-lows continued to exceed new-highs well into December. On December 4th, with the Dow up 369 points for the day, new lows actually expanded, a sign of bearish distribution. On a Dow up-day (103 points) 10 days later, new lows exploded to a level more than triple that of Dec. 4th, again indisputable evidence of distribution. **CONCLUSION: BEARISH**

<u>**The Peaking and Then Turn-down of Margin Debt**</u>: Margin debt is a reflection of speculative excess that often develops late in bull markets. After peaking at an all-time high of more than $500 billion in March, margin debt has dropped to $470 billion at year-end. Past peaks in margin debt and then a drop from the peak have led or coincided with the start of past bear markets. Notable examples include 1987 (prior to the infamous crash of that

year) and near the market tops of 2000 and 2007. Also the peaking of margin debt, as a percentage of GDP, has coincided with the 2000 and 2007 market tops as illustrated in the chart below.



Mergers and Acquisitions Activity. Fueled by low interest rates, M&A activity hit $4.4 trillion in 2015, easily surpassing the previous record of 2007. Peaks in mergers and acquisitions are typically bearish for stocks, as prior peaks in 2000 and 2007 were coincident with the start of those bear cycles. **CONCLUSION: BEARISH**

Lowry's Reports. Lowry's (Palm Beach, Florida) is one of the country's oldest and most respected technical services which I have followed for decades. Their late December commentary makes the following observation:

"Market tops are typically a gradual and often painfully slow process of erosion. The slow pace of this process and the fact that it occurs following several years of gains can result in investor complacency. But, a careful review of our primary measures of Supply and Demand, as well as other metrics that gauge the health of the primary trend, suggest that the foundations of the market remain weak and is persistently eroding despite the resilience of the Large Cap price indexes in recent weeks. For example, as of Dec. 23rd close, with the S&P 500 off only 3.1% from its May 21st closing high, 47% of the issues in the Lowry's "Operating Companies Only" (OCO) universe were down 20% or more from their 52-week highs, reflecting a vast number of issues are already trading in their own individual bear markets. In addition, as of the Dec. 23rd close, the average OCO issue was down 24.6% from its 52-week high, a metric that is not consistent with a market in the midst of a healthy primary uptrend." **CONCLUSION: BEARISH**

The First Breakthrough. Joe Granville, a pioneer in the art of technical analysis, wrote in the 1960s "Usually within four months from a designated top there is a clearly defined downside breakthrough. Major averages crack the trading range of the past three or four months and make a downside penetration of the 200-day moving averages of major indices". The breakthrough, in fact resonated itself in the August/September decline. That decline made its final low on Sept. 28th. Granville then described a "Strong Rally Attempt" about 60 days later that fails to make new highs. In fact, the rally attempt brought the averages back to within 3% (+ or -) of bull market highs on December 1st before faltering.

Economics. Economic growth is slowing as 2015 draws to a close. In each of the past two quarters, S&P 500 earnings have declined slightly….. Through November, the pace of new monthly job growth has fallen to an average of 210,000 new jobs as compared to an average of 260,000 new jobs a year earlier…..On the last day of the year, the Labor Department announced that the number of Americans filing for first-time unemployment benefits unexpectedly shot up by 20,000…..The Dallas Federal Reserve branch recently published data that implies a softening economy – both the "Production" and "Future Employment" indices point to a slowing of the economy, although not to the degree experienced in the 2008-2009 downturn. **A mild recession would suggest that the bear market in process will not be either severe in terms of percentage losses or lengthy in terms of time**…..Interest rates rose slightly in the later part of the year in response to the Federal Reserve Boards decision to raise rates for the first time in ten years by .25%. The general level of interest rates still remains very low. With no visible signs of inflation and a slowing economy, a significant rise in rates appears is improbable. The 10-year U.S. Treasury note yielded 2.25% at year-end, on par with the dividend yield of the S&P 500 index. A long-term continuation of the low level of interest rates should limit both the percentage loss and time duration of the current bear cycle. **CONCLUSION: MILDLY BEARISH**

Valuations. At year-end the price-earnings (PE) ratio of the S&P 500 index climbed to an elevated level of 22. The increase in the PE with market averages being slightly down is due to the drag on aggregate earnings caused by plummeting energy sector earnings. The long-term average of the S&P 500 falls within the range of 15-17, so the current PE suggests that stocks are fundamentally overpriced by 20-30%. **CONCLUSION: BEARISH**

The Class VIII Truck Sales: A leading indicator of the past two bear markets (2000 and 2007) was a sharp decline in the sale of class VIII trucks (essentially large semis used in the transportation of goods) in the lead up to the start of those bear markets. I found it noteworthy that after several years of robust growth in unit sales, Class VIII sales plunged in November by a not insignificant 60%. The industry projects a soft 2016. **CONCLUSION: BEARISH**

Typical Bear Market Behavior. Downtrends are a part of the stock market game and serve to correct the excesses of the prior uptrend. Uptrends will follow downtrends and downtrends will follow uptrends until the end of time – it is just the natural order. The previous bull cycle lasted an abnormally long period of time – more than 6 years. So the emergence of the current downtrend comes as no surprise. Even the 18 year time period of 1982-2000, described by some as the greatest bull market of all-time, was interrupted by four painful corrections – declines of 14.1%, 35.9%, 20.4% and 24.5%, or a significant correction every 4 ½ years on average.

Bear cycles usually take place in shorter time periods as compared to the bull cycles that precede them. For instance the 2000-2003 episode lasted about 33 months, while the 2007-2009 bear lasted just 18 months. Similar to bull cycles, the bear is divisible into three psychological phases. We are in Phase 1, in which denial that a bear market is in place is widespread. Stock market losses during the early part of the phase are not yet significant. During the latter part of Phase 1 the lows registered during the first significant decline are penetrated. This would imply that a stock market decline below the lows of August 25th (15,300 in the Dow and 1,880 in the S&P 500) is not far off. This would not be a decline without an uncomfortable level of pain, so defensive measures will be taken. This decline will create sufficiently oversold conditions that should lead to a significant Phase II rally.

Investment Ideas. The late nineties bull market was centered around fascination with high-priced tech stocks – many of those stocks sporting multi-hundred dollar prices, although earnings were notoriously absent. The current market environment more resembles the narrowness of the late nineties environment, and the fascination with the “FANG” stocks (Facebook, Amazon, Netflix and Google) in comparison to the tech darlings of 1999/2000. During the bear cycle of 2000-2003, value stocks held up remarkably well and I wouldn’t be surprised if that turns out to be the case this time. While bearish conditions persist, I would be inclined to own large-cap value stocks (deep value stocks Walmart and Cisco come to mind, for example), and high yield, low beta real estate investment trusts (REITs) and infrastructure/pipeline MLPs that represent excellent value and are conservative in nature…..Covered call writing strategies are especially effective in environments of elevated volatility and sideways to downward price direction…..Gold and mining stocks are of interest to me, after they have been in a 4 year bear market. 4 years ago, CNBC didn’t go 5 minutes without giving you the last price quote for gold, and now you don’t hear a peep about gold anymore. The yellow metal is now loathed. And there is evidence that there is accumulation of precious metal related securities while the public has abandoned these stocks…..Similar to the loathing of gold and metals, the energy sector is similarly oversold and shunned by the public. Tremendous profits lie ahead in this sector at some point.

Late Notes. The market finished 2015 on a weak note being down on three of the last four trading days. The first trading day of the new year was a continuation of market weakness. Percentage up-volume on those days was quite poor with readings of +25%, +12%, +38%, and 28% a continuation of behavior in place since June. But high/low statistics improved modestly on these days. Combined with oversold conditions and the seasonal favorability of the month of January, a short-term rally attempt appears likely.

Summary. The number one rule in investing in bear cycles is "He who loses the least, wins!" The greatest opportunities for maximum profit exist during the final phase of bear cycles and within a month of either side of a major bottom. The highest percentage gains in new bull markets are realized during the first year of the up-cycle. Patience will be a virtue in the upcoming months until the next major bottom is in sight.

HAPPY NEW YEAR!

I invite clients to review 21ST CENTURY'S most recent disclosure forms – ADV Parts 2A and 2B. Please call the office and I would be happy to send you an updated copy.

21ST CENTURY EQUITY ADVISORS CORPORATION January 5, 2015

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