

**FOURTH QUARTER
MARKET OVERVIEW**

Fourth Quarter 2015

Stocks rebounded strongly in Fourth Quarter 2015 on the heels of the significant market downturn in August, however, stock index performance for calendar-year 2015 was a mixed bag.

The S&P 500 index of large, U.S. stocks gained 7.04% during the quarter. In contrast, the Russell 2000 index of small U.S. stocks enjoyed a 3.59% gain for the quarter.

Large international stocks enjoyed a similar rebound in the fourth quarter, with the MSCI EAFE index of large stocks in Europe, Australia, and the Far East gaining 4.71%. In contrast, the EAFE Small Cap index gained 6.79% for the quarter.

Alternative asset classes were mixed as well. The Dow Jones U.S. REIT index gained 7.54% for the quarter, while the Dow Jones International REIT index rose 1.05% in the fourth quarter. Meanwhile, Emerging Markets stocks gained 0.66% for the quarter.

Municipal bonds fared better than corporate bonds in the fourth quarter. The Barclays Municipal bond index rose 1.50% for the quarter. In contrast, the Barclays US Govt/Credit Intermediate bond index declined 0.69% in the fourth quarter.

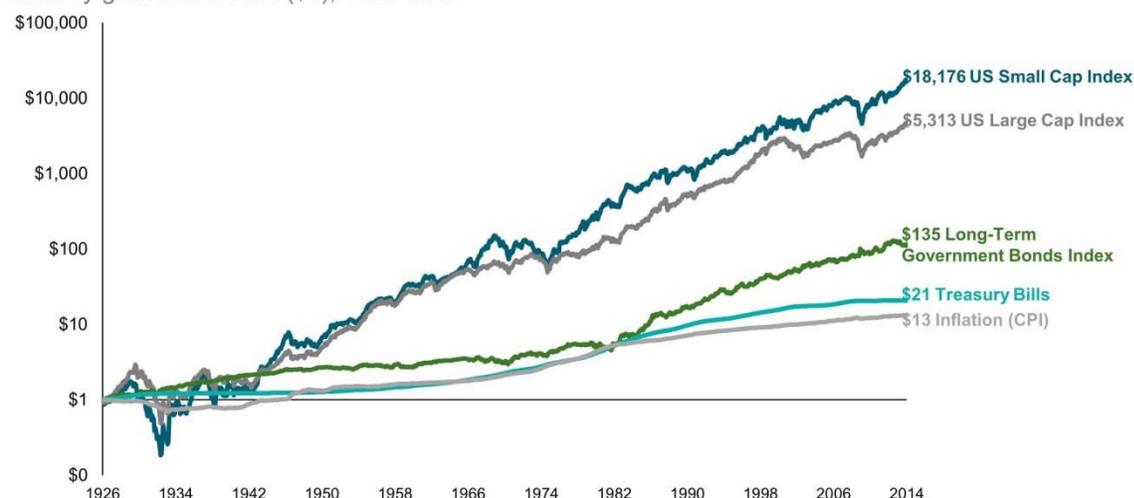
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Markets Have Rewarded Discipline:

A disciplined investor looks beyond the concerns of today to the long-term growth potential of markets. The chart below shows how \$1 invested in 1926 in various asset classes has grown through 2014. The top line shows that \$1 invested in small cap U.S. stocks in 1926 would have grown to \$18,176 by 2014, which is a full \$12,863 more

The Capital Markets Have Rewarded Long-Term Investors

Monthly growth of wealth (\$1), 1926–2014



In US dollars. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results. US Small Cap Index is the CRSP 6–10 Index; US Large Cap Index is the S&P 500 Index; Long-Term Government Bonds Index is 20-year US government bonds; Treasury Bills are One-Month US Treasury bills; Inflation is the Consumer Price Index. CRSP data provided by the Center for Research in Security Prices, The S&P data are provided by Standard & Poor's Index Services Group, University of Chicago. Bonds, T-bills, and inflation data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

EQUITY INDICES

	Dec. '15	4 th Qtr.	YTD
S&P 500 Total Return (Large-Cap Stocks)	-1.58%	7.04%	1.38%
Russell 2000 Total Return (Small-Cap Stocks)	-5.02%	3.59%	-4.41%
MSCI EAFE (Developed International Stocks)	-1.35%	4.71%	-0.81%
MSCI Emerging Markets (International Emerging Stocks)	-2.23%	0.66%	-14.92%

FIXED INCOME INDICES

	Dec. '15	4 th Qtr.	YTD
Barclays U.S. Aggregate (Broad Domestic Bonds)	-0.32%	-0.57%	0.55%
Barclays 1-5 Yr. Credit (Short-Term Domestic Bonds)	-0.35%	-0.41%	1.06%
Barclays 5-10 Yr. Credit (Intermediate-Term Domestic Bonds)	-0.86%	-0.52%	0.69%
Barclays U.S. TIPS (Treasury Inflation Protected Securities)	-0.79%	-0.64%	-1.44%
Citi World Gov't 1-5 Yr. Hedged (Short-Term Global Bonds)	-0.08%	-0.08%	1.00%

than \$1 invested in large cap U.S. stocks over that same period.

While these lines look relatively straight with only small flickers, we must remember that each small waver can feel like an all or nothing proposition when living through it. The chart below illustrates this point by showing the financial news headlines that have accompanied major market movements of the last 45 years.

While some of the movements may look minor from afar, if you take a closer look you can see how

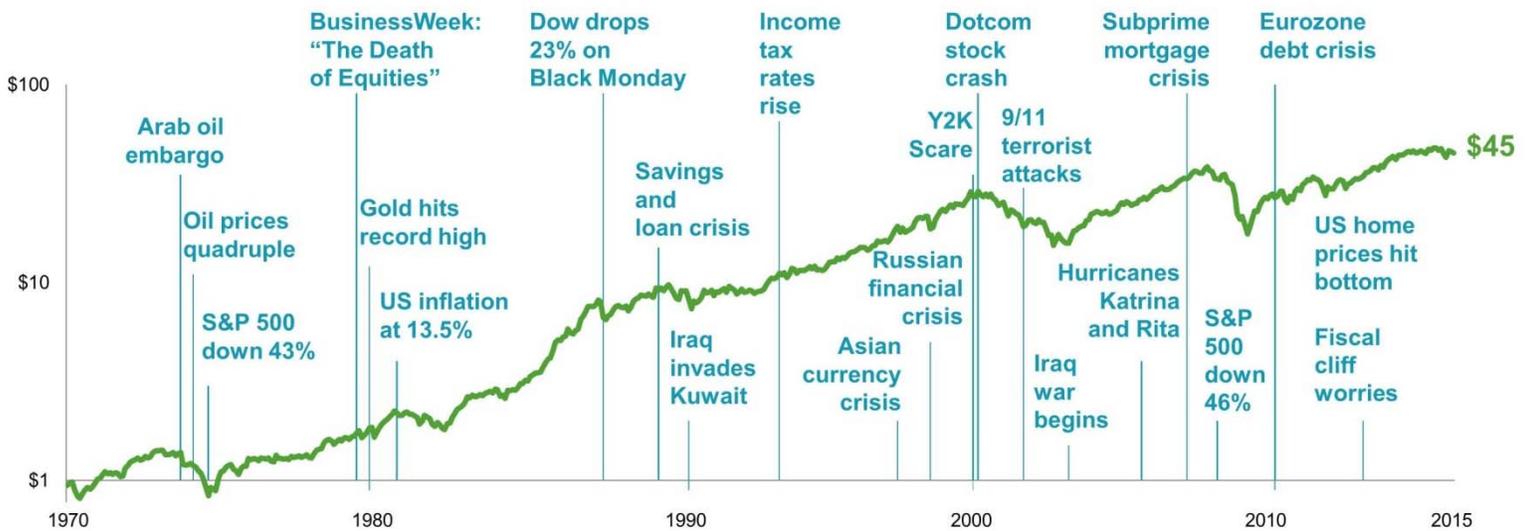
broader stock markets are reacting to the uncertainty surrounding them. This is not unlike other recent pullbacks when the market was trying to sort out the U.S. fiscal cliff worries and the European sovereign debt crisis. Our opinion is that this too shall pass and the market will regain its footing and climb higher over the long term.

Avoiding Trains:

It seems as though the market may continue to be bumpy, but we think your portfolios are well positioned to weather the storm. Many times, there is a

Markets Have Rewarded Discipline

Growth of a dollar—MSCI World Index (net dividends), 1970–2015



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large they actually were in the moment. For example, the S&P 500 Index was down 43% in 1974 and the Dow Jones Industrial Average dropped 23% *in one day* in 1987. However, the market recovered from these temporary declines and climbed ever higher.

More recently, headlines related to the current market pullback have focused on oil prices and China’s growth. Both of these areas are in transition, and the

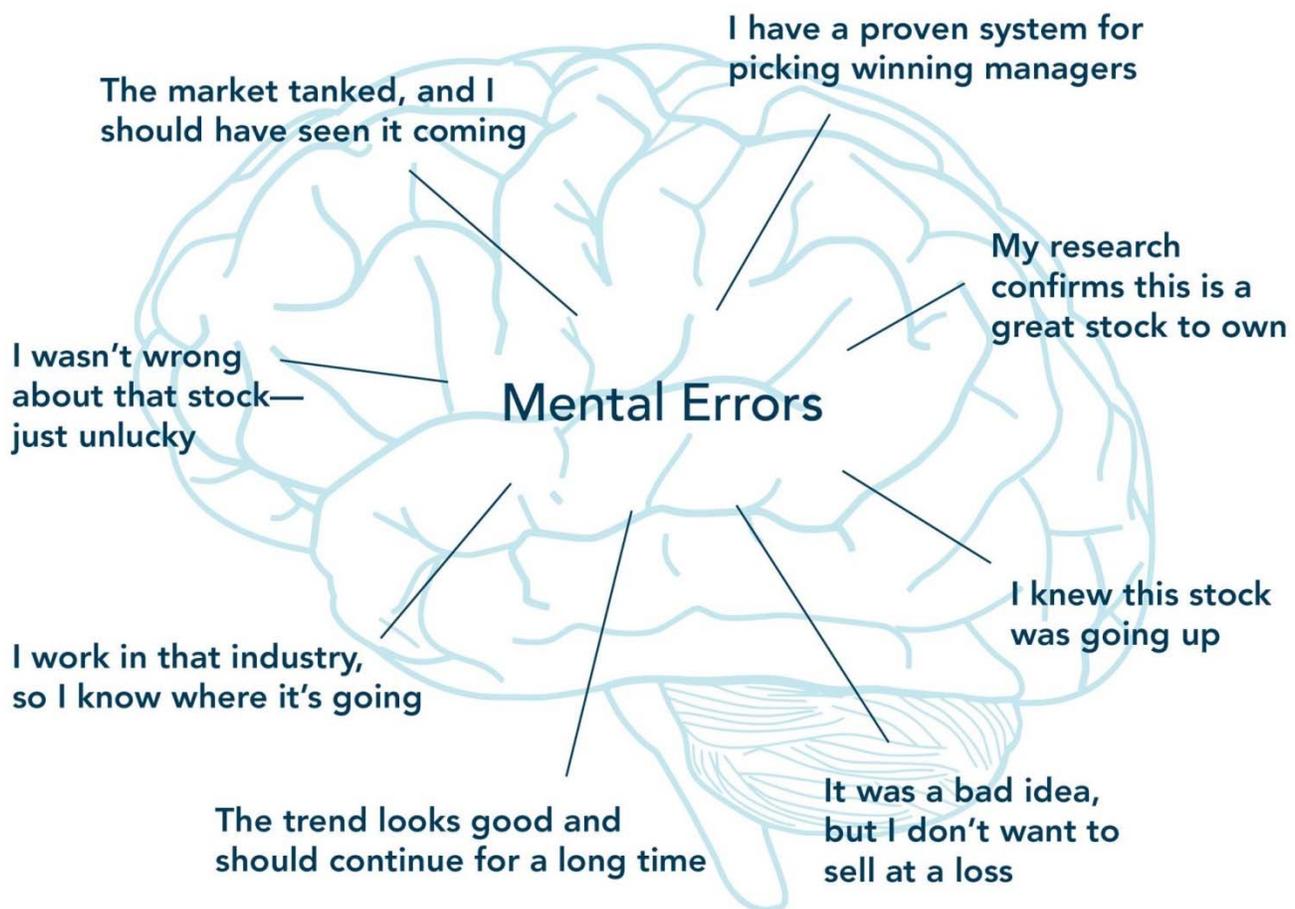
tendency to believe that stock investing is similar to walking along a train track. For example, if we are walking along a set of train tracks and see a train coming, it’s easy to get off the tracks, let the train pass, and then get back on the tracks again. However, with stock investing we think this is hard to do, and we have seen firsthand with clients how difficult it can be.

The difficulty is related to timing the market, which requires making two correct decisions:

- 1) When to get out of the market, and
- 2) When to get back into the market.

With so much noise in the news and financial press, it's hard to find a clear "sell" and "buy" signal for the top and bottom of the market. Moreover, research shows that even professional money managers are not good at making these calls.

2. Certain groups of stocks have shown to outperform others over the long term, but this does not always hold over the short term and it is difficult to pick which groups of stocks will outperform during those shorter periods, and
3. Having an appropriate balance between stocks and bonds provides the means for an investor to stick to an investment strategy, because all in-



The reason for this is that humans are not wired for disciplined investing. The research shows that people tend to apply faulty reasoning to investing, when they follow their natural instincts. This is why we follow a structured investment strategy at TAGStone Capital based on years of academic research.

What we do know is that:

1. Markets have historically shown to go higher over time,

vestment strategies have periods of relative underperformance.

The last point is reiterated by David Booth, CEO of Dimensional Fund Advisors, in the Barron's article we have shown many of you before. In the last paragraph of the article, Booth says, "Where people get killed is getting in and out of investments. They get halfway into something, lose confidence, and then try something else. It's important to have a philosophy."

This Too Shall Pass:

Although there is substantial weakness in several parts of the market, including energy, commodities, and heavy industry, we believe that the six-plus year expansion led by consumers is still in place.

The large-scale sell off we have seen in energy stocks over the last six months is partly due to high valuations as a result of low energy prices. The general market, on the other hand, as measured by the S&P 500, has recently been trading below its twenty-year forward P/E ratio, and valuations get better as markets decline.

Determining what exactly will happen over the short term is a difficult game. Since volatility tends

to arrive in clusters, the market may have more negative volatility ahead as over valuations in certain parts of the market are corrected.

We are optimistic that this too shall pass as the U.S. economy continues its long-term expansion. While we are optimistic, we do recommend that investors periodically review their basic ratio between stocks and bonds to be comfortable that their ratio is consistent with their current risk profile. At the same time, investors should be fully prepared to take advantage of long-term opportunities that may present themselves to rebalance into over-sold asset classes according to their investment strategies.

Past performance does not guarantee future results. All investments include risk and have the potential for loss as well as gain.

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