



**To: Interested Parties**

Despite the long anticipated FOMC decision to raise interest rates and the increase in volatility that returned in earnest during the fourth quarter, the S&P 500 managed to gain 7% for the quarter and finish the year marginally positive. The Intelligent Index Model Portfolio finished the quarter positively as well gaining 4.4%. But the weakness that persisted in the small cap indices resulted in the Model Portfolio finishing slightly negative for the year.

Below is a breakdown of the relevant indices:<sup>1</sup>

**Intelligent Index Model Portfolio Returns (ETF Returns)**

*As of December 31, 2015*

	<u>Q4 2015</u>	<u>1-Year</u>	<u>3-Year</u>	<u>5-Year</u>	<u>10-Year</u>	<u>Inception*</u>
<b>Intelligent Index (Gross)</b>	<b>4.60%</b>	<b>(1.07%)</b>	<b>13.61%</b>	<b>11.13%</b>	<b>8.07%</b>	<b>7.81%</b>
<b>Intelligent Index (Net)</b>	<b>4.27%</b>	<b>(2.30%)</b>	<b>12.20%</b>	<b>9.75%</b>	<b>6.73%</b>	<b>6.47%</b>
S&P 500 Index	7.04%	1.38%	15.13%	12.57%	7.31%	5.00%
Russell 3000 EW Index	4.16%	(6.17%)	11.51%	9.29%	8.49%	8.89%
S&P Citi Small-Cap Value Index	3.70%	(6.67%)	12.00%	10.37%	7.17%	8.80%
S&P Citi Small-Cap Growth Index	3.79%	2.78%	15.06%	12.58%	8.80%	8.83%
S&P Citi Mid-Cap Value Index	2.21%	(6.65%)	12.00%	10.19%	7.41%	9.03%
S&P Citi Mid-Cap Growth Index	2.91%	2.02%	13.37%	11.10%	8.85%	7.47%
S&P Citi Large-Cap Value Index	6.05%	(3.13%)	12.83%	10.96%	5.80%	4.66%
S&P Citi Large-Cap Growth Index	7.86%	5.52%	17.19%	14.06%	8.70%	5.17%

\*Inception date 1/1/2001  
Source: Morningstar Direct

As a result of the fourth quarter results, the Model Portfolios shifted to an equal weight between growth and value.<sup>2</sup>

**Quarter & Year in Review**

In the fourth quarter, plummeting oil prices and China growth concerns started to weigh more and more on the global capital markets. Domestically, estimates of fourth quarter GDP were below original forecasts and well below third quarter GDP growth. The positive drivers for the economy for the quarter were continued strong employment gains, an improvement in consumer confidence, the firmness in third quarter 2015 corporate earnings and the continued strength in the housing market translating to improved net worth among most American households. Unfortunately, the equity markets became increasingly bifurcated with only a handful of large cap expensive stocks driving the broader averages. Portfolio managers and traders, in looking for any opportunities to make a positive trade, continued to pile into the “usual suspects” such as Apple, Netflix, Google and other large cap leaders, making 2015 yet another year that investment returns for the capitalization weighted S&P 500 distorted what the average returns were across broader sectors of the markets.

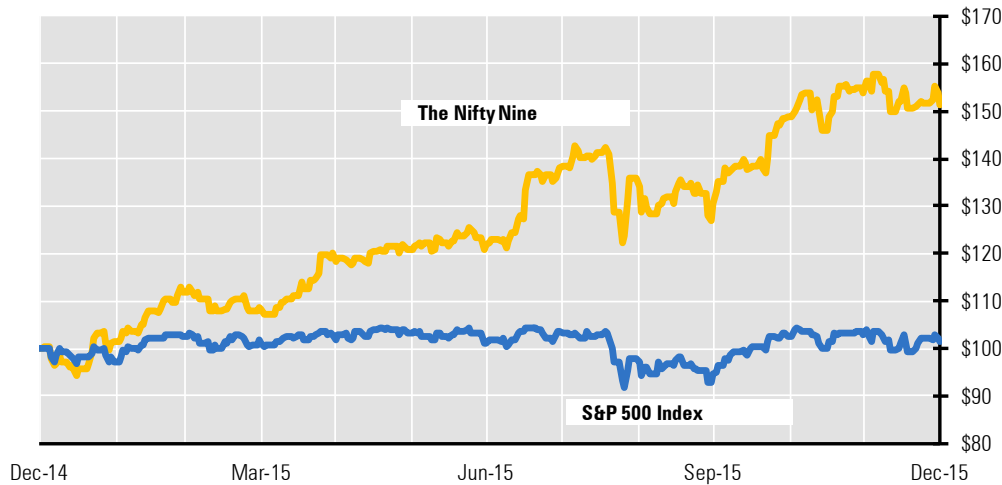
<sup>1</sup> Please see disclosure on final page for description of fees.

<sup>2</sup> The Intelligent Index Model Portfolio considers changes of less than 50 basis points, either positive or negative, to be statistically irrelevant, as such small variations can be the result of bid-ask spreads only or other last minute quarter-end institutional trading for proprietary purposes.

Strong performance by a small group of these companies dominated the market cap weighted S&P 500 Index, propelling it to a gain of 1.38% for the year. This gain stands in sharp contrast to the Russell 3000 EW (equally weighted) Index, which strips away the outside impact of companies with the largest market capitalizations and incorporates mid and small cap stocks into its universe. The Russell 3000 EW Index fell 6.17% in 2015 due to its inclusion of smaller stocks (which generally underperformed) and the fact that its equal weight methodology did not capture the outside performance of a small group of stocks to the degree that a market weight methodology would.

The chart below illustrates the degree to which this small group of stocks, referred to as the “Nifty Nine” by the Financial Times, outpaced the broader market represented by the S&P 500 Index.<sup>3</sup>

### The "Nifty Nine" in 2015



Investor excitement during the year centered on a few big new-economy stocks. This group of stocks was collectively dubbed the "Nifty Nine" and far outpaced the broader market.

Netflix, Amazon, Facebook, the Google companies, eBay, Priceline, Salesforce, Microsoft and Starbucks comprise the "Nifty Nine" and the growth of a portfolio equally weighted among them is reflected in the chart to the left.

Source: Morningstar Direct, The Financial Times

In general investors had little to cheer about as all asset classes struggled at best and got punished at worst. Diversification managed to spread investors' risk but did not provide any solution for the low return environment that extended from 2014 into 2015 as the table below illustrates. This was frustrating to both investors and advisers alike, as even portfolios appropriately allocated to a broader range of strategies came up empty.

### Morningstar US Mutual Fund Categories - 2015 Return

US Equity	2015 Return	International Equity	2015 Return	Taxable Bond	2015 Return	Allocation	2015 Return
Large Blend	-1.1	China Region	-4.2	Bank Loan	-1.3	Aggressive Allocation	-2.8
Large Growth	3.6	Diversified Emerging Mkt	-13.8	Corporate Bond	-1.4	Conservative Allocation	-2.3
Large Value	-4.1	Diversified Pacific/Asia	1.4	Emerging Markets Bond	-6.0	Moderate Allocation	-1.9
Mid-Cap Blend	-4.8	Europe Stock	1.7	High Yield Bond	-4.0	Retirement Income	-1.5
Mid-Cap Growth	-1.0	Foreign Large Blend	-1.6	Inflation-Protected Bond	-2.4	Tactical Allocation	-5.9
Mid-Cap Value	-5.4	Foreign Large Growth	1.0	Intermediate Governmer	0.5	Target Date 2000-2010	-1.2
Small Blend	-5.4	Foreign Large Value	-3.1	Intermediate-Term Bond	-0.3	Target Date 2011-2015	-1.3
Small Growth	-2.4	Foreign Small/Mid Blend	3.8	Long Government	-1.1	Target Date 2016-2020	-1.6
Small Value	-6.7	Foreign Small/Mid Growt	7.1	Long-Term Bond	-2.6	Target Date 2021-2025	-1.6
		Foreign Small/Mid Value	2.3	Multisector Bond	-2.2	Target Date 2026-2030	-1.8
<b>Alternative</b>	<b>2015 Return</b>	India Equity	-2.9	Nontraditional Bond	-1.4	Target Date 2031-2035	-1.8
Bear Market	-5.1	Japan Stock	12.0	Preferred Stock	3.2	Target Date 2036-2040	-2.0
Long/Short Equity	-2.0	Latin America Stock	-30.0	Short Government	0.2	Target Date 2041-2045	-1.9
Managed Futures	-0.9	Pacific/Asia ex-Japan St	-7.5	Short-Term Bond	0.2	Target Date 2046-2050	-2.0
Market Neutral	-0.3	World Stock	-1.7	Ultrashort Bond	0.2	Target Date 2051+	-1.7
Multialternative	-2.6			World Bond	-4.0	World Allocation	-4.2
Multicurrency	-0.1					Convertibles	-3.7

Source: Morningstar Direct as of 12/31/2015

<sup>3</sup> Authers, John. "And then there were nine." The Financial Times. 4 January 2016

## Intelligent Index Model Portfolio Returns

Since 2001 the Intelligent Index Model Portfolio has been a reliable compliment to actively managed mutual funds or passive index investing. We think it represents several of the most important investment tenants. Diversification across market capitalization and styles, an investment discipline that buffers against emotional reactions or attempts to time the market, as well as integrating a tactical, rule-based allocation strategy that over time has been able to exploit opportunities in the market to enhance performance.

More often than not, the Model Portfolio has provided all of the above including outperforming the widely used stock market benchmark of the S&P 500. When over a period of time it fails to do so, we carefully review what dynamics may be at the root of any under-performance. The irony is that the S&P 500, the holy grail of investment benchmarks, is a representation of equity returns based on the arbitrary decision to rank companies by total capitalization. Not on return on equity, not on price to book value, not on price to earnings and not on the dozens of other metrics that really ascertain the true worth of a company.

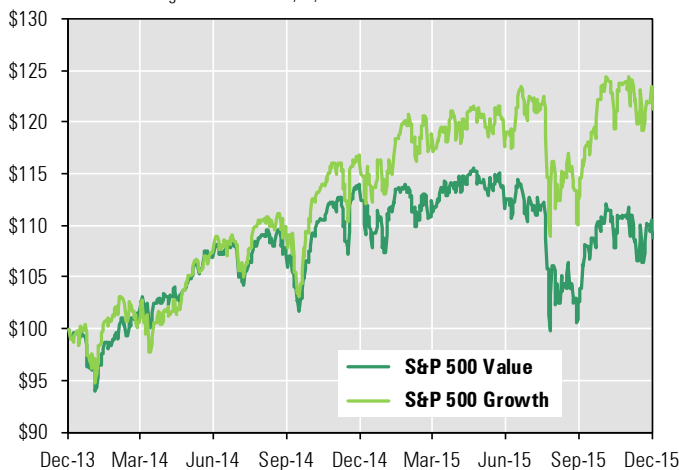
As we have long maintained, the S&P 500 is a glorified momentum fund. The bigger you get, the more weight you have in the index, period. The stock could be at 100 times earnings or 10 times earnings, all that matters is size. The fact that the top 50 companies account for almost 50% of the index and thus dominate performance suggests it should really be renamed the S&P 50 (or the S&P 9, as noted above) because the other 450 companies would have to double or triple in size to impact the index in any meaningful way.<sup>4</sup> Yet, the investor and investment community has for years paid homage to this arbitrary yardstick performance. Why? Probably because "it's always been this way" and no one has a better alternative that they think the investing public will embrace. In an economy and for an industry such as the investment industry that has embraced "disruption" on so many levels it's a bit bizarre how resistant to change the investment community is. The reality is that other than a handful of companies, the "market" was not up in 2015 despite what gets reported. Case in point is the fact that the equal weight S&P 500 was a negative 2.37%.

It's even more disingenuous that the index "guardians" such McGraw Hill (Standard and Poor's, and yes the same S&P that placed triple A ratings on pools of mortgage backed securities that ultimately failed) has knowingly created a community of betting parlors (a sub-set of the hedge fund industry) whose modus operandi is to trade and try to influence, by extension, the market capitalization of companies who are candidates for inclusion or deletion from certain indices and effectively manipulating the shares. Going forward, our quarterly reports will benchmark the results to an equal weighted Russell 3000 EW Index.

As we have explained in the past, any "underperformance" of the Index Portfolio relative to the S&P 500 is easily identified in years like the last few and is the result of representation in small and mid-size companies that generated lower returns than the large companies. A prudent investor has been at a disadvantage had they not placed all their chips on "Large Cap Growth" over the last 5 years. A well-constructed portfolio such as the Intelligent Index Portfolio has suffered from having representation in mid and small cap as well as value indices over the same period of time. The charts below illustrate this very well. The take away from this discussion is that a portfolio that only invests in the S&P 500 is not a portfolio, it's a crap shoot. A bet that the high flying stocks of today won't face the same challenges as the Luents, AOLs, Ciscos, JDS Uniphases, Lycos, and Webvans did during the heyday of the dot-com era. The Index Portfolio seeks to diversify investment dollars with inclusion of a broader universe of companies that are representative of the broader economy even if they are temporarily out of favor, such as energy and commodity businesses. It tries to mitigate the "casino" tendencies that influence most actively managed portfolios.

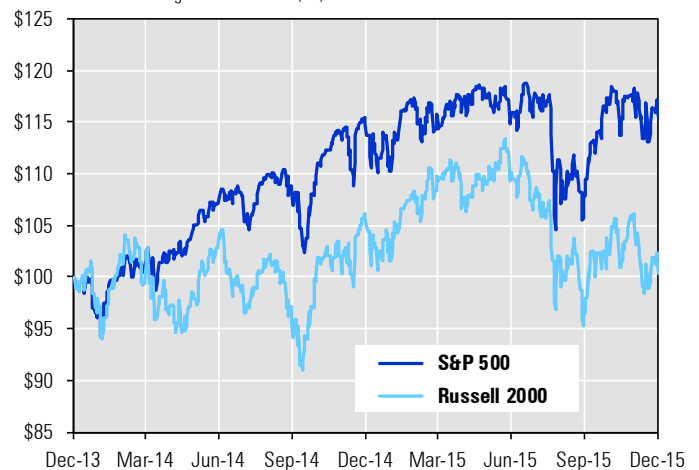
### **Growth Stocks Outperform Value**

Source: Morningstar Direct as of 12/31/2015



### **Large Cap Stocks Outperform Small Cap**

Source: Morningstar Direct as of 12/31/2015



<sup>4</sup> As of 12/31/2015 the top 50 S&P 500 constituents accounted for 48.39% of the total market capitalization of the index.

## **Looking Forward**

In almost a blink of an eye the market has erased almost \$1.6 trillion from US stock since the beginning of the year (as of 1/31/2016).<sup>5</sup> Global recession fears and persistent weakness in energy have created one of the most risk averse climates since the beginning on 2009. The vast majority of stocks have hit fresh 52 week lows with no bottom currently in sight. Among those punished the most are some of the very same high flyers that drove the market upwards over the last few years. It seems as if, overnight, the market has got the message that earnings do matter.

The optimistic investment outlooks many expressed for 2016 are history and quickly being replaced by more bearish and gloomy forecasts. But as we have maintained throughout our quarterly letters, corrections of this magnitude that we are experiencing are far from abnormal and generally occur every several years. But what makes the current environment different from almost anytime we can remember is the increasing difficulty of generating positive returns. Not just by the average investor but by the “best and the brightest” – from the hedge fund titans, to Warren Buffet (Berkshire Hathaway was down 11% in 2015), to the best managed endowments and pension funds.

As a result of all the uncertainty and lack of returns, money is heading for the exits as fast as it can be redeemed. In 2015, through the first 9 months of the year 674 hedge funds were liquidated, having to return billions back to their investors.<sup>6</sup> As this phenomenon persists, the market could be influenced by a deluge of redemptions that requires managers to sell meaningful percentages of their portfolios to meet redemptions, suggesting that the market may have difficulty staging a meaningful rally for the foreseeable future.

That being said, there are a number of positives that investors should bear in mind when “staying the course”. First, the market’s valuation at 16x projected earnings does not suggest the averages as a whole are overpriced. Extended bear markets generally start at higher valuation multiples unless accompanied by a recession. Interest rates that were expected to rise are unlikely to see the 4 increases that observers expected over the course of 2016. Earnings forecasts have been revised down by 3% – 4 %, but they are by no means being slashed, except for the above high flyers. In addition, a recent note from Bank of America Merrill Lynch puts the decline of oil into a much bigger perspective. It argues that a sustained price plunge “will push back \$3 trillion a year from oil producers to global consumers, setting the stage for one of the largest transfers of wealth in human history.”<sup>7</sup>

Lastly, rebalancing one’s portfolio to its target allocation is a key part of maintaining long-term investment discipline. Periodically rebalancing a portfolio back to its target asset mix helps to maintain the desired risk-return characteristic of the portfolio and has been shown empirically to boost returns over the long-run. With stocks having fallen significantly over the last few months, rebalancing entails moving some allocation from fixed income and into equities (sell high and buy low). While there is no guarantee that stocks will not fall further after rebalancing, if the recent selloff is overdone and the US economy remains in growth mode rebalancing now may be an opportunity to incrementally improve portfolio returns.

## **Conclusion**

We look forward to updating you at the end of the first quarter. As always, please feel free to contact us with any thoughts or questions you may have.

Sincerely,

Richard W. Greene  
Managing Principal Emeritus

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<sup>5</sup> Burger, Dani and Renick, Oliver. “Tracing Oil’s Hypnosis of Stocks from Wealth Funds to Junk.” Bloomberg News. 1 February 2016. <http://www.bloomberg.com/news/articles/2016-02-01/four-theories-on-how-oil-has-hypnotized-the-global-stock-market>

<sup>6</sup> Kishan, Saijel. “Hirsch to Close Hedge Fund Seneca After Almost 20 Years.” Bloomberg News. 29 December 2015. <http://www.bloomberg.com/news/articles/2015-12-29/doug-hirsch-s-seneca-capital-to-return-money-to-clients>

<sup>7</sup> Weisenthal, Joe. “BoFA: The Oil Crash is Kicking Off One of the Largest Wealth Transfers in Humany History.” Bloomberg News. 1 February 2016. <http://www.bloomberg.com/news/articles/2016-02-01/bofa-the-oil-crash-is-kicking-off-one-of-the-largest-wealth-transfers-in-human-history>

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The Intelligent Index Model Portfolio allocates its investments in BlackRock iShares ETF index funds designed to track the following indexes: S&P 600 Small Cap Value Index, S&P 600 Small Cap Growth Index, S&P 400 Mid-Cap Value Index, S&P 400 Mid-Cap Growth Index, S&P 500 Large Cap Value Index, and S&P 500 Large Cap Growth Index. The portfolio is systematically rebalanced to maintain the target weightings of its asset allocations based on a rule-based formula and determined on a quarterly basis. There can be no guarantee that rebalancing will achieve its intended result. The risks associated with an investment in the Intelligent Index Model Portfolio and equities in general may not be suitable for all investors.

Performance results for the Intelligent Index Model Portfolio are based on the performance results of the BlackRock iShares ETF index funds. All annualized return figures consist of both capital appreciation and dividends reinvested. "Gross" returns refer only to the deduction of the underlying ETF administrative fees charged by BlackRock. "Net" returns refer to the deduction of 1) the underlying ETF administrative fees charged by BlackRock, and 2) advisory fees charged by Centerpoint Advisors, which assumes a maximum annual rate of 1.25% for Intelligent Index Model Portfolio clients. Advisory fees for other types of investments vary depending upon the market value of the assets under management and the type of investments managed. Please see our Firm Disclosure Brochure for more information. The only source of compensation from client investments for discretionary accounts is obtained from asset based advisory fees paid by the client. All Intelligent Index Model Portfolio clients are fee based only and execution for these clients will not result in commission compensation. In addition to our advisory fee and BlackRock's administrative fee, you may also incur certain charges imposed by additional unaffiliated third parties, including, but not limited to, custodial fees, transaction fees, or other expenses charged by broker-dealers, which reduce returns.

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S&P 500 Large Cap Growth Index: An unmanaged index consisting of stocks within the S&P 500 Index that exhibit strong growth characteristics. The S&P 500 Large Cap Value Index: An unmanaged index consisting of stocks within the S&P 500 Index that exhibit strong value characteristics. The S&P 400 Mid Cap Growth Index: An unmanaged index consisting of stocks within the S&P 400 Index that exhibit strong growth characteristics. The S&P 400 Mid Cap Value Index: An unmanaged index consisting of stocks within the S&P 400 Index that exhibit strong value characteristics. The S&P 600 Small Cap Growth Index: An unmanaged index consisting of stocks within the S&P 600 Index that exhibit strong growth characteristics. The S&P 600 Small Cap Value Index: An unmanaged index consisting of stocks within the S&P 600 Index that exhibit strong value characteristics. Russell 3000 EW (equal weight) Index: An unmanaged index consisting of the largest 3,000 US stocks by market capitalization. The index is equally weighted among its constituents.