Lucien, Stirling & Gray Advisory Group, Inc.

Fourth Quarter Report 2015

January 2016

LUCIEN, STIRLING & GRAY
ADVISORY GROUP
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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

We are pleased to provide you with our report for the period ending December 31, 2015.

Please forgive my failure to confine my comments here to 2015, but as I write this in mid-January 2016, on the Martin Luther King Jr.'s birthday, equity markets in the United States and around the world have experienced exactly 10 trading days during 2016. In that brief window the S&P 500 Index has fallen sharply to a closing low on Friday, January 15th of 1880 - from a December 31, 2015 close of 2044. This represents a decline of 164 points, or 8% (a percentage decline, incidentally, which statistically has taken place somewhere between once per quarter and once per year in this broad-based index ever since 1928.)

As one has come to expect, this most recent bout of downward volatility has been seized upon once again by the media as an opportunity to shriek, cry, gnash their teeth and rend their garments as if this were an unprecedented catastrophe. ***"The Worst Decline in History to Start a New Year"***, wails the headline, and the underlying commentary purposefully attempts to ratchet up the reader's anxiety with references to the "catastrophic" drop in the price of a barrel of oil, the "implosion" of the Chinese equity market, and the "unexpected" devaluation of their currency versus the U.S. dollar. Wasn't it only eight or ten months ago that headlines were regularly bemoaning the strength of the Chinese currency, and the possibility that it would achieve "reserve currency status" with the International Monetary Fund – thereby signifying the terminal decline of the U.S. economy? And since when is it a singularly bad thing for the vast majority of consumers in the U.S. and abroad that the most sought-after commodity – the one they depend upon most to power their cars, heat their homes, and deliver to the supermarket all the other necessities they rely upon – is two thirds less expensive than it was just a year or two ago?

Volatility is actually your friend if you will learn to treat it that way, for it's precisely this variability of short-term behavior that historically has led to the superior long-term returns of the asset class for patient investors.

We've been through this before. In fact, only four months ago, in just six trading days between August 17th and August 25th 2015, the S&P 500 Index fell slightly over 11%, from 2102 to 1868. The headlines then, by the way, were remarkably similar to today, and many so-called "investors" were head-faked into making a classic mistake and bailing out. While few people relish this kind of volatility, the fact is that it happens all the time. Volatility is actually your friend if you will learn to treat it that way, for it's precisely this variability of short-term behavior that historically has led to the superior long-term returns of the asset class for patient investors. As we pointed out in an email we sent to all of our clients in early September, the average intra-year decline of this index for the last 35 years is -14.2%. And yet, if one had invested a hypothetical $100,000 in this asset class at the beginning of 1980 and just left it there to compound through all the crashes, crises and implosions du jour (forever accompanied by end-of-the-world headlines) it would have been worth well more than $4.5 million by the end of 2015. The secret was not to get scared out. Better yet, do the opposite of what most others always do and add new money to your long-term investments at times like these.

None of this is to suggest that this current decline is over. I wouldn't tell you that because I don't know – and I never have. (Neither, by the way, does anyone else who's telling you the truth.) It's possible it's over, but it's also possible this could turn into a full-blown bear market – defined as at least a 20% decline. These on average have happened every five or six years in this asset class, and have averaged approximately -30%. But for a true long-term investor, with a sound financial plan and a thoughtfully designed and properly diversified portfolio, it shouldn't matter. Exercise patience and discipline, re-balance, add to your investments if you're able, turn off the TV, and focus your attention on the real reasons you're a long-term investor in the first place – to educate your children or grandchildren; to enjoy a long and healthy retirement of dignity and independence; or to endow your family or a favorite charity with multi-generational support – objectives that encompass decades, not months.

It's crucial always to remember that in the long run, stocks are not pieces of paper randomly blown hither and yon by the fickle winds of human emotions, government policy or gyrating commodity markets. Stock means ownership – in the case of the S&P 500, of some of the most successful, well-financed and dynamic businesses in the United States and the world. They produce products and services that are sought after by millions, if not billions of people. They are run by smart management teams who are well-compensated to mind the interests of shareholders, to navigate economic challenges successfully, to innovate relentlessly, and to adapt to ever-changing environments. We have every reason to believe that this is still as much the case as it has ever been, so keep the faith.

Thank you for your confidence and trust.

Thomas G. Twombly

President

INVESTMENT COMMENTARY

2015 was a challenging and often frustrating year for diversified investors of all types. It was characterized by large-cap U.S. equity markets that appeared largely flat on the surface, but which demonstrated a remarkable dispersion of returns among sectors and individual companies, and also displayed bouts of sharp volatility along the way; small-cap equity markets that declined for the year and were also volatile and showed similar dispersions of results; international developed market equity returns which were strong in local currency terms, but which were frustratingly diminished for U.S. investors by unexpected strength in the U.S. dollar; emerging market equities which suffered mightily under the twin strains of a rising dollar and sharply falling commodity prices; historically low yields in virtually all fixed-income securities throughout the world; and a pervasive sense of confusion and anxiety among investors throughout the globe about political trends, government policies, growth and inflation forecasts, and interest rates.

The top performing asset class for the year was Real Estate Investment Trusts, with a total return of +2.8%. Large-cap U.S. equities finished second with a nominal decline in the S&P 500 index of -.8%, but with sufficient dividends to push the total return for the year to a modest +1.4%. Interestingly, these seemingly flat returns for the index as a whole masked a huge disparity of results underneath. For instance, the top performing 100 stocks in the S&P 500 averaged a +32% return for the year, led by Netflix (+134%), Amazon (+118%), Activision Blizzard (+94%), Nvidia (+67%), and Cablevision (+58%). Meanwhile, the bottom performing 100 stocks in the index averaged -35%, and included such well-known companies as Staples (-46%), Ralph Lauren (-39%), Alcoa (-37%), Whole Foods (-33%), and Walmart (-27%).

Fixed income securities, characterized by the Barclay's Capital Aggregate Index, finished the year with a total return of +.55% after experiencing a decline of -.57% in the final quarter. Notably, cash rounded out the top four performing asset classes with a return of 0.0%. Clearly, 2015 was a year when broad-based good news was difficult to come by.

The worst performing asset classes, on the other hand, pulled down much harder than the top performers pulled up. Commodities as a whole, impacted substantially by falling oil prices around the globe, brought up the rear and fell by -24.7% for the year. Emerging market equities, which were notably impacted by falling oil and a strengthening U.S. dollar, declined by -14.6%. Small-cap U.S. equities also declined for the year, showing particular weakness in the final month and posting net results of -4.4%. High Yield bonds, impacted by sharp contractions in the oil and gas production and exploration sector and worries about rising default rates, rounded out the bottom four with total returns for the year of -2.7%. Again, individual results within each of these broad-based indices showed a wide dispersion, and left many highly diversified investors like the proverbial man with one foot in a bucket of ice water and the other in a bucket of boiling water who, on-balance, is supposed to feel fine.

Looking forward, there is little doubt that volatility is likely to continue for the foreseeable future. According to JP Morgan, there is currently almost $12 trillion sitting in cash and money market funds held by individual investors, the highest on record, and this suggests that very large numbers of people have reacted to the turmoil by simply retreating to the sidelines to get emotional relief from the volatility. In this type of environment, therefore, markets are influenced more heavily by short-term traders than long-term investors, so we believe it's important to just steel ourselves to expect more bumps along the way. At the same time, long-term investment decisions should be driven by financial needs, and not emotional wants, so there remains little doubt in our minds that holding outsized cash or fixed income positions is the wrong thing to do. With yields at such meager levels, the risks to long-term erosion of purchasing power are just too great, while the comparative value of equity holdings of all types (in spite of, or in fact *because of* their short-term volatility) is more compelling.

We recognize that this is a particularly difficult environment for investors to maintain the patience of a long-term view, the discipline of a plan that at times appears not to be "working", and the faith that it will do so in the end. But we're also convinced that is precisely in times like these that trusted advisors provide their most critical long-term value. If you'd like to meet to discuss your particular situation or our perspective in more detail, please give us a call. And remember, *this too shall pass.*

Conservative Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
1.86%	-1.33%	-1.33%	5.46%	3.62%	4.12%

Inception Date 06/03/1999

Core Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
2.08%	-5.33%	-5.33%	4.83%	3.34%	4.10%

Inception Date 05/31/2003

Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
3.65%	-3.83%	-3.83%	5.40%	3.06%	4.81%

Inception Date 10/16/1992

Specialty Model

Diversified Growth Model

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
3.64%	-3.12%	-3.12%	9.45%	7.19%	5.11%

Inception Date 10/31/00

Education Models

UT ORP

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
3.12%	-2.35%	-2.35%	6.54%	5.14%	4.15%

Inception 08/10/1999

Retirement Growth

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
3.11%	-4.41%	-4.41%	6.11%	4.94%	4.20%

Inception Date 06/03/1999

Check out our new, updated website at www.lsggroup.com

General Market Results

	4th Quarter	YTD	One Year	Three Year	Five Year	Ten Year
CPI	-0.26%	1.07%	1.07%	1.11%	1.60%	1.89%
Barclays Agg Bond	-0.57%	0.55%	0.55%	1.44%	3.25%	4.51%
S&P 500	7.04%	1.38%	1.38%	15.13%	12.57%	7.31%
DJI	7.70%	0.21%	0.21%	12.66%	11.30%	7.75%
S&P 400	2.60%	-2.18%	-2.18%	12.76%	10.68%	8.18%
Russell 2000	3.59%	-4.41%	-4.41%	11.65%	9.19%	6.80%
NASDAQ	8.38%	5.73%	5.73%	18.37%	13.55%	8.55%
MSCI EAFE	4.75%	-0.39%	-0.39%	5.46%	4.07%	3.50%
MSCI EM	0.73%	-14.60%	-14.60%	-6.42%	-4.47%	3.95%

Lucien, Stirling & Gray Advisory Group, Inc. is a Registered Investment Advisory firm providing fee-only asset management, fiduciary-level advice and financial planning services to individuals, corporations, trusts and foundations.

For more information about our firm, please visit our website at www.lsggroup.com • Model holdings may change due to ongoing management • Sector and style breakdown is constructed with the best available information and therefore is only as accurate as the available information • Past performance is no guarantee of future results • It is impossible to invest directly in indices • Percentages may not equal 100 due to rounding

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