The humdrum returns obscure meaningful fluctuations and widespread divergences that played out below the surface: 2015 was a year of disappointing growth, historically low rates, deflation, inequality, volatility, and lackluster returns. It was a massive roller coaster ride that left most returns in the negative, a year where nothing worked. Stocks, bonds, cash — all went nowhere. According to Bloomberg, it was the worst year for asset allocation in almost 80 years.

The year was full of event risks: the surprising abandonment of the currency peg by the Swiss National Bank; the negative reading on the first quarter GDP in the US, bringing up fears of a double-dip recession and a global slowdown; the Greek crisis in the spring; China’s devaluation of the yuan and the crash of the Chinese stock market, with hard-lending fears that ensued; the unrelenting slide in oil prices extending the recession in much of the emerging market space; the Syrian refugee crisis; the terrorist attacks in Paris; and the US Federal Reserve increasing rates for the first time in almost a decade.

At a time when the Fed’s campaign of stimulus drew to an end there was nowhere to run. Worldwide there were $6 trillion of government bonds with negative yield (meaning that you pay the government to hold your money) and $17 trillion of bonds yielding less than 1%. The initial public offering market underscored the negative tone — only 170 companies went public in 2015, down 38% from a year earlier, and on average these issues were down 5% from the offer price (a big swing from +21% in 2014).

Developed markets dropped on average 3%, while emerging markets sank 17%. Commodities were down across the board, with Brent crude oil down 30%, natural gas -24%, copper -28%, and gold -11%. The dollar gained 9.3%, while the euro fell 7.1%. Although the depth of losses in equities and commodities is nowhere near as bad as in 2008, the high correlation of declines highlights the challenges for our diversified portfolio.

In this convoluted year the KF portfolio was down 1%, largely due to currency devaluation in the fixed income portfolio and from equity losses, mostly in emerging market positions. The expense ratio continues to be low, at 0.36%. At year-end the total portfolio amounted to $13.6 million.

We would like you to keep in mind that the performance of the portfolio should always be considered over the long term, because our investment objective is to grow the fund over time. Therefore annual comparisons to benchmarks are useful but can only act as a reference, since investment decisions are made to match the needs of capital to support continuing projects.
Fixed Income

Commodities have fallen to a decade low as tepid global inflation dimmed the allure of precious metals, weak Chinese demand hurt raw-materials prices, and a global supply glut sent crude oil tumbling, leading to a drastic movement in commodities-based currency. Meanwhile the US dollar appreciated 9.3% throughout the year.

In the bond market, high-yield corporate debt had its first annual decline since 2008 amid a flood of investor redemptions from junk bond funds and concern that rising borrowing costs will threaten corporate solvency.

As a result, the currency diversification that we have implemented for years, carrying about 28% of the fixed income portfolio in Canadian dollars (CAD) and Brazilian Real (BRL) has negatively affected the returns, bringing the overall bond portfolio performance to -1%.

We sold off the CAD bonds at a loss of 5% around mid year and converted the proceeds into US dollars. This avoided further losses as CAD had depreciated more than 15% at year-end. We held on to our BRL bonds (issued by US financial institutions) because the high coupon partially offset the exchange rate losses.

Equities

Both developed international and emerging markets moved together in the early part of the year, but they began diverging in April and widened once oil and commodities prices began crumbling. The collapse in commodities has been brutal on the currency and growth of all emerging markets tied to commodity exporters.

The equity portfolio returned -3.5% in 2015, in line with the MSCI World Index (Developed Markets), which was down 2.7%, and much better than the MSCI Emerging Market Index, which was down 17%. For further reference, the S&P 500 (US Index) was up 1.4%.

KF investments in US equities were up 1.6%, in line with the S&P index, largely due to the strong performance of a few names in the technology sector. We also used options on the S&P 500 Index, generating a positive return of 1% on the overall portfolio. This option strategy allows us to take advantage of the volatile market, and the worst case for us is to take delivery of the S&P 500 Index ETF (Exchange Traded Fund).

We terminated our investments in Canada in July with a loss of 10%, before they ended up falling 25% due to a combination of commodity prices and currency depreciation.

Although equity markets in Japan and Europe were supported by monetary policy and both countries showed further evidence of economic stabilization, we had negative returns of -3% and -5%, respectively, as we added to our winning positions by mid year, therefore suffering with the August correction.

Investments in Hong Kong were down 6% and in China down 10%, a consequence of the huge selloff that wiped out 30% of the value of stocks in China since the market peaked in June. We have since taken advantage of some strength in Chinese equities to reduce our allocation, reducing risk. Present holdings focus on technology and service-oriented companies.

PORTFOLIO BREAKDOWN

50% Equities
19% Cash
31% Bonds
Finally, we also terminated our investments in India at half of the potential loss we could have endured, if we had held on to them until year end.

During these turbulent times our cash allocation was on average 25%, helping to enhance our performance and allowing us to invest when we see value opportunities in the fixed income or equity market.

### 2016 Outlook

The global investment environment is challenging as we enter 2016. Global growth is constrained — moderate in the United States, Europe, and Japan, and uneven in the developing world. In the developed world, commodity exporters are still navigating the commodity cycle downturn, and some are deeply troubled. A strong US dollar continues to weigh on US multinational exporters’ profits and on emerging-market highly indebted economies.

The strength of China’s service sector and consumer-facing industries has not been enough to allay fears of a poorly managed hard landing, and the damage it would wreak in global demand. Geopolitical worries remain simmering in the Middle East and Eastern Europe. The OPEC cartel has capitulated, and oil’s failure to find a convincing bottom is leading market psychology into fears that a global recession is around the corner. And the US Fed is embarking on interest rate normalization after years of extraordinarily accommodative monetary policy, bringing a lot more uncertainty to financial capital markets.

As per Rinpoche’s teachings, we trust that everything is impermanent and we look forward to better days in the coming year. We continue to feel fortunate to be able to serve Rinpoche and his vision and to have the trust of our donors.