FIRST NEBRASKA Trust COMPANY

Fourth Quarter 2015

Quarterly Letter to Clients

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Halfway through the 2nd decade of the new millennium already! How quickly time passes. As we flip the calendar and bid farewell to 2015, we leave a year of transitional change that most likely will be considered by economists as a pivot point in measuring economic activity. It was a year characterized by continued soft economic growth, falling commodity prices, satisfactory job creation, and an increasing level of geopolitical risk.

It was a year where the capital market's gyrations provided more excitement than return. Indeed, from an investment perspective, it was a year of disappointment, as almost all asset classes saw total returns that ranged from barely positive to significantly negative. U.S. Stocks had their worst annual performance since the Great Recession of 2008. After experiencing just over a 45% increase from 2012 to 2014, the Dow Jones Industrial average fell 2.2%, excluding dividends, during 2015. The S&P 500 fell 0.7%, also without dividends. The bond market provided similarly lackluster returns, with the 10-year Treasury issue hovering around 2.15% for much of the year.

During the 4th Quarter of 2015, the bright spots in the U.S. Economy began to lose their luster, mainly driven by falling oil prices, the softening of the Chinese economy and the negative impact of a rising U.S. Dollar versus other currencies. Lower oil prices appear to be the result of excess supply combined with slightly lower global demand. The oil and gas industry's innovative use of fracking and directional drilling produced huge gains for domestic petroleum production, which provided the United States with an opportunity to regain a top spot in world production and provided, for the first time in decades, a chance for energy self-sufficiency.

Many other world oil producers have become dependent on the oil revenues to fund their social programs, with the members of the OPEC cartel and Russia being prime examples. They then realized that either they had to defend the world oil price OR defend their future market share of global production. Most pundits proclaimed that OPEC would be led by Saudi Arabia to defend pricing. However, what seems rational in the world of competing political and social pressures can quickly turn irrational, as it did when OPEC announced an increase in their production ceiling from 30 million to 31 million barrels per day during the quarter. This action signaled that there could be additional supply that would put further downward pressure on prices, and potentially squeeze out producers with higher marginal costs.

Softer demand also contributed to oil's extreme price decline. The widely reported slowdown in the growth of the Chinese economy has put a damper on the appetite for all commodities, including oil. Commodity producers around the world have made significant investments in anticipation of consistent Chinese demand only to be surprised by the seemingly sudden decline in Chinese growth. Lower Chinese demand for resources to produce their goods and services has spread into manufacturing and the intermediate goods arena, as well as the energy supply chain, resulting in slightly lower energy demand. An additional factor impacting the Emerging Markets and other foreign producers is the rising U.S. Dollar. Many of these companies have taken advantage of the low interest rates and borrowed in U.S. Dollars to make the aforementioned capital investments to increase their production capacity and to meet the now waning Chinese demand. However, the rising dollar negatively impacts some of the factors in their cost of production (i.e. oil is traded in dollars) and also negatively impacts their costs of financing, as they pay back interest and principal with higher and higher relative values. Thus, the combination of higher currency translation costs and slowing Chinese demand are putting further downward pressure on oil prices, pushing the near $30 price per barrel to 12-year lows.

As the energy and manufacturing sectors continue to battle against these headwinds, the ripple effect is beginning to show itself in the financial arena where the rapidity of the commodity price declines has retarded the ability of the highly-leveraged companies to repay their loans. This has already been demonstrated in the rising default levels in energy junk-bonds and the recently reported reserves made by financial lenders against energy loans, both of which are contributing factors to the rapid rise in junk-bond yields and their precipitous declines in market value. The proverbial $64 question is whether or not these two sectors of the U.S. Economy, that apparently are in recession, will recover quick enough to avoid the possible contagion to other parts of the economy.

Now add to the mix the fact that after seven years of instituting and managing a Zero Interest Rate Policy (ZIRP) and implementing an unprecedented and extraordinary liquidity vehicle through its Quantitative Easing (QE) Program, the Federal Reserve announced in Mid-December that it would raise its benchmark Fed-funds rate up to a range between 0.25% and 0.50%, providing the first step towards moving policy back to a more "normal" level. In making this announcement, Fed Chair Yellen emphasized that this was a small step and that future increases would be dependent on continued economic growth and inflation expectations.

As we outlined in our last quarterly letter, the Fed is faced with a poor set of alternatives to choose from in normalizing Monetary Policy. Given that this was the first Fed interest rate increase in over 9 years, many investors may not remember what "normal" really means. Historically, normal would peg the Fed-funds rate somewhere close to the core inflation rate *plus* the expected growth in the economy. Thus, if our current economy is growing at 1% and the inflation rate is at 1.5%, then the nominal interest rate should be close to 2.5%. Obviously the Fed has a long way to go if it pursues a slow and tentative path back to normalization. Still, raising interest rates too much, too quickly could put the brakes on an already ailing economy. Not raising rates leaves the Fed with only extraordinary and dubious measures (think QE4 and continued negative interest rates) to try and reflate, should the economy tip back into recession.

As the bond performance chart below shows, intermediate corporate bonds lost 0.50% for the quarter, while intermediate government bonds posted a 1.17% quarterly loss. A further examination of the bond performance chart confirms that longer maturity bonds performed worse than shorter ones, while poor quality (riskier credits) outperformed the higher quality paper.

Morningstar Bond Indexes

Broad Market	Quarter	1-Year	3-Year	5-Year
US Inter Core Bd TR Bond	(0.32)	1.96	2.12	3.51
US Lng Core Bd TR Bond	(0.84)	(1.55)	1.81	6.12
US Shrt Core Bd TR Bond	(0.40)	0.79	0.80	1.28
Corporate				
US Inter Corp Bd TR Bond	(0.50)	1.25	2.10	4.48
US Lng Corp Bd TR Bond	(0.44)	(2.78)	1.56	5.83
US Shrt Corp Bd TR Bond	(0.15)	1.17	1.51	2.46
Government				
US Inter Gov Bd TR Bond	(1.17)	1.67	0.92	2.87
US Lng Gov Bd TR Bond	(1.33)	0.50	2.28	6.42
US Shrt Gov Bd TR Bond	(0.50)	0.65	0.57	0.92

Source: Morningstar Index Review 12-31-2015

The risk parameters of the bond market are currently in a state of change, as fixed income investors' focus on increasing credit risks and the possibility of a stop-n-go tightening policy by the Federal Reserve. Poor quality credits are seeing spreads widen, while many bond investors are coming to grips with the potential downside in their "reach for yield" strategies. While in the foreseeable future the return and risk parameters of the bond market will continue to be hinged to Federal Reserve Policy decisions, long-term investors will continue to benefit from a strategy that emphasizes capital preservation. Consequently, our fixed income strategy will continue to focus on constructing a shorter-duration portfolio containing high-quality bonds that compensate us for the increasing risks found in fixed income markets.

The Stock Market provided mixed results in the Fourth Quarter of 2015, with the major indices recovering much of the losses experienced during the prior quarter. However, even with what appeared to be a rapid recovery, the average stock, as measured by the broad NYSE Composite Index, was down over 6 percent for 2015. The reason for the divergence between the popular averages and the "average stock" is found in the leadership of just a few stocks that are, for the most part, larger-capitalization companies found in the technology space that, because of the calculation methodology of the indices, have a greater proportionate impact on the relative reported performance. If a portfolio did not have these top 5 to 10 stocks over the past year, they most likely wound up in the negative column. (Wall Street's acronym for the top 5 is FANGS – representing Facebook (FB), Amazon (AMZN), Netflix (NFLX), Google (Now named Alphabet TKR: GOOGL), and Starbucks (SBX).)

For the quarter, the Dow Jones Industrial Average increased 7.0% and the S&P 500 was up 6.5%, while the tech-heavy NASDAQ posted a gain of 8.4%. As the Lipper Mutual Fund chart below shows, larger capitalization stocks outperformed their smaller brethren, while the divergence between types of stocks widened considerably. The average mutual fund, represented as General Equity in the chart below, saw a gain of 4.0% for the quarter. While the market had a sharp recovery, it was not enough to offset the downdraft experienced in the 3rd Quarter. As such, most measures of stock performance remained in negative territory, with the wide range of returns demonstrated in the 1-year return column below.

LIPPER MUTUAL FUND INVESTMENT PERFORMANCE AVERAGES

MONDAY, January 4, 2016

	Qtr	1 year	5 year	10 year
S&P 500	6.8	0.8	11.9	6.8
S&P 500 Index P	6.5	(0.7)	10.2	5.1
Dow Jones Ind. Average P	7.0	(2.2)	8.5	5.0
Equity Income	4.5	(3.7)	9.2	6.3
General Equity	4.0	(2.1)	9.1	6.1
Large-Cap Core	6.0	(0.6)	10.9	6.4
Large-Cap Growth	7.5	5.3	12.3	7.5
Large-Cap Value	4.9	(4.2)	9.8	5.4
Mid-Cap Core	2.4	(4.3)	9.0	6.6
Mid-Cap Growth	3.0	(1.1)	9.7	7.2
Mid-Cap Value	2.5	(5.0)	9.5	6.6

P-Price only Index. Calculated without reinvestment of dividends. Source: Lipper

Despite the improved performance during the 4th Quarter, stocks continue to try and discount the challenges of a softer growth world that is facing an increasing number of hurdles. Stock market returns are really a function of earnings, P/E multiples and dividends. The majority of stock market gains between 2012 and 2014 were driven by multiple expansion and a reach for yield in stocks that provided a small additional income flow, versus bonds or money market alternatives. For the S&P 500 stocks, earnings per share peaked in 2014 and have been in a downward trend since that time. During the past year, markets continued to ignore the fundamentals of companies and valuations, and instead focused on Federal Reserve policies that skewed the market towards stocks as the “cleanest dirty shirt” of many poor investment alternatives. Thus, with the Fed’s announced plan of gradually moving policy towards normalization, markets may again refocus on profit margins, as investors try to determine whether the declining trends in profits will morph into a broad-based slowdown. With the twin headwinds of a slower growth global economy, and the strength of the U.S. dollar, top-line growth for most domestic stocks will be scarce. This will most likely retard the earnings and dividend growth rates required to prop up stock prices at year-end valuations.

With the first two weeks of the New Year providing most market participants with a Yogi Berra “It’s déjà vu all over again” feeling due to stocks dropping over 8% since the New Year began, many investors are invoking what I call the P^2 Strategy – praying and panicking. However, while no one knows what the near-term holds for stock prices, long-term investors should welcome the prospect of being able to buy good quality companies at more attractive prices. Our strategy for your account remains consistent with our long-term focus on purchasing stocks below our estimate of their fair value. While the current correction should provide some opportunities, we will continue to adhere to our methodical process of purchasing those stocks that can be bought at prices that meet our investment standards, while providing an acceptable margin-of-safety. Likewise, we will reduce or sell those stocks that exceed our estimate of fair value, irrespective of the prevailing currents found in the capital markets.