2016 Market Recap and 2017 Outlook

If 2016 taught us anything, it is that the world is complex and unpredictable. In the first half of the year, there was a sharp sell-off in stocks as oil prices tumbled, China growth scares resurfaced, and U.S. growth slowed. Major geopolitical events, such as Brexit, an unexpected Trump victory in the U.S. presidential election, and a resounding "no" vote against the Italian referendum took stocks on a wild ride. However, equity markets once again finished in positive territory, as the S&P 500 crossed 2,200 for the first time ever in November and the Dow Jones Industrial Average finished the year just under the 20,000 mark.

The highlight of 2016 was U.S. small cap stocks that far outperformed all other asset classes - up 22% for the year. U.S. large cap stocks ended up over 12% and commodities increased 10% as production cuts from OPEC and prospects of increased infrastructure spending supported these elevated prices. As a result of a better economic growth outlook and improvement in commodity prices, Emerging Markets grew 11%, recapturing most of the 2015 drawdown.

Core fixed income and other interest rate sensitive sectors, such as Real Estate, did not fare as well in 2016. Interest rates moved upward in the second half of the year as a result of higher expected inflation and growth. The Barclays Agg was up only 2% for 2016 and REITs up 8%. Cash, yet again, was the underperformer up just 0.3%.

INDEX	Q1	Q2	Q3	Q4	2016
S&P 500 (US Large Cap)	1.42	2.34	3.89	4.01	12.16
Russell 2000 (US Small Cap)	-1.47	3.93	8.92	9.02	21.6
MSCI EAFE (Int'l Developed)	-2.28	-0.53	6.26	-1.66	1.58
MSCI EM (Emerging Markets)	6.4	1.11	9	-5.44	10.87
GSCI (Commodities)	-3.09	12.54	-4.51	5.74	10.12
US Real Estate	6.3	6.76	-1.49	-2.85	8.6
Aggregate Bond	2.96	2.43	0.4	-3.21	2.48

**Sources: Morningstar/ Yahoo Finance*

With consumer confidence climbing in December to the highest level since August 2001, investors have the task of allocating capital for the future today. Slow growth and low (even negative) interest rates have defined the global economy over the last few years, and many are curious as to what 2017 and the future hold. The answer is simple – no one exactly knows (just review the points above regarding 2016). However, the outlook for portfolio returns continues to be modest relative to what has been experienced since early 2009.

The information below is not meant to provide investment advice or in any way guarantee results. Rather, these are viewpoints based on current market observations and meant only for discussion purposes.

- The U.S. economy has been expanding for seven years, more than doubling the average length of an expansion (38 months). The rapid appreciation of prices over the last two months with no meaningful improvement in earnings continues to leave valuations stretched. While there are reasons to be optimistic about 2017, risks still remain, and the speculation that this "Trump-rally" has been built on will need to translate into stronger fundamentals for the current levels to be sustained.
- The U.S. dollar has reached its highest level in fourteen years, and a strong dollar has traditionally been a headwind for the earnings of companies with significant international exposure.
- Value stocks have underperformed growth stocks in six of the last seven years. Yet recently, with earnings growth stalled and stock valuations relatively high, cheaper companies have outpaced growth stocks. This could be favorable should the Trump administration continue to strike a more pro-cyclical, pro-business tone.
- While developed international stock prices are trading at relatively cheaper valuations than companies in the U.S., one should remain cautious. A perceived decline in the efficacy of monetary policy support in the Eurozone and Japan, along with risks of the negotiated UK exit from the EU, could continue the uncertainty.
- Valuations remain attractive in Emerging Markets. Both Russia and Brazil are working out of recessions and the negative impact from commodity prices have somewhat abated. However, questions regarding U.S. trade deals could impact the prospects.
- In fixed income, the Federal Reserve raised the fed funds rate ¼ of a percent in December to 0.75%. It is likely that the U.S will continue to experience rate increases in 2017, as the Fed anticipates three increases, all subject to the underlying economic data. This in turn will likely have a negative effect on bond prices, therefore continuing a shorter duration posture and higher exposure to investment grade credit may mitigate some of the effects.
- Alternative strategies continue to provide a diverse opportunity set and may provide benefits should investors experience bumps in stocks and bonds along the way.

In some ways, the investment environment for the next 5-7 years may prove more challenging than the last. This highlights the need for disciplined, diversified investment portfolios, reasonable expectations, and low-cost strategies. If you would like to discuss the specifics of your portfolio please do not hesitate to contact us. As always, please keep us informed of your cash needs as they play an integral part in the construction of your investment strategy.

The following sources were used to provide information for this communication:
www.advisorperspectives.com/dshort/updates/2016/12/27/consumer-confidence-increases-in-december
finance.yahoo.com
Morningstar
www.researchaffiliates.com
www.federalreserve.gov

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