Market Update

December 31, 2016

"America First" turned out to be more than just a campaign slogan during the fourth calendar quarter. U.S. markets reacted rationally and positively after the surprise election of Donald J. Trump as President of the United States on November 8, 2016.

President-elect Trump's prospective cabinet appointments are decidedly pro-business individuals, many coming from a Chief Executive Officer position within private industry, a marked contrast to previous administrations. These choices, along with Republican retention of majorities in the House and Senate, prompted investors to surmise that individual and corporate tax rates would decline and regulatory oversight would be scaled back. Coupled with statements about rebuilding infrastructure, the overwhelming consensus among investors was that economic growth would improve markedly from the 2.0% rate of the last eight years.

At the beginning of 2016, the equity markets declined over fears of an impending recession, a circumstance that never materialized. Now, with an economic expansion that is in its eighth year, market forecasters expect 3-4% growth in 2017 and beyond. What a turnabout in sentiment.

The best performing market sectors after the election were banks and telephone companies, two industries that would benefit from scaled back regulations. Interest rates rose dramatically from 1.6% on the Ten Year U.S. Treasury Note on September 30, to 2.5% on December 31, producing negative returns to bond investors and prompting significant withdrawals from bond mutual funds. The Federal Reserve raised short term rates by 0.25% but the bond market decline was a response to projected higher economic growth, a good thing, and not due to inflation concerns, a bad thing.

Foreign equity markets were negative during the fourth quarter with Developed Market returns down 2.7% and Emerging Market returns down 6.5%. A strengthening dollar and higher yields in the U.S. market prompted European and Japanese bond markets to decline and brought yield levels in those markets back above zero, another good development. U.S. equity markets had positive returns for the quarter with the S&P Index up about 2.0%. Small-cap indices were up more than 6.0%, as smaller companies have less exposure to economic headwinds flowing from a stronger dollar. With the expectation that the U.S. economy is poised to improve markedly, small companies appear to be positioned to be the largest beneficiaries of that potential outcome.

We remain optimistic about the prospects for equity market returns in 2017 and we continue to position client portfolios to participate in what we believe will be another good year.

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