INVESTMENT UPDATE NEWSLETTER

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2016 in Review: U.S. Markets Gain; Bonds Reach Tipping Point

After 2015, a year in which 2% U.S. GDP growth and the threat of disinflation seemed the eternal state of being with only a handful of growth stocks providing the bulk of positive market returns, 2016 broadened out with value stocks across the size spectrum outpacing the market overall. Economic data supported increasing evidence of an improving U.S. economy. On the fixed income side spreads narrowed so that "value" was found in high yield and emerging market debt. Thank you to Eaton Vance's Monthly Market Monitor for the numbers that follow.

U.S. stock indices were positive on the year, with the S&P 500 returning 12.0% and the Russell 2000 returning 21.3% (this follows a -4.4% return in 2015 for this small-cap weighted index). Meanwhile, U.S. bond indices had a positive return for the year, with U.S. high yield bonds being a superior performer. The **Barclays U.S. Aggregate** returned 2.7%, while **U.S. Corporate Investment Grade** topped the Aggregate components with a 6.1% return. Meanwhile, the **BofAML High Yield Index** returned 17.5% as investors searched for yield.

The **U.S. Dollar appreciated** further, 3.3% in 2016 versus the Euro (spot basis) and 6.2% versus the Japanese Yen. Commodities, which had a bloody 2015, had mixed returns in sub categories, although overall the **Bloomberg Commodity Index** rose 11.8% for the year. Brent Crude had an impressive 25.4% bounce. Both **Industrial Metals and Precious Metals** provided positive returns, the former up 19.9% and the latter up 9.5% for the year.

The developed markets **MSCI EAFE Index** was up a subdued 1.0%, as Europe more aggressively pursued a U.S.-style monetary stimulus program and Japan tried further fiscal stimulus. Foreign bonds managed a small gain, with the **Bloomberg Barclays Global Aggregate (Ex-U.S.)** up 1.5% for the year. The **MSCI Emerging Markets Index** bounced back nicely from 2015 with an 11.2% return in 2016.

While the broad U.S. benchmarks performed well for the year, it was not without a roller coaster ride. On the downside, the beginning of 2016 started with an approximate two hundred point drop in the Standard and Poor's 500 Index from year-end 2015 through February 11, 2016, only to circuitously retrace those footsteps upward through November 4, 2016. Fourth quarter 2016 ended with a nearly 200 point upward sprint from November 4 through year end. In addition, one must not forget the approximate 800 point after-hours drop election night to dawn the next day as it became increasingly clear Donald Trump was going to win the election. Along the way in 2016, noteworthy data points include the EpiPen debacle, which followed on the Daraprim price hike in 2015, just two examples of the challenges the **Health Care Sector** was faced with in 2016. This was the only S&P 500 Sector to be down for the year returning a negative (2.7%) for 2016. **Energy and Financials** were two top performing sectors, up 27.4% for the former and 22.8% for the latter.

Coming into 2017, the political winds of change loom large, just as recent economic data points toward increasing stability in the U.S. economy. Third quarter 2016 GDP came in at a 3.5% ("third estimate") annualized rate and the unemployment rate for December came in at 4.7%, which is below the long-term average of 5.8%. Inflation is running just under 2%, the Federal Reserve's long-term target, for the latest twelve months to November. The economic data points for the United States have slowly yet judiciously progressed positively since the recession of 2008-2009. U.S. equity markets are reaching for all-time highs, while the U.S. fixed income markets are coming off of extraordinarily low interest rates. With demographic, geopolitical, and social issues still looming large in the global economy, 2017 will likely not be without its surprises. For 2017 to be a year of continued stock market gains, earnings growth, whether from tax rate reduction, productivity gains, or revenue growth, will likely be a key area of focus for investors.