Market Update

December 2016 Review

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"New Fiscal Plans Fuel Market Outperformance"

After all the political turmoil and growing populist sentiment throughout 2016, the final month of the year ended on a positive note. Domestic and international equity markets finished December with gains and posted double digit returns for the full calendar year. While fixed income markets also posted gains, they were quite muted and may face increased pressure if pro-growth fiscal policies increase inflationary pressures in 2017. The post election environment in the U.S. has been surprising, as the markets have rallied significantly and consumer confidence readings are at record high levels.

Entering 2017 under a new administration, the U.S. economy is in the eighth year of an economic expansion. This is one of the longest recoveries since 1900 and before the election, many questioned our economy's ability to continue to grow. President-elect Donald Trump ran a campaign on the promise of lower taxes for companies and individuals, increased infrastructure and defense spending and financial and environmental deregulation: all reforms promoting higher economic growth. However, there is still a lot of uncertainty on what his actual impact will be and how long it will take to implement some of these reforms. For instance, Washington Analysis indicates that tax reform may not take effect until January 2018. Regardless of the timing of new policies, markets like the fiscal plans the President-elect has communicated so far. Also, given that Republicans have control of both houses of Congress, it should theoretically be much easier to pursue an agenda than under the previous administration. The major equity indices have reacted to these plans and have set new records in the last month of the year. The Dow returned 3.4% in December and closed out its best year since 2013, gaining 16.5%. The S&P 500 was also up in the double digits for the year at 12.0% and returned 2.0% for the month. NASDAQ was up 1.1% and closed the year at 7.5%.

This has proved to be one of the largest post-election rallies in history, however it will be interesting to see if consumer spending will trend in the same direction, given that it accounts for most of our economic growth. So far, consumer confidence has surged, as the Michigan Consumer Sentiment Index hit a 12-year high and the Conference Board's Consumer Confidence Index hit a 15-year high in December. However, retail sales have only increased modestly, personal income remained unchanged and personal spending increased softer than expected in November.

	December 2016	YTD
DJIA	3.44%	16.50%
S&P 500	1.98%	11.96%
NASDAQ	1.12%	7.50%
MSCI EAFE	3.42%	1.00%
MSCI Emerging Markets	0.22%	11.19%
Barclays Aggregate	0.14%	2.65%
Barclays Corp High Yield	1.85%	17.13%
	12/31/2016	11/30/2016
US 10-Year Treasury Yield	2.45%	2.37%

Internationally there has been a growing populist sentiment which could inspire events similar to Brexit and the U.S. Election. Upcoming elections in Germany and France could push these key European economies into pursuing more nationalistic policies. The MSCI EAFE Index, which represents international developed markets, gained 3.4% in December but was only up 1% during the full calendar year. On the other hand, emerging markets sold off sharply following Trump's election. A major influence on emerging markets performance has been Federal Reserve action. The FOMC voted to raise rates 25 basis points in December and signaled possibly three more rate hikes in 2017. Higher interest rates in the U.S. are associated with a stronger dollar and capital flows out of emerging markets, which is why this index only gained a meager 0.2% in December.

Investment-grade fixed income indices were only slightly positive for the month, as measured by the Barclay's Aggregate Index. However the Barclays U.S. High Yield Index tacked on 1.9% for the month and was the best performing index in 2016, gaining 17.1%. Going forward, the impact of higher growth, inflationary pressures and future rate hikes suggests a more cautious fixed income environment in 2017.

Plans to lower taxes and increase infrastructure spending could help boost economic growth, which has been averaging about 2.1% a year during the most recent expansion. Higher growth and future expected rate increases during the year may be positive for global equities. However, faster growth may have its own negative implications such as an uptick in inflation, which would sharply contrast disinflationary forces in Europe. This, combined with a continued political risk in Europe, could be key drivers of volatility as we navigate through 2017.

For previous market commentaries please click here.

An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The 10 Year Treasury Yield is the interest rate the U.S. government pays to borrow money for a 10-year period. In addition to influencing how much the government pays to borrow over this timeframe, the 10-year Treasury Yields also determines how much investors earn by investing in this debt and it is a good indicator of investor sentiment. The higher the yield, the better the economic outlook.

The S&P Case Shiller Index is a group of indexes that tracks home prices in the U.S.. It seeks to measures the value of residential real estate in 20 major U.S. cities.

Michigan Consumer Sentiment Index is a survey of consumer confidence conducted by the University of Michigan. The Michigan Consumer Sentiment Index (MCSI) uses telephone surveys to gather information on consumer expectations regarding the overall economy.

Conference Board's Consumer Confidence Index an index by the Conference Board that measures how optimistic or pessimistic consumers are with respect to the economy in the near future.

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