



Asset Strategy Consultants

# MARKET ENVIRONMENT

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Fourth Quarter 2016

# Market Environment: Economy

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*The U.S. economic picture continued to improve during the final quarter of 2016. In response to relatively strong data the Fed, in a widely anticipated move, raised its Fed Funds target in December. The U.S. dollar reached its highest level against a basket of major currencies in 14 years. Outside the U.S., the euro zone grew at a slow pace and Japan's economy remained stagnant.*

- Third quarter GDP was revised up to +3.5%
  - The sharpest quarterly increase in two years
  - Year-over-year +1.7%
- The Fed raised its Fed Funds target 25 bps to a range of 0.50% – 0.75%
  - This was the Fed's only move for 2016
  - The Fed expects three additional hikes in 2017, though the markets expect fewer
- Inflation remained benign but wages picked up
  - Personal Consumption Expenditures Index +1.4% y-o-y as of November, but still short of Fed's 2% target; Core was +1.6% y-o-y
  - Headline CPI +1.7% y-o-y; Core CPI +2.1% y-o-y
  - Wages advanced 3.9% in October, the fastest since November of 2008, per Atlanta Fed's wage growth tracker index
- Unemployment reached a nine-year low of 4.6% in November
- Consumer confidence hit its highest level in 15 years in December
  - According to the Conference Board's Index
- Car sales in 2016 set a record high of more than 17.6 million
  - The number of cars sold has been increasing since 2009
- Home prices hit an all-time high in November
  - Average price for an existing single family home reached \$282,341 in November
- Euro zone economies remained weak but showed some improvement
  - Euro zone unemployment declined to 9.8% in October from 10.0% in September
  - Consumer prices in the euro zone increased but remained below the 2% target
  - Euro zone GDP +0.3% (+1.6% y-o-y) in the third quarter
  - ECB announced an extension of its asset purchase program but purchases will be €20 billion lower per month after March 2017
- Japanese GDP +0.3% (+1.0% y-o-y) in Q3
  - Below the preliminary estimate of +0.5%



# Market Environment: Fixed Income

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*Interest rates in the U.S. rose sharply in the fourth quarter, driven both by encouraging economic data and concerns that the pro-growth agenda put forth by President-elect Donald Trump will have an inflationary effect. The 10-year U.S. Treasury yield rose 85 bps and returned -6.8% for the quarter in the sharpest quarterly selloff in more than two decades.*

- Bloomberg Barclays U.S. Aggregate Index returned -3.0% for the quarter but +2.6% in 2016
  - Corporate bond sector outperformed (Q4: -2.8%; 2016: +6.1%)
  - Corporate issuance hit another record high in 2016 (roughly \$1.4 trillion)
- High yield corporates performed best
  - Bloomberg Barclays High Yield Index Q4: +1.8%; 2016: +17.1%
- Municipal bonds faced headwinds
  - Robust supply, concerns over Trump's tax policy, and tax loss harvesting contributed to outflows
  - Bloomberg Barclays Municipal Bond Index Q4: -3.6%; 2016: +0.2%
- TIPS outperformed nominal Treasuries
  - Bloomberg Barclays TIPS Index -2.4% Q4; +4.7% 2016
  - 10-year breakeven spreads widened to 1.95% from 1.60% as of 9/30
- Global bonds (unhedged) plunged due to strong dollar
  - Bloomberg Barclays Global Aggregate ex-US (unhedged): Q4: -10.3%; 2016: +1.5%
  - Yen lost more than 13% versus the dollar over the quarter while the euro depreciated by more than 6%
  - Bloomberg Barclays Global Aggregate ex-US (hedged): Q4: -1.9%; 2016: +5.0%
- Emerging markets debt underperformed
  - Dollar-denominated JPM EMBI Global Diversified Index Q4: -4.0%; 2016: +10.2%
  - Local currency-denominated JPM GBI-EM Global Diversified Index Q4: -6.1%; 2016: +9.9%



# Market Environment: Global Equity

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*U.S. equities posted strong returns in the fourth quarter, cheered by relatively good economic data, a rebound in corporate earnings, and speculation that Trump's presidency will bring lower taxes, lighter regulation and increased spending. The S&P 500 climbed to an all-time high of 2,239 on December 30. Non-US equity returns were negatively impacted by the strong dollar.*

## U.S. Equity

- Small stocks outperformed large caps
  - S&P 500 Q4: +3.8%; 2016: +12.0%
  - Russell Mid Cap Q4: +3.2%; 2016: +13.8%
  - Russell 2000 Q4: +8.8%; 2016: +21.3%
- Value outperformed growth
  - Russell 2000 Value Q4: +14.1% vs. Growth +3.6%
  - Russell 2000 Value 2016: +31.7% vs. Growth +11.3%
  - Value bolstered by Financial and Energy stocks, which comprise significant portion of value indices
- Sector returns divergent
  - Best performing sector was Financials (+21.1% Q4; +22.8% 2016)
  - Health Care (Q4: -4.0%; 2016: -2.7%) and Real Estate (Q4: -4.4%; 2016: +3.4%) are among the worst

## International Equity

- Developed markets underperformed U.S.
  - MSCI EAFE: Q4: -0.7%; 2016: +1.0%
  - Best performer was Italy (Q4: +11.0%; 2016: -10.5%)
- Emerging markets underperformed
  - MSCI EM: Q4: -4.2%; 2016: +11.2%
  - Russia posted the best return (Q4: +19%; 2016: +54.8%) while Turkey (Q4: -14%; 2016: -8.5%) sank
  - Mexico (Q4: -7.9%; 2016: -9.2%) was hurt by Trumponomic concerns



# Market Environment: Liquid Real Assets

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*Commodities benefitted from OPEC announced cuts as well as the prospect of increased infrastructure spending.*

- Oil prices rose to the highest level since July 2015
  - WTI ended the year at \$53.72 (Q4: +11.4%; 2016: +45.0%)
- Gold plummeted after rate hike
  - Down 12.6% for the quarter but up +8.6% for the year
- Commodities up modestly
  - Bloomberg Commodity Index: Q4: +2.7%; 2016: +11.8%
- MLPs up modestly
  - Alerian MLP: Q4: +2.0%; 2016: +18.3%
- REITs down on higher interest rates
  - NAREIT Equity: Q4: -2.9%; 2016: +8.5%
- Headline inflation rose but remained benign
  - Headline CPI +1.7% y-o-y as of November (vs. +1.1% in August)
  - Core CPI +2.1% y-o-y as of November
- TIPS outperformed nominal Treasuries
  - Bloomberg Barclays TIPS Index -2.4% for the quarter but +4.7% for the year
  - 10-year breakeven spreads widened to 1.95% from 1.60% as of 9/30



# Returns for Various Periods

	Month Ending			Last	Last 2	Last 3	Last	Last 3	Last 5	Last 10	Last 15
	Dec-31	Nov-30	Oct-31	Quarter	Quarters	Quarters	Year	Years	Years	Years	Years
MSCI:ACWI	2.16	0.76	-1.70	<b>1.19</b>	6.55	7.61	<b>7.86</b>	3.13	9.36	3.56	5.92
Russell:3000 Index	1.95	4.48	-2.16	<b>4.21</b>	8.79	11.65	<b>12.74</b>	8.43	14.67	7.07	7.11
Russell:3000 Growth Index	1.25	2.67	-2.64	<b>1.20</b>	6.18	7.03	<b>7.39</b>	8.27	14.44	8.28	6.50
Russell:3000 Value Index	2.63	6.28	-1.68	<b>7.24</b>	11.40	16.49	<b>18.40</b>	8.55	14.81	5.76	7.54
Russell:Top 50	2.93	2.29	-1.74	<b>3.45</b>	6.95	9.34	<b>10.43</b>	8.77	13.96	6.26	5.33
Russell:Top 200	2.18	3.36	-1.45	<b>4.08</b>	8.07	10.52	<b>11.33</b>	8.87	14.67	6.79	6.10
Russell:Top 200 Growth	1.55	1.42	-1.74	<b>1.21</b>	5.84	6.09	<b>6.95</b>	9.53	14.94	8.61	6.05
Russell:Top 200 Value	2.83	5.46	-1.14	<b>7.21</b>	10.47	15.45	<b>16.20</b>	8.22	14.40	4.97	6.19
S&P:500	1.98	3.70	-1.82	<b>3.82</b>	7.82	10.47	<b>11.96</b>	8.87	14.66	6.95	6.69
Russell:1000 Index	1.88	3.94	-1.95	<b>3.83</b>	8.01	10.75	<b>12.05</b>	8.59	14.69	7.08	7.00
Russell:1000 Growth	1.24	2.18	-2.35	<b>1.01</b>	5.64	6.29	<b>7.08</b>	8.55	14.50	8.33	6.42
Russell:1000 Value	2.50	5.71	-1.55	<b>6.68</b>	10.39	15.45	<b>17.34</b>	8.59	14.80	5.72	7.41
S&P:400 Mid Cap	2.19	8.01	-2.68	<b>7.42</b>	11.87	16.33	<b>20.74</b>	9.04	15.33	9.16	9.73
Russell:Midcap Index	1.14	5.39	-3.17	<b>3.21</b>	7.87	11.30	<b>13.80</b>	7.92	14.72	7.86	9.51
Russell:Midcap Growth	0.35	4.35	-4.06	<b>0.46</b>	5.07	6.71	<b>7.33</b>	6.23	13.51	7.83	7.96
Russell:Midcap Value	1.78	6.26	-2.42	<b>5.52</b>	10.22	15.47	<b>20.00</b>	9.45	15.70	7.59	10.28
S&P:600 Small Cap	3.37	12.55	-4.48	<b>11.13</b>	19.14	23.28	<b>26.56</b>	9.47	16.62	9.03	10.17
Russell:2000 Index	2.80	11.15	-4.75	<b>8.83</b>	18.68	23.18	<b>21.31</b>	6.74	14.46	7.07	8.49
Russell:2000 Growth	1.36	8.95	-6.21	<b>3.57</b>	13.12	16.79	<b>11.32</b>	5.05	13.74	7.76	7.48
Russell:2000 Value	4.13	13.27	-3.29	<b>14.07</b>	24.19	29.54	<b>31.74</b>	8.31	15.07	6.26	9.22
Russell:Microcap	4.55	11.62	-5.70	<b>10.05</b>	22.43	27.28	<b>20.37</b>	5.77	15.59	5.47	8.16
MSCI:ACWI ex US	2.56	-2.31	-1.44	<b>-1.25</b>	5.57	4.89	<b>4.50</b>	-1.78	5.00	0.96	5.87
MSCI:EAFE	3.42	-1.99	-2.05	<b>-0.71</b>	5.67	4.13	<b>1.00</b>	-1.60	6.53	0.75	5.29
MSCI:EAFE Growth	2.21	-3.41	-4.30	<b>-5.53</b>	-0.84	-0.99	<b>-3.04</b>	-1.20	6.67	1.64	5.06
MSCI:EAFE Value	4.58	-0.62	0.23	<b>4.17</b>	12.50	9.37	<b>5.02</b>	-2.14	6.28	-0.22	5.41
MSCI:EAFE Small Cap	2.87	-2.81	-2.83	<b>-2.86</b>	5.54	2.79	<b>2.18</b>	2.10	10.56	2.95	9.53
MSCI:EM	0.22	-4.60	0.24	<b>-4.16</b>	4.49	5.18	<b>11.19</b>	-2.55	1.28	1.84	9.50
Blmbg:Aggregate Idx	0.14	-2.37	-0.76	<b>-2.98</b>	-2.53	-0.37	<b>2.65</b>	3.03	2.23	4.34	4.58
Blmbg:US TIPS Index	-0.10	-1.92	-0.40	<b>-2.41</b>	-1.47	0.22	<b>4.68</b>	2.26	0.89	4.36	5.30
Blmbg:Long Gov/Cr	0.73	-5.83	-2.84	<b>-7.84</b>	-6.70	-0.59	<b>6.67</b>	7.16	4.07	6.85	7.03
Blmbg:Long Credit A	1.33	-4.81	-2.24	<b>-5.71</b>	-4.02	1.77	<b>8.44</b>	7.30	5.26	6.40	6.67
Blmbg:High Yield CP	1.84	-0.47	0.39	<b>1.75</b>	7.40	13.34	<b>17.13</b>	4.65	7.36	7.46	8.36
Blmbg:Mn 1-10(1-12)	0.72	-2.75	-0.58	<b>-2.62</b>	-2.72	-1.32	<b>-0.10</b>	2.32	2.03	3.69	3.87
Blmbg:Gl Agg ex US	-0.96	-5.27	-4.35	<b>-10.26</b>	-9.34	-6.26	<b>1.49</b>	-2.59	-1.39	2.44	4.96
Blmbg:Gl Agg x US H	0.37	-1.09	-1.15	<b>-1.86</b>	-1.35	1.34	<b>4.90</b>	4.97	4.50	4.41	4.48
JPM:EMBI Plus	1.32	-4.64	-2.01	<b>-5.32</b>	-2.37	3.48	<b>9.62</b>	5.82	5.10	6.61	9.41
Blmbg:Commodity TR Idx	1.80	1.33	-0.49	<b>2.66</b>	-1.31	11.30	<b>11.77</b>	-11.26	-8.95	-5.57	1.16
GS Commodity Index	4.72	2.53	-1.50	<b>5.76</b>	1.37	14.22	<b>11.37</b>	-20.60	-13.13	-8.10	-1.03
S&P:Gold Spot Price Ix	-1.89	-7.79	-3.34	<b>-12.56</b>	-12.79	-6.79	<b>8.63</b>	-1.42	-5.97	6.08	9.91
FTSE:NAREIT Equity Index	4.69	-1.69	-5.66	<b>-2.89</b>	-4.29	2.37	<b>8.52</b>	13.38	12.01	5.08	10.80

