2016 Investment Market Recap

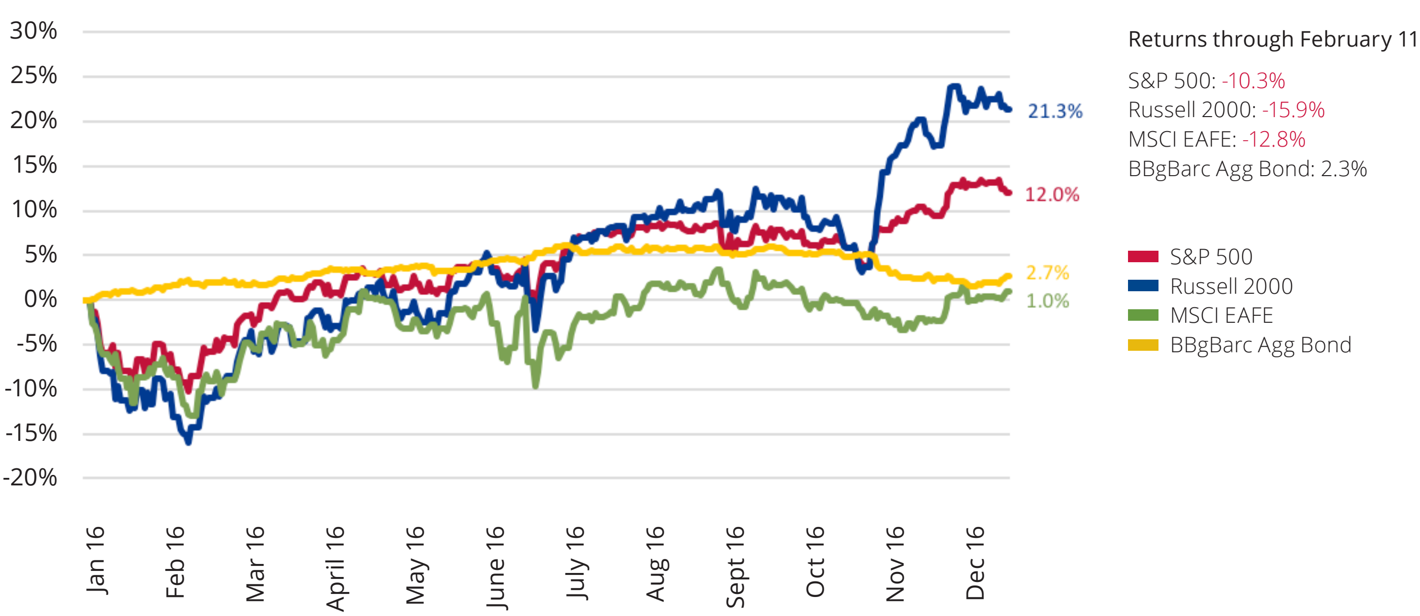
2016 was marked by several events that impacted markets throughout the year. Notable events included the British voting to exit the European Union ("Brexit"), the U.S. presidential election, and the second hike in the federal funds rate since the Federal Reserve (the "Fed") set the target rate to zero in 2008. In addition, slow economic growth, gradually improving labor markets, and volatile oil prices were a constant source of investor uncertainty throughout the year.

Through early February, the equity markets were in negative territory in response to weak economic data, and bonds rallied as interest rates fell. The S&P 500® Index reached its low point for the year on February 11 and charted a general upward trend thereafter, with the exception of a sharp, but short-lived, dip following the Brexit vote and some downward pressure heading into the election. Late in the year, as employment and Gross Domestic Product (GDP) numbers improved and investors became optimistic about the pro-growth strategies of President-elect Donald Trump, stocks moved even higher.

Equity Markets

Standard & Poor's 500 index hit record highs during the year and finished the year up 12.0%, a significant improvement from performance earlier in the year. The Russell 2000 Index®, a domestic small-cap equity benchmark, generally followed the same trend as large-cap stocks, but responded more significantly to economic growth expectations late in the year and returned an impressive 21.3% in 2016. The MSCI EAFE Index®, a benchmark that tracks the returns of non-U.S. developed equity markets, primarily in Western Europe and developed Asia, had a positive return of 1.0% for the year. The Bloomberg Barclays U.S. Aggregate Bond Index had been up over 5% through the summer months as interest rates fell during the first half of the year, but the index gave back some of this return as rates rose late in the year. The index finished the year in positive territory, up 2.7%.

2016 Returns



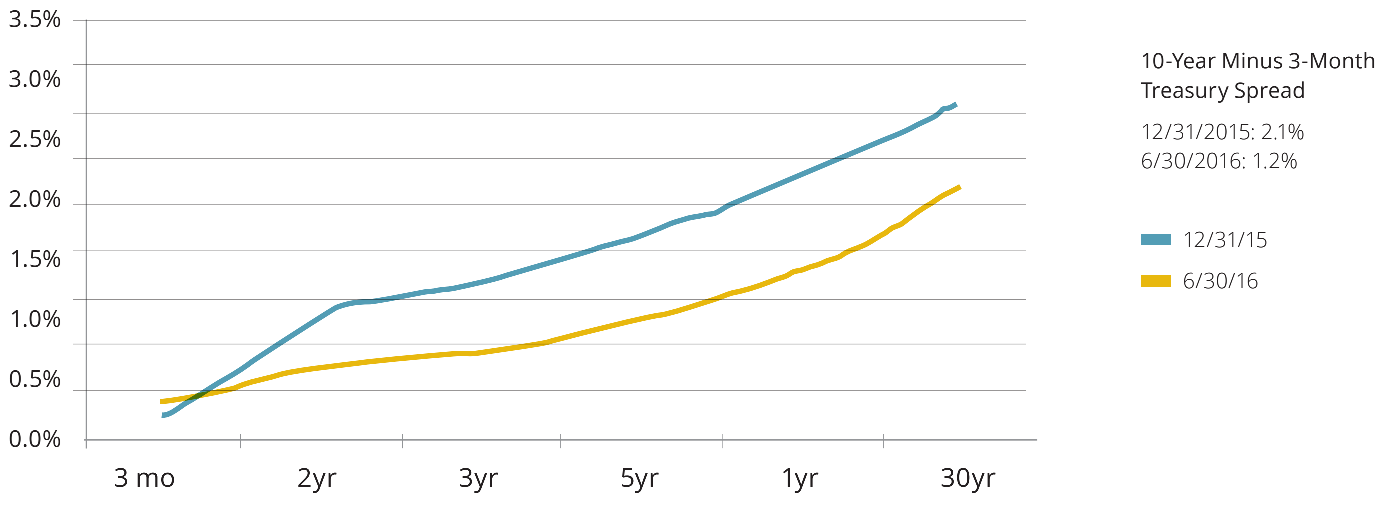
Source: Morningstar® Direct℠

Interest Rates

During the first half of the year, the U.S. Treasury yield curve flattened somewhat as long-term rates came down markedly. The changing shape of the yield curve was a topic of interest for investors during 2016. Investor interest in the shape of the yield curve stems from its historical connection to recessions. Specifically, the interest is so great because every case of a negative yield spread [ten-year Treasury yield minus three-month Treasury yield] in the past 30 or so years has been followed by a recession within the next 12 months. Although the spread did not turn negative during the year, the change was still a noteworthy discussion point as "declines in the yield spread are argued to signal economic slowdowns.[1] However, by the end of the year the spread on U.S. Treasurys was nearly back to the level that it began the year.

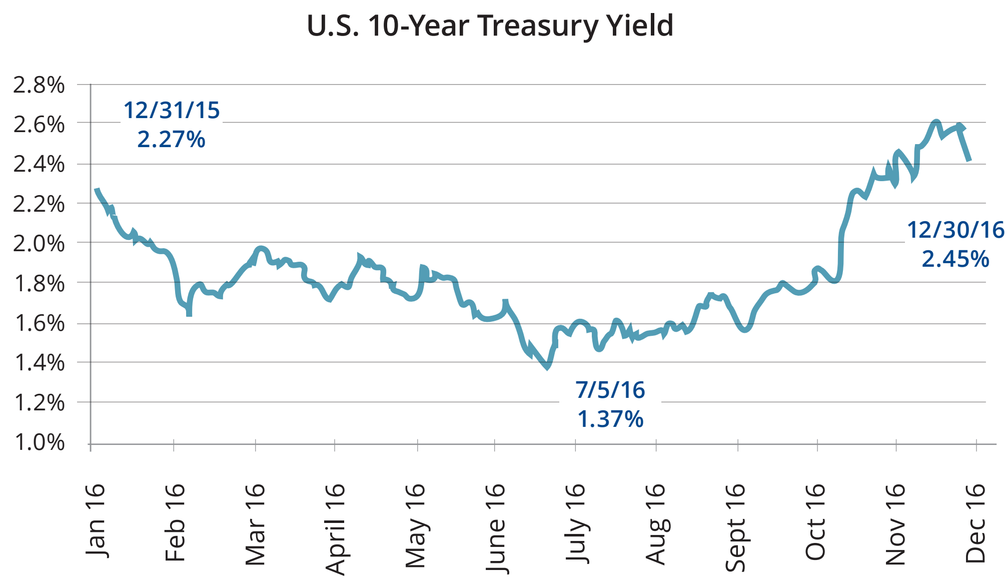
On the short end of the curve, the Fed had been reluctant to raise the fed funds rate throughout the year as it was cautious not to short circuit the anemic economic recovery and had not seen meaningful inflation to drive a move in rates. In December, the Fed finally elected to increase the fed funds rate by a quarter of one percent (25 basis points), believing that the economy could withstand higher rates.

U.S. 10-Year Treasury Yield Curve



Source: U.S. Department of the Treasury

1 https://www.stlouisfed.org/on-the-economy/2016/march/is-yield-curve-signaling-recession



Source: Federal Reserve Bank of St. Louis

Brexit

In late June, the citizens of the United Kingdom voted to exit the European Union. Then Prime Minister David Cameron had previously promised, during his 2015 campaign, to bring the Brexit referendum to a public vote. Cameron had supported continued membership in the European Union and resigned as prime minister after the vote. Following this referendum, the S&P 500 lost over one hundred points, or about 5% of its value, in just two days. Within a week the equity markets had shrugged off the news and regained the lost ground. The domestic market was again setting new highs by late summer.

Economic Growth

A theme in early 2016 had been slow GDP growth. GDP measures the domestic output of all goods and services in the U.S. economy. In the first quarter of the year, GDP growth was an anemic 0.8%, annualized.[2] During the second quarter GDP growth improved to 1.4%, but still was not the robust growth that the Fed was looking for before raising the fed funds rate. Third-quarter U.S. GDP showed a huge improvement with a rise of 3.5%. This improvement in the economy gave Federal Reserve Board Chair Janet Yellen the ammunition that she needed to increase the fed funds rate by 25 basis points at the December Federal Open Market Committee meeting.

Labor Markets

According to data from the Bureau of Labor Statistics, more than 270,000 jobs were created each month during the final quarter of 2015. Moving into 2016, job creation dipped as an estimated 168,000 jobs were created in January. However, it was not until May of 2016 that there was a strong cause for concern. Job creation during the month of May fell to 24,000 jobs and this data point raised the question of whether or not the economic recovery was running out of steam. While economists' estimates of break-even job growth vary substantially, the median estimate from The Wall Street Journal's survey of economists suggests that 145,000 jobs need to be created each month in order to hold the unemployment rate steady.[3] That number is significantly

2 https://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm
3 http://blogs.wsj.com/economics/2016/04/07/the-new-magic-number-for-monthly-job-growth-145000/

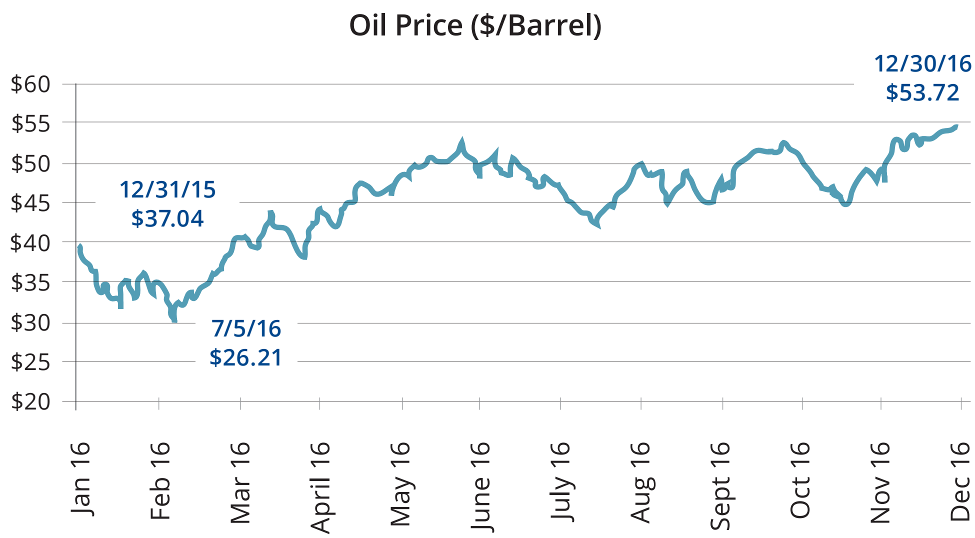
higher than the 24,000 jobs that were created in May. However, the job market very quickly recovered when the number of jobs created in June was once again above 270,000.

Data from the Bureau of Labor Statistics indicates that the unemployment rate fell below 5% at the beginning of 2016. The unemployment rate hovered between 4.9% and 5% for much of the year before falling as low as 4.6% in November.

Oil

Oil prices began the year in a downward trend. Consumers benefitted from the lower cost of gasoline early in the year as oil prices fell to $26.55 per barrel in January and then fell again in February, reaching a low for the year of $26.21 per barrel.[4] After rebounding from the low in February, oil prices reached above $50 in June and then spent much of the second half of the year between $40 and $50 per barrel. Although oil prices ended the year at $53.72, prices still have a considerable way to go before they reach the $100-per-barrel mark that we last saw in 2014.

According to data from the International Energy Agency, global supply for oil continued to exceed global demand for oil during 2016, a condition that supports low oil prices. In November the members of OPEC, the Organization of the Petroleum Exporting Countries, decided to take action and cut oil production in order to support the recovery of oil market balance.



Source: Bloomberg
Oil prices shown for West Texas Intermediate (WTI) Crude

4 http://www.opec.org/opec_web/static_files_project/media/downloads/press_room/OPEC%20agreement.pdf

Presidential Election

As the year came to a close, the U.S. presidential election brought more uncertainty to the markets. We saw additional downward pressure on equity prices heading into November that was soon followed by exuberance and new equity-market highs in December following the unanticipated election of Donald Trump. The equity markets soared with President-elect Trump's promise to deregulate financial services, the potential repeal of Obamacare, and the promise to reduce taxes for individuals and businesses to stimulate growth and keep corporations from moving outside the United States.

2016 demonstrated investors' lack of ability to predict the future outcome of various events. Some examples were the outcome of the U.S. presidential election, Brexit and interest rates falling to historical lows and then rising toward the end of the year. Although markets responded quickly and sharply to events throughout the year, the U.S. stock market managed to end each quarter higher than it ended the previous. Investors who stayed the course in equity markets through the challenging year were ultimately rewarded for their patience.

The S&P 500® Index is an unmanaged index considered indicative of the domestic large-cap equity market. The MSCI EAFE® Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity performance of developed markets, excluding the U.S. and Canada. As of December 31, 2014, the MSCI EAFE® Index consisted of 22 developed market country indices. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The FTSE NAREIT U.S. Real Estate Index Series is to present investors with a comprehensive U.S. REIT performance index. The FTSE EPRA/NAREIT Developed ex-U.S. Index is a subset of the FTSE EPRA/NAREIT Developed Index and is designed to track the performance of listed real estate companies and REITs outside of the U.S. The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Bloomberg Commodities Index tracks the returns of a broad based basket of various commodities.The S&P 500® Index is a registered trademark of Standard & Poor's Financial Services, LLC. Russell 2000® Index is a registered trademark of Russell Investments. MSCI EAFE® is a registered trademark of MSCI Inc.

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