Fourth Quarter Commentary, January 2017

Final Quarter of 2016 Contributes to Positive Year

Who would have imagined record market highs at this point last year, when the indices ended the year in negative territory? Or when 2016 got off to such a rocky start, tumbling 10% in the first two weeks—the worst start to a year since 1930?

The markets eventually bottomed in mid-February and began a long, slow recovery, turning positive by the end of March, suffering a setback when the U.K. decided to leave the Eurozone and endured another hard bump right after the elections. In the end, the Dow finished at 19,762.60 for the year and the bull market has continued.

Equities

This was the second year in a row that the final quarter provided investors with solid gains. The Wilshire 5000–the broadest measure of U.S. stocks—was up 4.54% in the fourth quarter of 2016, ending the year up 13.37%. The comparable Russell 3000 index gained 4.21% in the final quarter, to finish up 12.74% for the year.

Large cap stocks were up as well. The Wilshire U.S. Large Cap index gained 4.14% in the fourth quarter, and finished the year up 12.49%. The Russell 1000 large-cap index closed with a 3.83% fourth quarter performance, and finished the year up 12.05%, while the widely-quoted S&P 500 index of large company stocks was up 3.25% in the fourth quarter, finishing up 9.54% for calendar 2016.

The Wilshire U.S. Mid-Cap index gained 5.31% in the final quarter, finishing the year with a gain of 17.22%. The Russell Midcap Index gained 3.21% in the fourth quarter, and was up 13.80% in calendar 2016.

This was a year to remember for investors in small company stocks. As measured by the Wilshire U.S. Small-Cap index, investors posted an 8.30% gain over the last three months of the year, for a total return of 22.41% over the entire 12 months. The comparable Russell 2000 Small-Cap Index finished the year up 21.31%, while the technology-heavy Nasdaq Composite Index rose 1.34% in the fourth quarter, to finish the year up 7.50%.

International

International investments contributed a slight decline to overall portfolio returns. The broad-based EAFE index of companies in developed foreign economies lost 1.04% in the fourth quarter of the year, finishing the year down 1.88% in dollar terms. In aggregate, European stocks lost 3.39% for the year, while EAFE's Far East Index gained just 0.14%. Emerging markets stocks of less developed countries, as represented by the EAFE EM index, gained 8.58% for the year.

Commodities and Hard Assets

Looking over the other investment categories, real estate investments, as measured by the Wilshire U.S. REIT index, lost 2.28% during the year's final quarter, but managed to finish up 7.24% for calendar 2016.

Last year, investors were wondering why they owned commodities in their portfolios, when their statements showed that the index delivered a whopping 32.86% loss. This year, they may be wondering why they weren't more committed to the asset class, as the S&P GSCI index gained 27.77%, fueled in part by a 45.03% rise in the S&P crude oil index. Gold prices shot up 8.63% for the year and silver gained 15.84%.

Fixed Income

In the bond markets, it's possible that the decades-long bull market—which basically means declining interest rates—has ended, and the fixed-income world is experiencing rate rises. But despite the nudge by the Federal Reserve Board, the moves have not exactly been dramatic. Over the past year, rates on 10-year Treasury bonds have risen from 2.25% to 2.44%, while 30-year government bond yields have risen from 3.00% to 3.07%. According to Barclay's Bank indices, U.S. liquid corporate bonds with a 1-5 year maturity have seen yields rise incrementally from 2.4% to 2.8% on average.

As always, there were many unpredictable anomalies in the investment world. In the international markets, anyone lucky enough to have speculated on the Brazilian Bovespa index—comparable to the U.S. S&P 500—would have reaped a gain of 68.9% this year, despite all the headline drama around the Zika virus and political uncertainties that were reported on during the Olympic games. Russian stocks were up 51% for the year, despite the recent sanctions from the U.S. government and the lingering international sanctions related to the invasion of the Crimean peninsula.

Outlook

What's going to happen in 2017? Short-term market traders seem to be expecting a robust economic stimulus combined with lower taxes and deregulatory policies that would boost the short-term profits of American corporations. But it is helpful to remember that we are entering the ninth year of economic expansion, making this the fourth longest since 1900. In addition, growth has not exactly been robust;

the U.S. GDP has averaged just 2.1% yearly increases since the Great Recession, making this the most sluggish of all post-World War II expansions.

Slow but steady has not been a terrible formula for workers or stock investors. The unemployment rate has slowly ticked down from a post-recession peak of 10% to less than 5% currently. U.S. stock indices are posting record highs with double-digit gains, and that Dow 20,000 level, while essentially meaningless, is still catching a lot of attention.

Domestically, a new president takes office on January 20 and the policies of the new administration and those of the US Congress will set the pace for the market's strength or weakness. At the same time, there are many unknowns around the globe. China's economic growth has stalled for the second consecutive year, and you will soon be reading about a banking crisis in Italy that could force the country to leave the Eurozone—potentially a much bigger blow to European economic unity than Brexit or a still-possible Greek exit. There can also be a continuation of ISIS-sponsored terrorism in Europe and elsewhere.

Every year of this longstanding bull market, we have had to look over our shoulders and wonder when and how it will end. With the January downturn and so much uncertainty at this time last year, nobody could have predicted double-digit returns on U.S. stocks at year-end. What we have learned over the past few years is that the markets have a way of surprising us. Therefore, continuing to stay committed to solid, long term goals and a well thought out strategy has been shown, again, to pay off over the long run.

We appreciate your continued confidence in our firm and for referring new clients to us. Feel free to call us with any questions.

Disclosure