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Investment Review & Outlook
2016 Fourth Quarter Report

2016 Year End Report

You know you're deep into a longstanding bull market when you see things like average pedestrians keeping one eye on the market tickers outside of brokerage houses to see when the Dow Jones Industrial Average has finally breached the 20,000 mark. Who would have imagined record market highs at this point last year, when the indices ended the year in negative territory? Or when New Year 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. In the end, the Dow finished at 19,762.60 for the year—the bull market has continued for another year.

Large cap stocks were as 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%, The S&P 500 index of large company stocks was up 3.25% in the fourth quarter, finishing up 9.54% for 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 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.

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.

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.

It's clear that the new President-elect wants to accelerate America's economic growth, but the policy prescription has not always been clear. Will we rip up longstanding trade agreements, cut back on immigration quotas and deport millions of workers who crossed the border without a visa? Will there be a wall built between the U.S. and Mexico? Will the government pay for huge infrastructure projects, at the same time reducing taxes and thus raising the national debt? Will Congress raise the debt ceiling without protest if that happens? Will the Fed raise rates more aggressively in the coming year, or cooperate with the President-elect in his efforts to drive the economy into a faster lane?

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. Russian hackers may have ushered in an era of unfettered global intrusions into our Internet infrastructure, and there will surely be a continuation of ISIS-sponsored terrorism in Europe and elsewhere.

Every year of this longstanding bull market, we have 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. Next year could bring more of the same, or it could fulfill the dire predictions many have made during the election cycle, including both Democrats and Republicans who believe the country is in worse shape than the numbers would indicate.

What we have learned over the past few years is that the markets have a way of surprising us, and that trying to time the market, and get out in anticipation of a downturn, is a loser's game. When we get on a roller coaster, we don't bail out and jump over the side at some scary point on the track; we hang on for the ride. The history of the markets has been a general upward trend that benefits long-term investors, and looking out over the long-term, that—and a few hard bumps along the way--is probably the best outcome to expect.

The FAM Team