

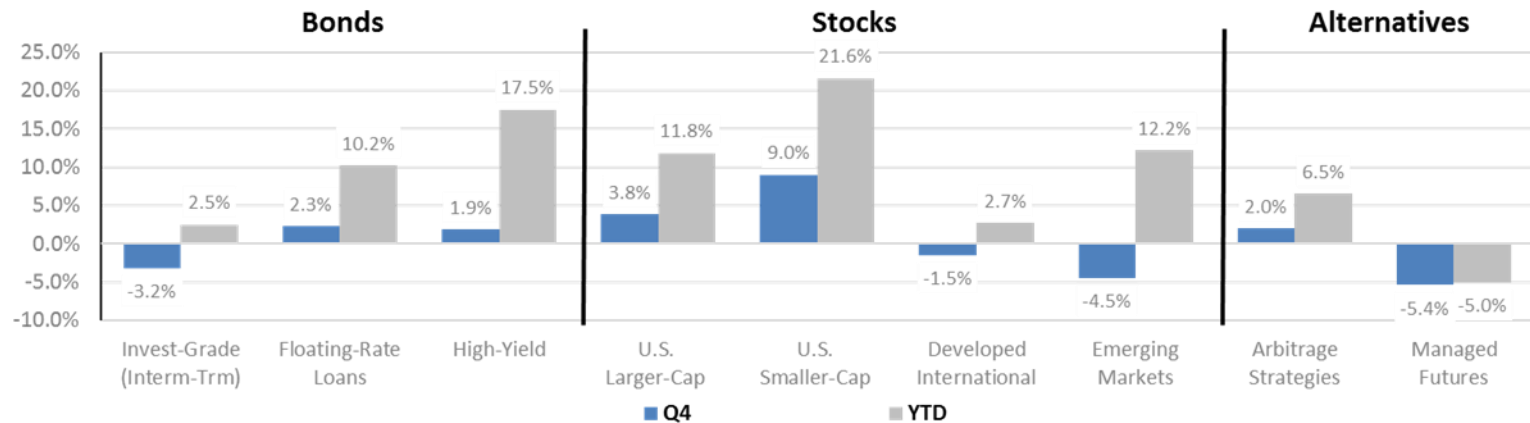
Client

Market Analysis / Fourth Quarter 2016



**INDEPENDENT WEALTH MANAGEMENT**

# Market Review



- Global equities performed well in absolute terms and relative to core bonds. U.S. stocks again took the lead, marking the eighth straight year the S&P 500 had a positive return. Emerging markets were also strong, though they did give back some gains in the fourth quarter.
- Developed International stocks were the big laggard on the year, returning just 2.7% in U.S. dollar terms. European stocks did worse, falling 0.4%. Currency exposure was again the main culprit as the British Pound and euro fell 16% and 3% relative to the U.S. dollar. This was the third straight year dollar appreciation was a drag on foreign stock returns.
- The core bond index fell 3.2% in the fourth quarter—its worst quarterly performance in 35 years. Fixed-income sectors with more credit risk (and less interest rate risk), such as high-yield and floating-rate loans, generated very strong returns both in the fourth quarter and year to date.
- Arbitrage strategies delivered solid absolute returns for the year and performed well as interest rates rose over the fourth quarter. Managed futures, which are volatile and have a wide range of potential returns, suffered from the many market reversals that occurred this year.

# Asset Class Returns

Through – 12/31/2016 Past performance may not be indicative of future returns.

Asset Class	4th Qtr. 2016	12 Months	5 Years (Ann.)
Russell 1000 Value iShare (Domestic Large-Cap Value)	6.80%	17.26%	14.60%
Russell 1000 Growth iShare (Domestic Larger-Cap Growth)	1.10%	7.01%	14.33%
Vanguard 500 Index (Domestic Larger-Cap Blend)	3.80%	11.82%	14.49%
Russell 2000 Value iShare (Domestic Smaller-Cap Value)	14.24%	31.98%	15.00%
Russell 2000 Growth iShare (Domestic Smaller-Cap Growth)	3.73%	11.68%	13.93%
Russell 2000 iShare (Domestic Smaller-Cap Blend)	9.02%	21.60%	14.58%
Vanguard FTSE Developed Markets ETF (Foreign Stocks)	-1.52%	2.67%	6.79%
Vanguard REIT Index (Real Estate Investment Trust)	-3.04%	8.34%	11.63%
Merrill Lynch High Yield Master (High-Yield Bonds)	1.88%	17.49%	7.35%
Vanguard Total Bond Mrkt Index (Domestic Invest-Grade Bonds)	-3.19%	2.50%	2.03%
Citigroup World Gov't Bond (Global Invest-Grade Bonds)	-8.53%	1.60%	-0.99%
Dow Jones-AIGCI (Commodity Futures)	2.66%	11.77%	-8.75%
JP Morgan Emg Local Mrkt+ (Short-term Local Currency Emg Markets Bonds)	-6.09%	9.94%	-1.29%

# 2016: A Year of Market Reversals

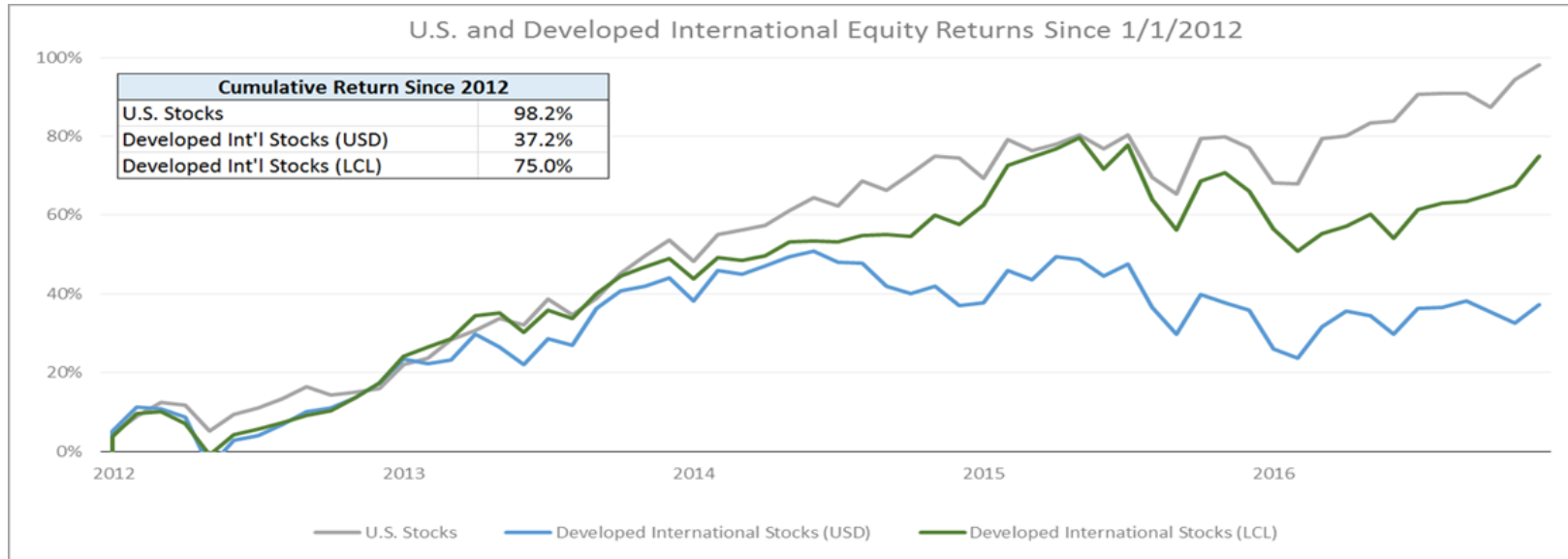
## Performance Reversals in 2016

	Previous Two-Year Return	Return Since
<b>Since Emerging-Markets Low in January</b>		
Emerging-Markets Stocks	-25.5%	28.2%
Oil (WTI)	-68.7%	82.4%
<b>Since U.S. Market Low in February</b>		
U.S. Small Cap Stocks vs. U.S. Large Cap Stocks	-18.0%	19.5%
U.S. Value Stocks vs. U.S. Growth Stocks	-7.7%	10.8%
U.S. Value Stocks vs. U.S. Momentum Stocks	-11.2%	14.1%
<b>Since 10-Year U.S. Treasury Yield Low in July</b>		
U.S. Core Bonds	9.1%	-3.3%
U.S. Treasuries (7-10 Year Index)	14.8%	-7.0%
<b>Since U.S. Presidential Election</b>		
Consumer Staples Stocks vs. S&P 500	6.3%	-6.2%
Utilities Stocks vs. S&P 500	4.3%	-5.2%
Energy Stocks vs. S&P 500	-25.5%	4.0%
Financials Stocks vs. S&P 500	-3.4%	11.8%

# Diversification Works Over Time

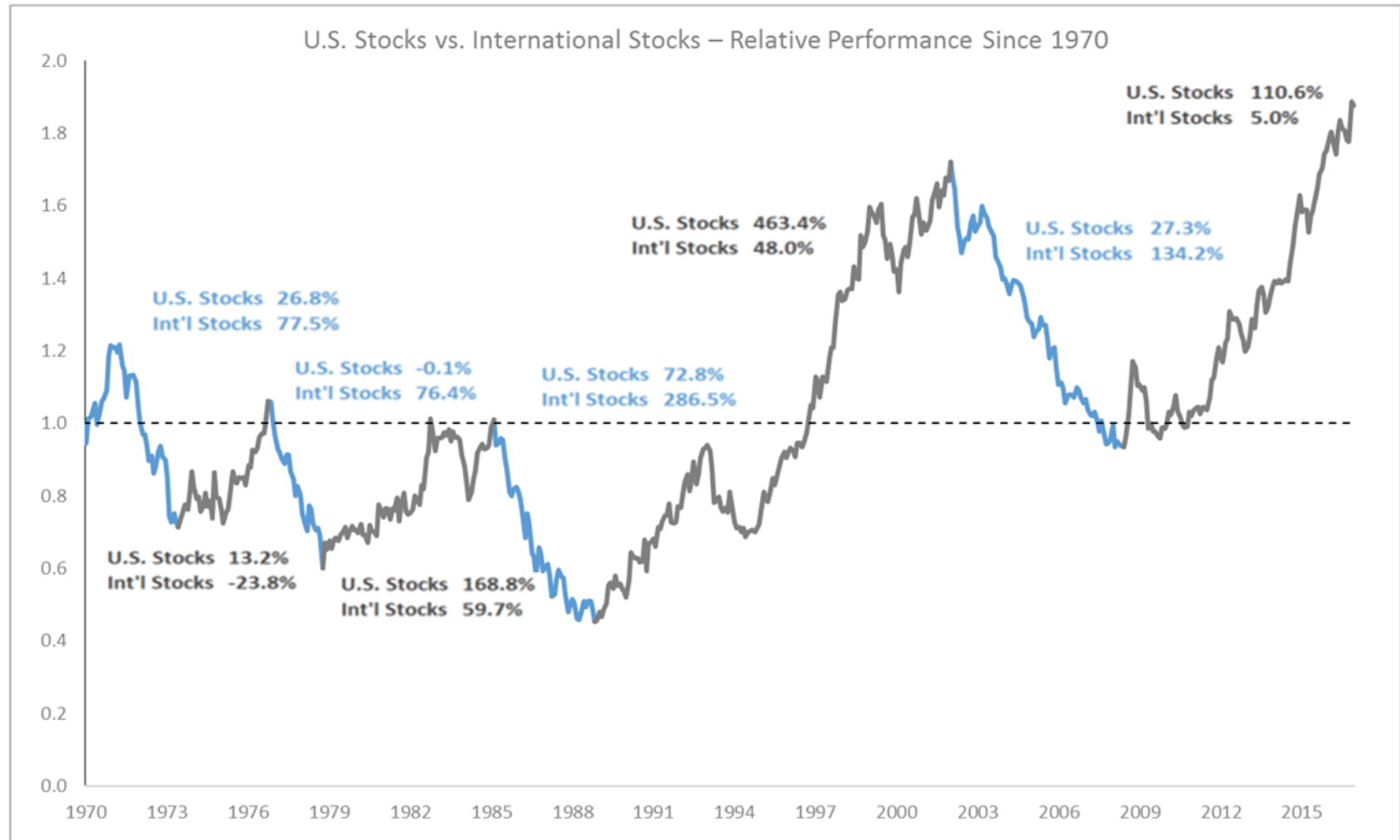
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	15-Year Return
Best ↑       ↓ Worst	Fixed Income 10.3%	EM Stocks 55.8%	EM Stocks 25.6%	EM Stocks 34.0%	EM Stocks 32.1%	EM Stocks 39.4%	Fixed Income 5.2%	EM Stocks 78.5%	US Small Stocks 26.9%	Fixed Income 7.8%	EM Stocks 18.2%	US Small Stocks 38.8%	US Large Stocks 13.7%	US Large Stocks 1.4%	US Small Stocks 21.3%	EM Stocks 9.5%
	EM Stocks -6.2%	US Small Stocks 47.3%	Dev Intl Stocks 20.2%	Dev Intl Stocks 13.5%	Dev Intl Stocks 26.3%	Global Stocks 11.7%	Balanced Portfolio -22.8%	Global Stocks 34.6%	EM Stocks 18.9%	US Large Stocks 2.1%	Dev Intl Stocks 17.3%	US Large Stocks 32.4%	Balanced Portfolio 6.0%	Fixed Income 0.5%	US Large Stocks 12.0%	US Small Stocks 8.5%
	Balanced Portfolio -9.4%	Dev Intl Stocks 38.6%	US Small Stocks 18.3%	Global Stocks 10.8%	Global Stocks 21.0%	Dev Intl Stocks 11.2%	US Small Stocks -33.8%	Dev Intl Stocks 31.8%	US Large Stocks 15.1%	Balanced Portfolio 1.9%	US Small Stocks 16.3%	Global Stocks 22.8%	Fixed Income 6.0%	Dev Intl Stocks -0.8%	EM Stocks 11.2%	US Large Stocks 6.7%
	Dev Intl Stocks -15.9%	Global Stocks 34.0%	Global Stocks 15.2%	Balanced Portfolio 5.2%	US Small Stocks 18.4%	Fixed Income 7.0%	US Large Stocks -37.0%	US Small Stocks 27.2%	Global Stocks 12.7%	US Small Stocks -4.2%	Global Stocks 16.1%	Dev Intl Stocks 22.8%	US Small Stocks 4.9%	Balanced Portfolio -1.5%	Global Stocks 7.9%	Global Stocks 5.9%
	Global Stocks -19.3%	US Large Stocks 28.7%	US Large Stocks 10.9%	US Large Stocks 4.9%	US Large Stocks 15.8%	Balanced Portfolio 6.8%	Global Stocks -42.2%	US Large Stocks 26.5%	Balanced Portfolio 12.6%	Global Stocks -7.3%	US Large Stocks 16.0%	Balanced Portfolio 12.1%	Global Stocks 4.2%	Global Stocks -2.4%	Balanced Portfolio 7.8%	Balanced Portfolio 5.7%
	US Small Stocks -20.5%	Balanced Portfolio 21.0%	Balanced Portfolio 9.9%	US Small Stocks 4.6%	Balanced Portfolio 12.5%	US Large Stocks 5.5%	Dev Intl Stocks -43.4%	Balanced Portfolio 19.9%	Dev Intl Stocks 7.8%	Dev Intl Stocks -12.1%	Balanced Portfolio 12.1%	Fixed Income -2.0%	EM Stocks -2.2%	US Small Stocks -4.4%	Fixed Income 2.6%	Dev Intl Stocks 5.3%
	US Large Stocks -22.1%	Fixed Income 4.1%	Fixed Income 4.3%	Fixed Income 2.4%	Fixed Income 4.3%	US Small Stocks -1.6%	EM Stocks -53.3%	Fixed Income 5.9%	Fixed Income 6.5%	EM Stocks -18.4%	Fixed Income 4.2%	EM Stocks -2.6%	Dev Intl Stocks -4.9%	EM Stocks -14.9%	Dev Intl Stocks 1.0%	Fixed Income 4.6%

# Currencies Were Again a Headwind for Foreign Stock Returns



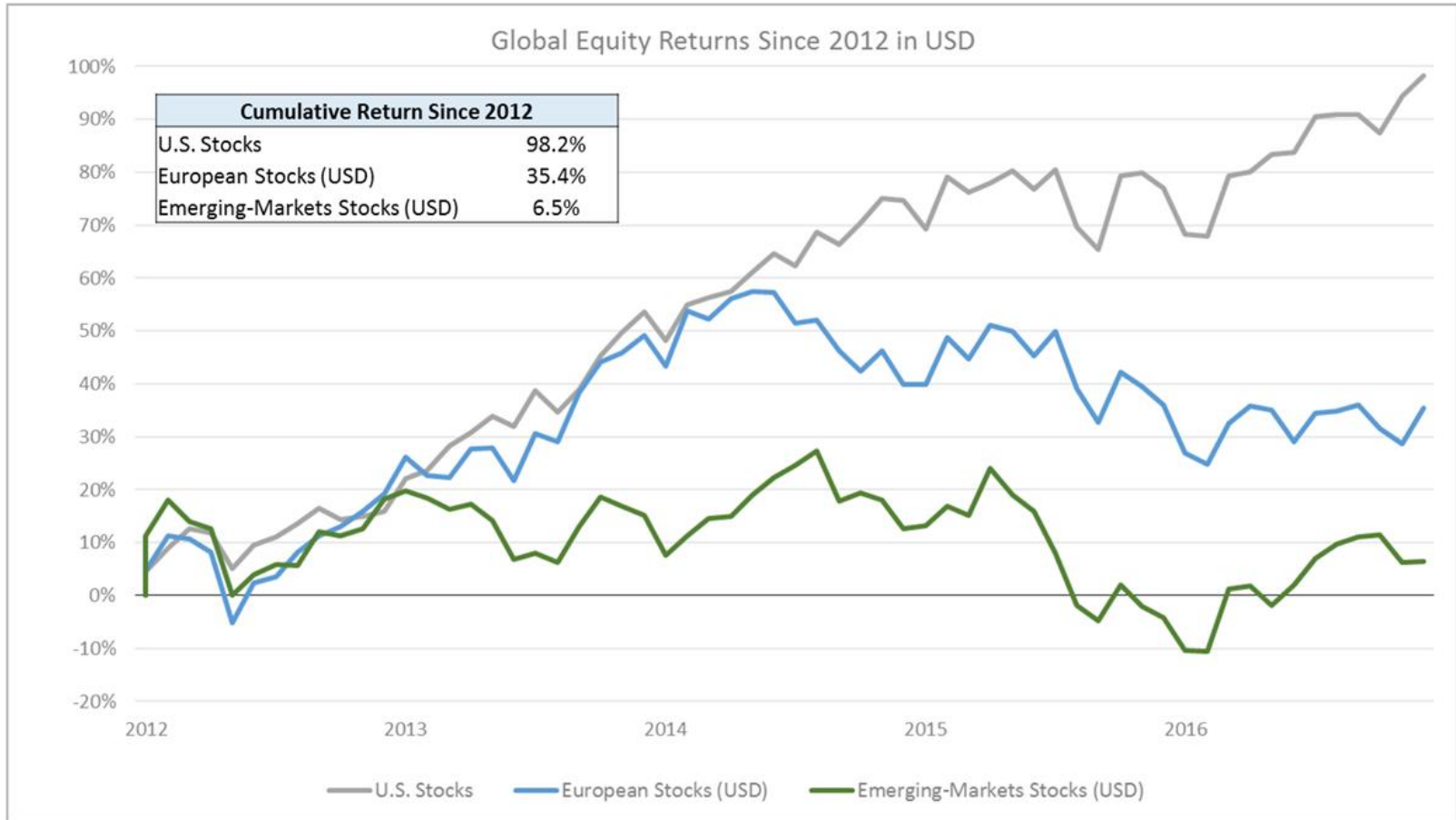
- For the third straight year, dollar appreciation was a drag on foreign stock returns. The major currency decliner was the British pound which fell 16% versus the U.S. dollar, triggered in June's Brexit vote.
- This marks the fourth straight calendar year and the sixth in the past seven that U.S. stocks have outperformed foreign stocks. Going back to 2008, this is one of the longest stretches of U.S. outperformance on record.

# Stock Markets Move in Cycles – Yesterday's Loser is Often Tomorrow's Winner



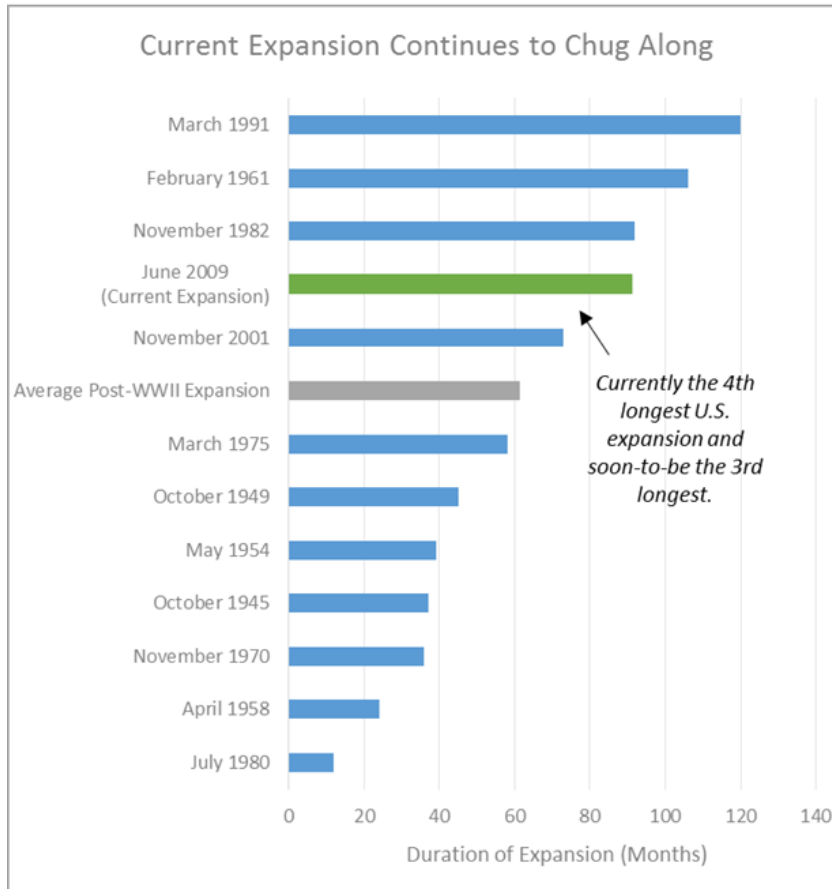
# U.S. Stocks Have Outperformed Foreign Stocks

## – We Expect This to Change





# Outlook for the U.S. Economy is Fairly Positive



## Positive Economic Contributors

Strengthening Labor Market

Rising Wages

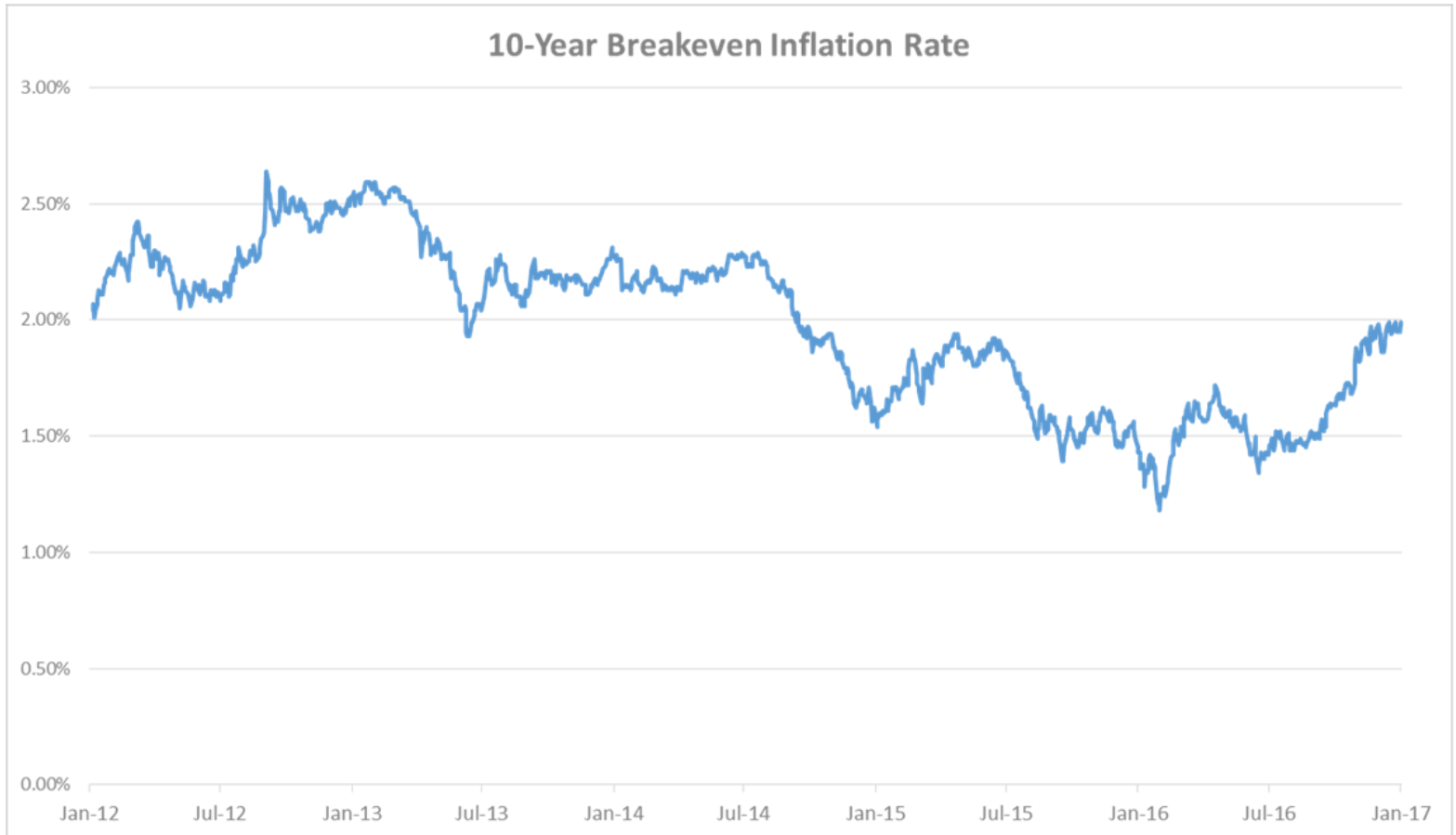
Improving Household Balance Sheets

High Levels of Consumer Confidence

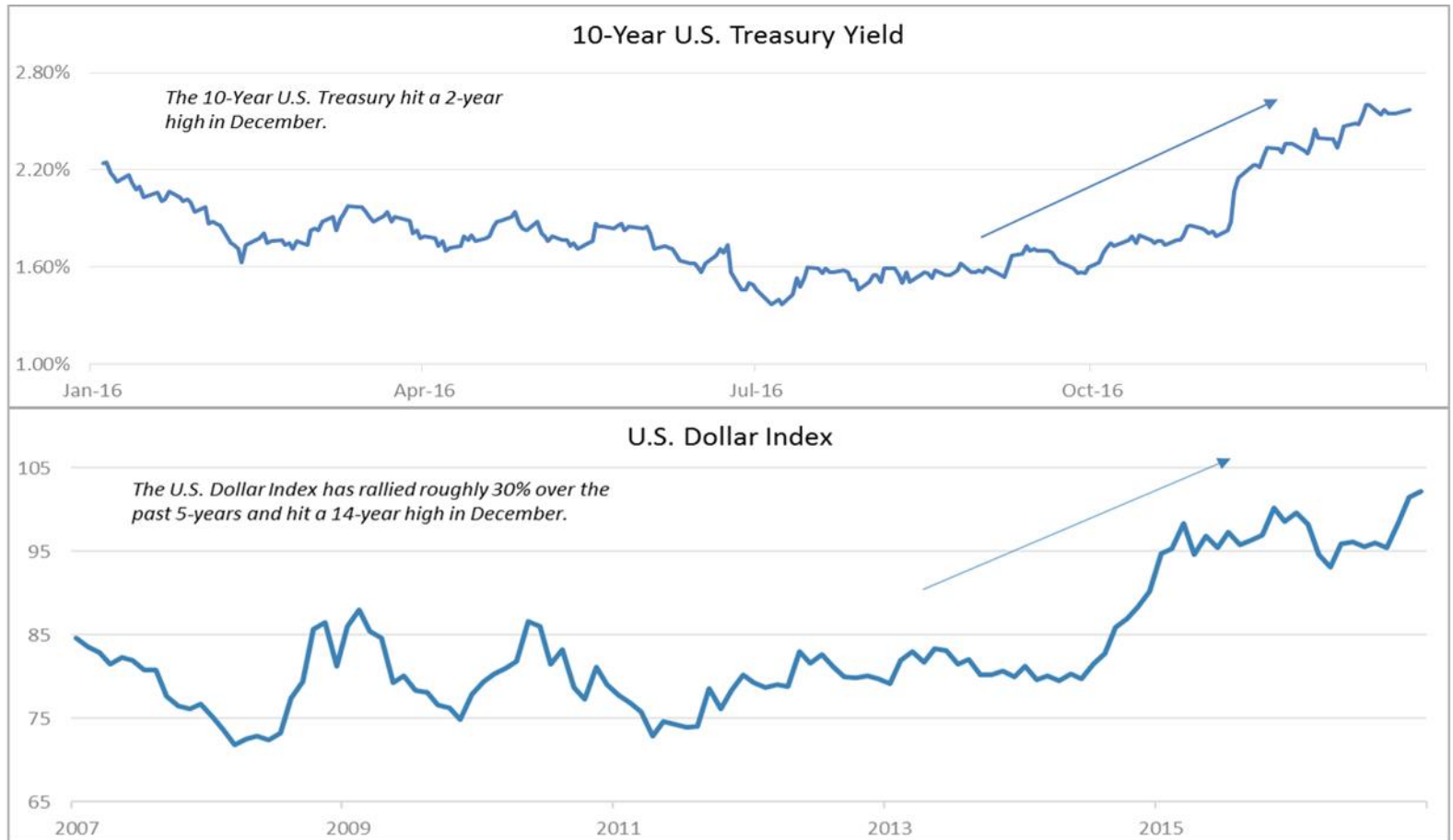
Rising Inflation

Services and Manufacturing Strength (PMI's)

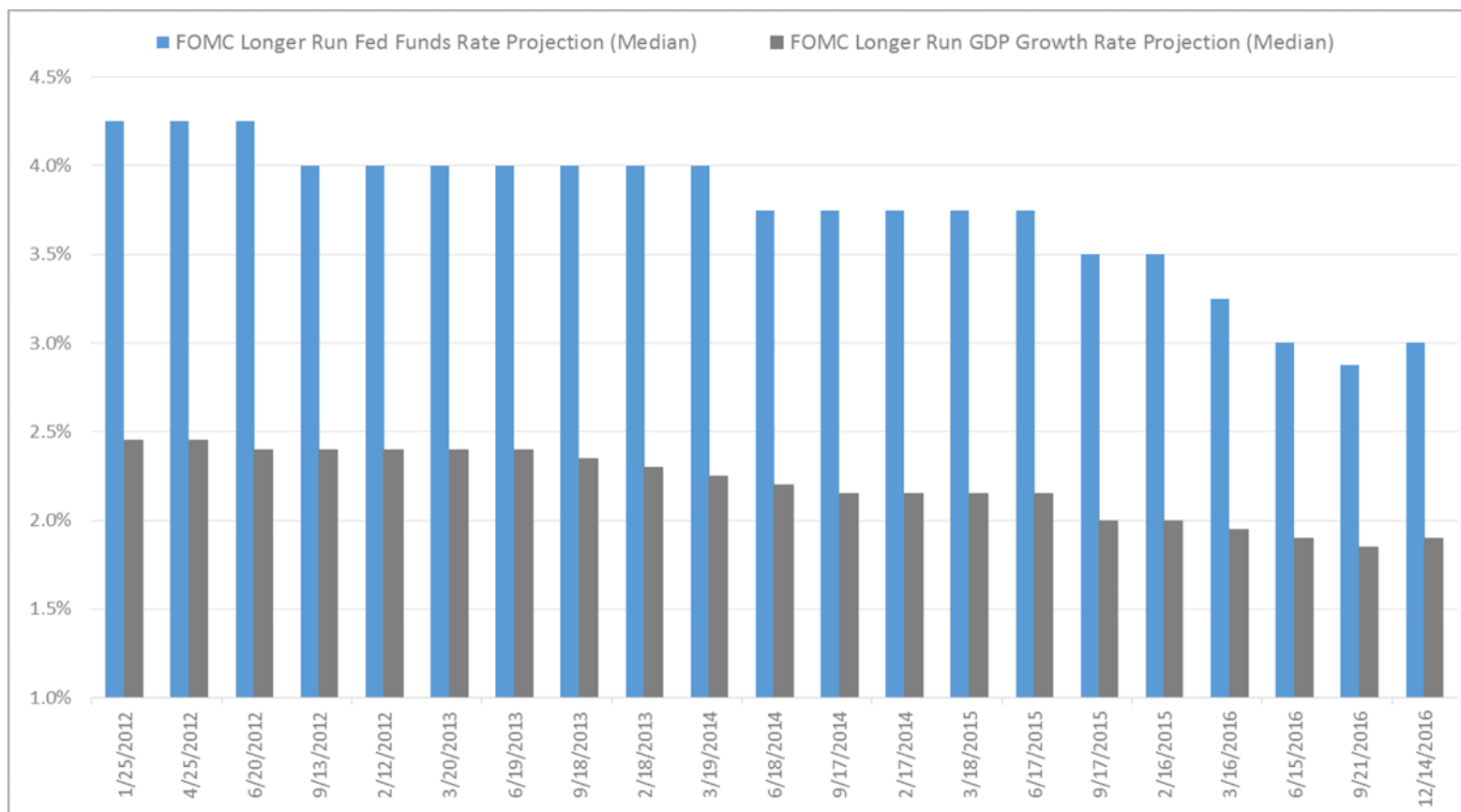
# Trump's Policy Agenda Suggests Further Inflationary Pressure is Likely



# Interest Rates Rose and the Dollar Rallied Post-Election

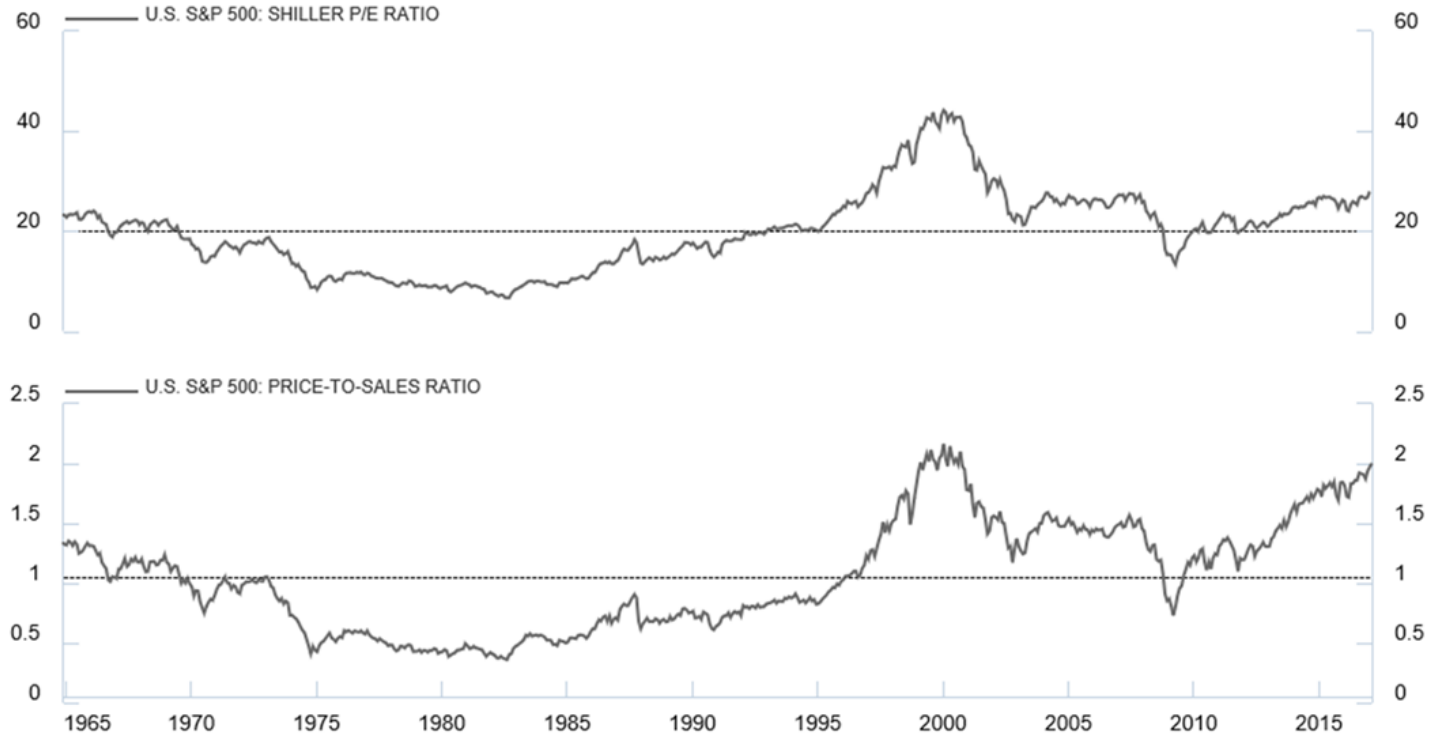


# The Fed Upped Their Longer Run Estimates for GDP Growth and the Fed Funds Rate in December



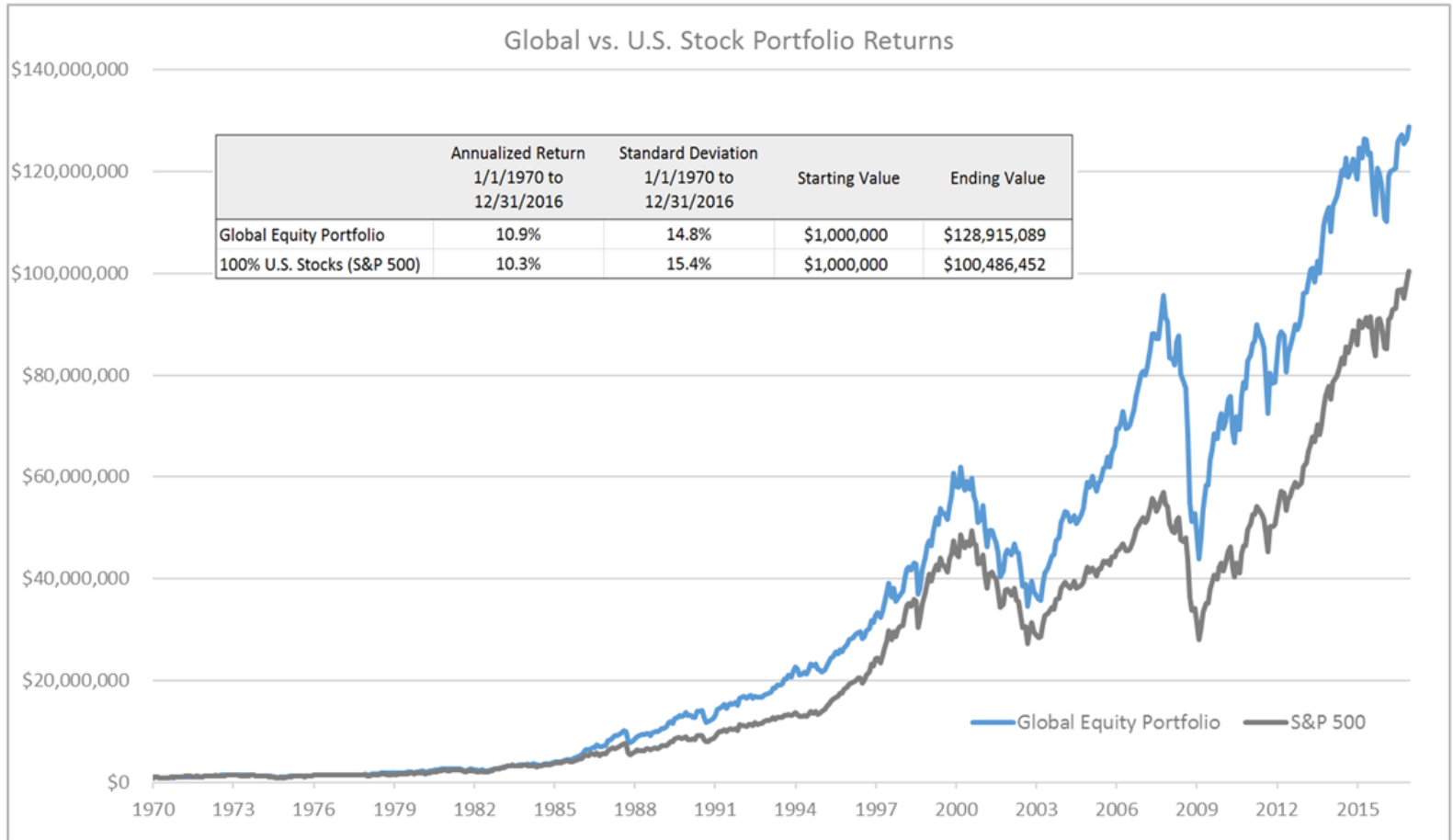
# U.S. Stocks Appear Overvalued With a Lot of Optimism Baked into Current Prices

## U.S. Stock Market Valuations

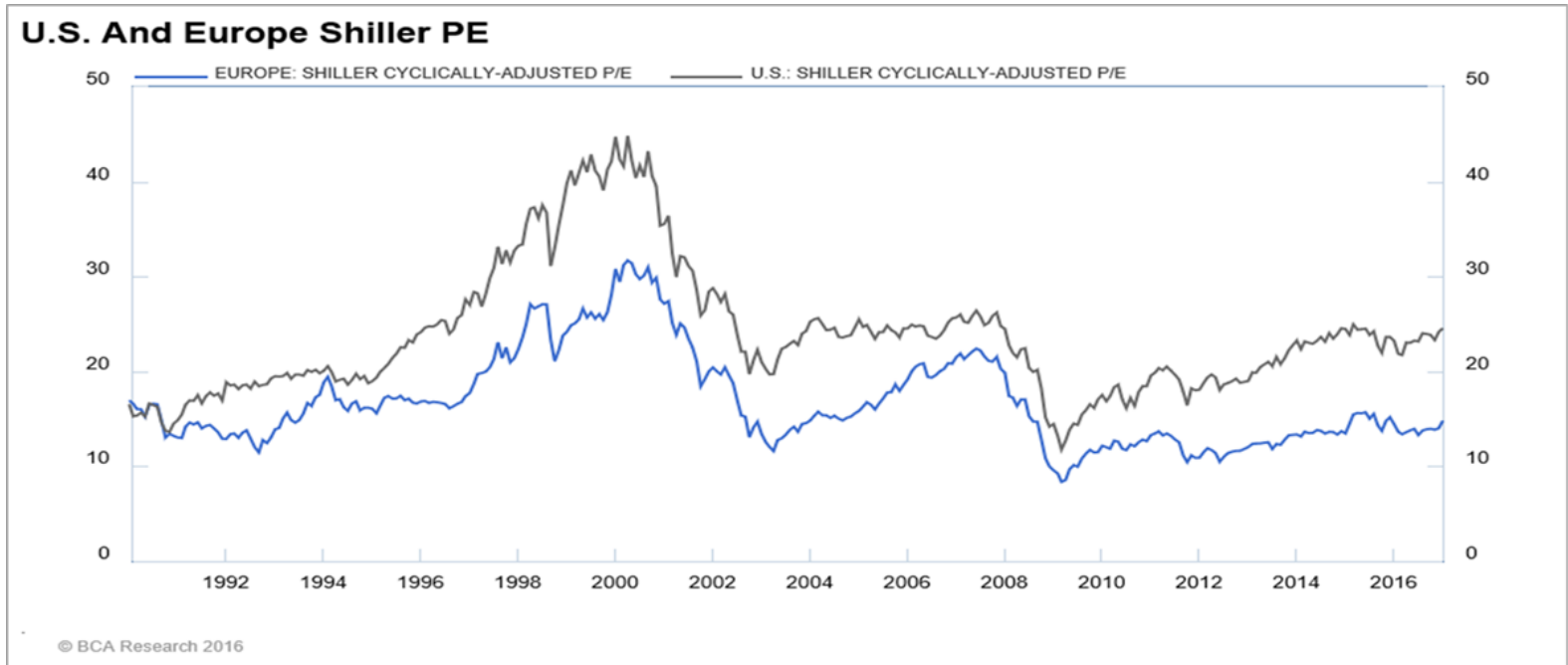


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NOTE: HORIZONTAL DASHED LINES INDICATE MEDIAN (1960 - PRESENT).

# The Long-Term Case for Global Equity Exposure Remains a Compelling One



# European Stocks are Trading at a Valuation Discount in Absolute Terms and Relative to U.S. Stocks



Region	Current Shiller P/E	Historical Median	Premium/Discount
U.S. Stocks	24.9	19.8	26%
European Stocks	12.5	17.5	-29%

# Estimated Asset Class Returns

## Average Annual Returns Over Next Five Years

### Equity Asset Classes

	Bear Case	BASE CASE	Bull Case
U.S. Larger Cap	-5.8%	3.2%	10.4%
Developed International - Europe	-5.8%	13.8%	21.0%
Emerging Markets	0.2%	11.4%	18.4%
REITS	3.3%	5.2%	4.3%

### Fixed-Income Asset Classes

	Bear Case	BASE CASE	Bull Case
Investment-Grade Bonds	2.6%	1.8%	0.9%
High Yield Bonds	2.0%	2.6%	2.6%
Floating-Rate Loans	6.6%	5.7%	6.8%
Treasury Inflation Protected Securities (TIPS)	2.2%	0.7%	-1.6%

### Alternative Asset Classes

	Bear Case	BASE CASE	Bull Case
Alternative Strategies	Mid-single-digit returns in most scenarios		



# Our Base Case Economic Scenario Continues to be a Moderate Economic Recovery

SCENARIO	DEFINITION
<i>Bull Case</i>	U.S. economic growth is above average and/or earnings end the period above the long-term trendline. Helped by stronger non-U.S. growth, releveraging of the U.S. consumer, and corporate investment spending, a self-reinforcing global growth cycle develops.
<i>Base Case</i>	Moderate economic recovery continues with no major crisis, but a normal recession is likely within the five-year time horizon. Assumes GDP growth rates and interest rates start to “normalize” toward the end of our five-year horizon.
<i>Bear Case</i>	The economy falls into recession for any of various reasons, such as deleveraging/deflation from Europe or China, unexpected systemic shock, Fed policy error, etc. This scenario does not assume another severe financial crisis, i.e., not a repeat of 2008-2009.

# Asset Class Descriptions

**Domestic Investment-Grade Bonds** (Barclays Capital U.S. Aggregate Bond Index): We are currently using the Vanguard Total Bond Market Index Fund to represent the Barclays Capital U.S. Aggregate Bond Index, an index of domestic investment grade bonds.

**Floating-Rate Loans** (S&P/LSTA Leveraged Loan Index): We are currently using the S&P/LSTA Leveraged Loan Index to represent an index of floating rate loans.

**High-Yield Bonds** (Merrill Lynch U.S. High Yield Master Cash Pay Index): We are currently using the Merrill Lynch U.S. High Yield Master Cash Pay Index to represent an index of domestic high yield bonds.

**Domestic Larger-Cap Stocks** (S&P 500 Index): We are currently using the Vanguard 500 Index Fund to represent the S&P 500, an index of primarily domestic larger-cap stocks.

**Domestic Smaller-Cap Stocks** (Russell 2000 Index): We are currently using the Russell 2000 Index iShares Exchange Traded Fund (ETF) to represent the Russell 2000, an index of primarily domestic smaller-cap stocks.

**International Developed-Market Stocks** (FTSE Developed ex North America Index): We are currently using the Vanguard FTSE Developed Markets Exchange Trade Fund (ETF) to represent an index of international developed-market stocks. Prior to May 2013, this Vanguard Exchange Traded Fund followed MSCI-EAFE. Prior to the July 2007 inception of Vanguard MSCI EAFE ETF, we use iShares MSCI EAFE Index from September 2001 to July 2007, and the MSCI EAFE Index adjusted for 0.35% expenses annually prior to September 2001.

**Emerging-Market Stocks** (FTSE Emerging Markets Index): We are currently using the Vanguard FTSE Emerging Markets Index Exchange Traded Fund (ETF) to represent an index of emerging market stocks. Prior to January 2013, this Vanguard Exchange Traded Fund followed the MSCI Emerging Markets Index. Prior to the March 2005 inception of Vanguard MSCI Emerging Markets ETF, we use iShares MSCI Emerging Markets Index from May 2003 to March 2005, and the MSCI Emerging Markets Index adjusted for 0.67% expenses annually prior to May 2003.

**Managed Futures:** We are currently using the Newedge Trend Index to represent an index of managed futures (trend following) strategies.

# Additional Disclosure

## **Disclosures:**

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Before trading, investors should carefully consider their financial position and risk tolerance to determine if the proposed trading style is appropriate. Investors should realize that when trading futures, commodities, options, derivatives and other financial instruments one could lose the full balance of their account. It is also possible to lose more than the initial deposit when trading derivatives or using leverage. All funds committed to such a trading strategy should be purely risk capital.