

LOCAL FIRM, NATIONAL PROMINENCE

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2016 Year End Review

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 and endured another hard bump right after the elections. In the end, we were disappointed; the Dow finished at 19,762.60 for the year—by the bull market has continued for another year.

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% and 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.

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 whopping 22.41% return 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, and emerging markets stocks of less developed countries, as represented by the EAFE EM index, gained 8.58% for the year.

Looking over the other investment categories, real estate investments 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. The utility sector returned an impressive 15.89% despite the threat of rising interest rates. Finally, gold prices returned 8.63% for the year and silver gained 15.84%.

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.

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.

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. At the county fair, when we get on the 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 the best outcome to expect.

Stay Diversified, Stay the Course! Empyrion Wealth Management wishes you a very Happy and Blessed 2017!



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