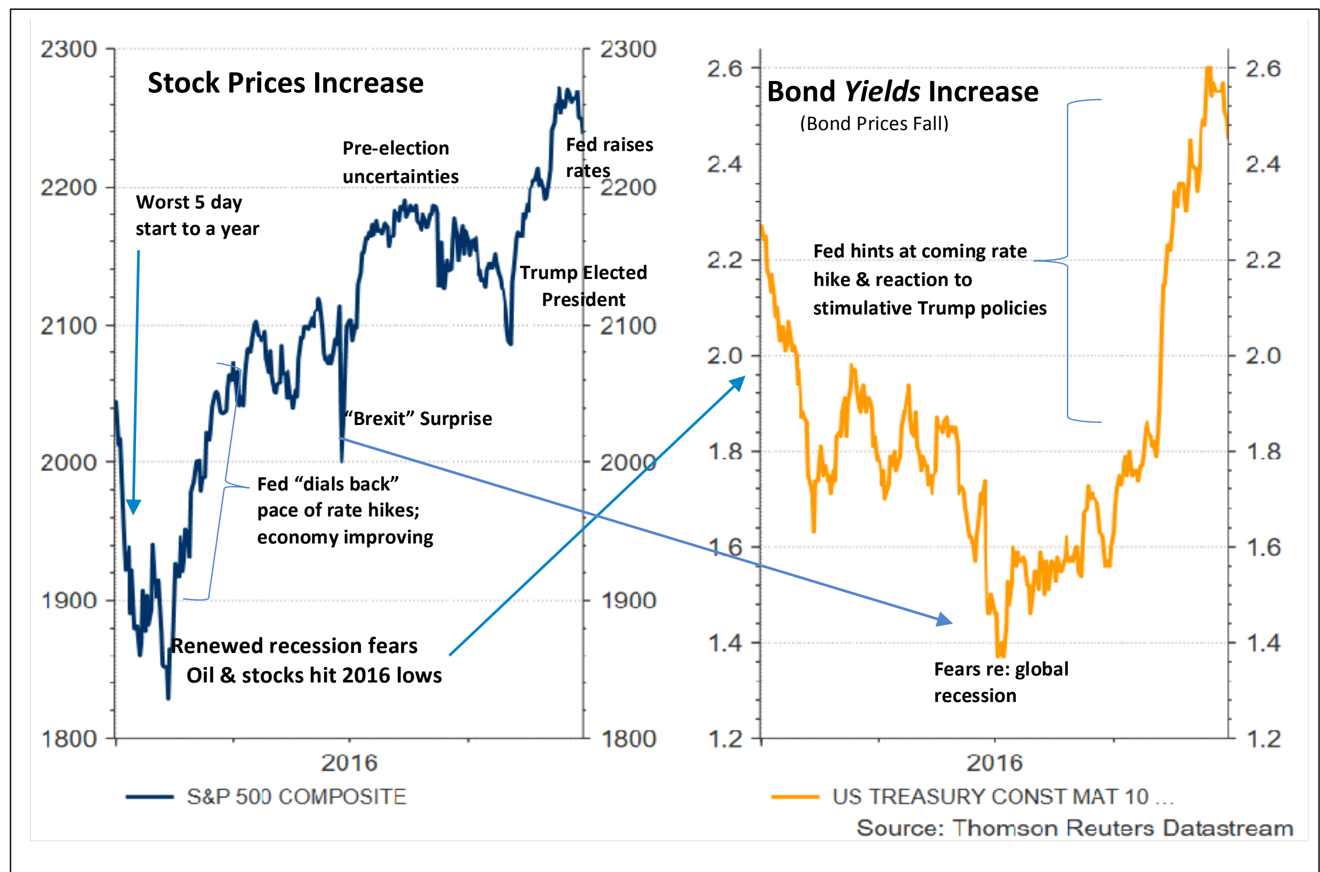
THE FINANCIAL MARKETS – 2016/2017

This Is The Year That Was (Unbelievable!)

After the worst start to a year on record, stocks staged a remarkable rally and actually wound up with positive returns in the first quarter of 2016. During the second quarter, equity markets were again shaken (-10%) by the unexpected UK vote to exit the European Union ("Brexit). However, within 48 hours, they had reversed direction with major indices again reaching for new all-time highs. All of that occurred *BEFORE* the election!

As the election neared, pollsters were clearly anticipating a Democratic presidential win and many Wall Street strategists were predicting dire financial market consequences if that was not to be. However, the polls and financial market predictions were off the mark and Donald Trump became the president-elect. After a few hours of equity market sell-off, the stock market was again advancing toward new highs.

Despite all of the uncertainties and challenges encountered in 2016, our expectations (previous market outlooks) were that a growing economy combined with historically low interest rates and oil prices, a cautiously acting Fed, and a continuously improving housing and employment "picture" would keep the "wind in the sails" of equity prices and again provide investors with positive returns.



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In addition to the events described above, volatility could be seen in other financial market sectors and was a factor that kept this second longest bull market in history one of the "most hated" (investor skepticism). In February crude oil fell to $ 26 a barrel as fears of a global recession increased, and in July, following the "Brexit" vote, the benchmark ten-year maturity US Treasury note fell to an historic low of 1.36%. By year-end however, crude was again selling above $ 54 a barrel and the yield on the ten- year note had reached 2.45%, signaling underlying economic strength.

The Stock Market

When the dust settled, domestic equity returns were positive. Both the Dow Jones Industrial and the Standard & Poor's 500 averages provided double digit total returns of +16.5 % and +12.0% respectively; the NASDAQ posted a total return of +7.5%. While the returns from these major indices were quite attractive, they were bested by returns from both the Small and Mid-Cap indices which achieved returns of +24.2% and +18.7%. Patience and asset class diversification were rewarded.

During the year, nine of the now eleven (Real Estate was added as a separate sector in September) Economic Sectors within the S&P 500 provided positive returns with four of the sectors out-performing the index itself. The sectors that preformed Best and Worst are displayed below:

Best		***Worst***	
Materials	+23.4%	Technology	+6.1%
Energy	+22.1%	Telecommunications	+5.9%
Industrials	+17.2%	Cons. Discretion	+2.4%
Financials	+10.0%	Cons. Staples	+0.9%
Utilities	+ 6.4%	Healthcare	-14.6%
		Real Estate	N/A

As an aside, the "profile" of the best performing stocks was smaller market capitalization, lower P/E and higher yield.

Outside the U.S. the Brazilian, Russian and Canadian markets achieved the strongest returns, while China, Italy, Mexico and Spain fell the most.

The Bond Market

Returns from the bond market in 2016 were generally positive as well. Except for the returns from the higher-yielding (lower quality) sector though, returns were not as attractive as those from stocks. Longer maturity, high-yield bonds provided the highest returns, while investment grade corporate, Treasury inflation protected securities, and Treasury bonds provided annual returns ranging between 1.0% and 6%. Returns from a well-diversified municipal bond portfolio are likely to have been "flat" for the year.

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All things considered, and after a very difficult beginning to 2016 and multiple challenges during the year, many investors i.e., those with a balanced portfolio (investment in both stocks and bonds) achieved attractive returns during 2016. While the bull market in bonds (rising bond prices) probably came to an end during this past year, positive bond returns when coupled with positive equity returns should please investors.

Looking Ahead (2017) – Our View

The S&P 500 has now achieved positive total returns for eight consecutive years. The record for the most consecutive up years (nine) was established in the bull market period of 1991 to 1999. During these past eight years, we have remained bullish and counseled our clients to remain invested, remain balanced, diversified and focused on quality. We remain optimistic. Being optimistic eight years ago, was more difficult than it is today. Back then the economy was struggling (not too different from today), the incoming administration appeared not business friendly, regulatory legislation was increasing, energy prices were higher, unemployment was higher, the banks and the capital markets were in shambles, etc., etc.

While economic growth continues to be a concern, it appears that the economic climate has improved (Est. 2017 U.S. GDP growth 2.5%+) and we do not see recessionary concerns in the short-term. Manufacturing has rebounded, employment remains strong, housing and consumer sentiment are near multi-year highs, and modest reflation is on the horizon. Trump's proposed policies that focus on infrastructure spending and lower corporate tax rates may be stimulative for both the economy and the equity markets if, ultimately, they are implemented and prove positive for job growth and corporate profits.

Unlike the recent past when our optimistic outlook was not part of the consensus, today it is, and thus it "sets the table" for some disappointment if everything does not work out as we see it. While we are optimistic, we are not blind to the possibility for continued meaningful market volatility due to geopolitical shocks or new policies that take longer to put in place than investors believe they should. However, we believe the positives that we have described above, outweigh the possible negatives of a strong US dollar and/or rapidly rising labor costs.

We believe that global bond yields have bottomed and therefore prefer equities over fixed-income (a few more Fed hikes this year). Where fixed-income is required and/or held, we prefer short duration over longer duration issues.

Within the equity portfolio, we suggest a high level of diversification while maintaining over-weighted positions in companies/sectors that are *operationally leveraged* to an improving economy such as stocks representing the Industrial, Technology, Financial and Consumer Discretionary sectors.

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As previously stated, our current strategy has a positive bias for strong fundamental reasons. However, we remain sensitive to risks that are apparent. Geopolitical risk, almost anywhere around the globe today, is a "given". In addition, political and policy risks are meaningful. President-elect Trump remains an unknown quantity as is his ability to implement the new administration's policies. Elections in France and Germany later this year will test the strength of the EU. China's capital outflows and the value of its currency and general growth policies will also continue to worry investors. We focus on these issues as much as we focus on the positive factors.

If you have any questions or comments (positive or negative), please do not hesitate to let us know. We hope you had a pleasant holiday season with family and friends and we look forward to meeting with you in the near future.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful. All indices are unmanaged and may not be invested into directly.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

The prices of small and mid-cap stocks are generally more volatile than large cap stocks.

Stock investing involves risk including loss of principal.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

Investment advice offered through Stratos Wealth Partners, Ltd., a registered investment advisor.

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