Market Commentary
Fourth Quarter 2016

The financial markets ended 2016 on a strong note, defying most market prognosticators predicting doom and gloom at various times of the year. The first "Sell Everything" call of 2016 was by RBS on January 11, with many more recommendations from other pundits to reduce investment risk and "get out of the market". Equity and commodity markets continued to decline until midway through the first quarter before staging a very strong rally. From the market bottoms and depths of despair in the first quarter, domestic equity markets moved to one all-time high after another and finished the year on a euphoric note following the unexpected election of Donald Trump. If you had sold in January, you potentially missed a 45% gain in small cap stocks, 25% gain in large cap stocks and 31% gain in emerging markets stocks. Once again, following the pundits was not a good investment strategy.

For the year, nine of ten S&P 500 sectors had positive gains, led by energy (28%), financials (23%) and industrials (20%). Health care was the only sector declining, down 3%. Value stocks did better than growth and small stocks did better than large. During the year, there were three corrections in the domestic equity markets: November 3, 2015 to February 11, 2016 (100 days and -14.5%); June 8 to June 27 (19 days and -6.1%); and August 15 to November 4 (81 days and -5%). It was the eighth consecutive year of gains for the domestic equity markets.

Domestic equity markets have performed much better than foreign equity markets for several years. Since 2012, the S&P 500 has doubled while the rest of the world is up 25%. Valuations by every metric are cheaper in foreign than domestic equity markets. Markets tend to revert to the mean because trends both up and down get over-extended before eventually moving back towards the long term average. Market trends function like a pendulum, swinging too far in one direction before swinging too far in the opposite direction. In addition, strong trends can last longer than you think possible. At some point we should expect the foreign equity markets to outperform domestic. Domestic equity outperformance will not last forever.

On June 24, Britain shocked the world with its vote to separate from the European Union. The British pound declined by 8% and the volatility index increased to 49%, both levels of volatility which should statistically occur only once every few ***billion*** years. Within a few weeks, markets normalized and most asset classes recovered their short term losses. Surprisingly, the United Kingdom FTSE 100 index was the best performing equity market in Europe, up almost 8% for the year. The takeaway is just when you think something cannot happen, the "impossible" occurs.

Regarding interest rates, it was another unbelievable year. In July, Switzerland 50 year bonds offered investors an opportunity for ***negative yields*** and the U.S. ten year bond yield reached its all time low of 1.37% before almost doubling by the end of the year. Tax-exempt municipal

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bond yields increased more than taxable bond yields as concerns about the impact of tax reform, lower marginal rates and rising inflation expectations increased after the election. The Federal Reserve Open Market Committee (FOMC) forecast four interest rate increases in 2016 but only increased interest rates once in December. The FOMC has a similar forecast for 2017.

So what is the meaning of all this? To paraphrase Donald Rumsfeld, there are too many "known unknowables" to accurately predict the future, whether it be geopolitical events, interest rates or stock prices. We do not attempt to play the guessing game masquerading as market forecasting, sector rotation or any other form of market timing. Instead, our focus is building diversified investment portfolios that meet each client's financial goals and risk tolerance. There will be periods when a certain investment style or asset category is popular (or unpopular) but a diversified investment portfolio will partially protect patient investors from an unknowable future.

During the fourth quarter, The Certified Financial Planner Board conferred its Certified Financial Planner (CFP) designation to Phil McDonnell after he successfully passed its examination. It is a rigorous examination that tests candidates ability to apply financial planning knowledge to real-life situations. It covers the financial planning process, tax planning, employee benefits and retirement planning, estate planning, investment management and insurance. The CFP certification is the recognized standard of excellence for financial planning.

Thanks again for your trust and confidence. Best wishes for a healthy, happy and prosperous 2017.

Sincerely,

Jack McDonnell
Jack R. McDonnell
President & Founder

Phil McDonnell
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