

# Market Commentary

## Q4 2016

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## Fourth Quarter 2016 Market Commentary

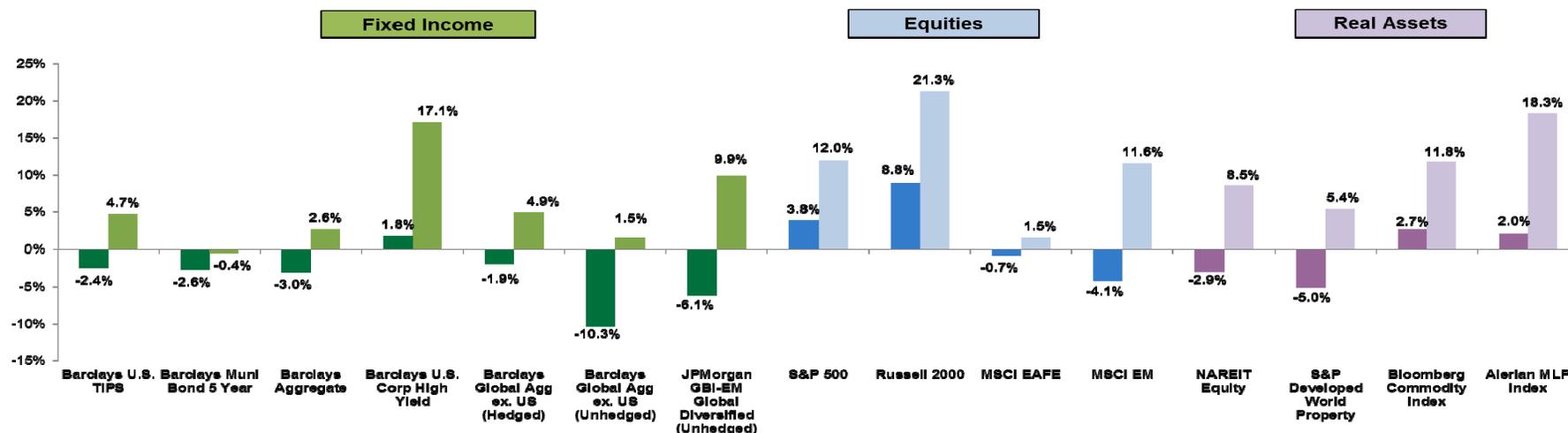
Domestic equity indices finished higher for the quarter while international developed and emerging markets both declined. Fixed income indices ended the quarter mostly lower during the three months with the exception of U.S. high yield. Returns for the final quarter of the year were largely driven in some form or fashion by the results of the U.S. Presidential election as markets continued to digest potential policy implications.

For the quarter, the S&P 500 Index rose 3.8%, while the Russell 2000 Index of smaller companies gained 8.8%. The energy, financials and basic materials sectors were the best performers, while the healthcare, utilities and consumer discretionary sectors lagged. Across market capitalizations, small-cap securities significantly outperformed their large- and mid-cap counterparts. Across styles, value outperformed growth across all market caps.

U.S. fixed income markets were generally negative for the quarter. Short-maturity Treasuries outperformed longer-dated issues as the yield curve steepened. Investment grade corporate securities fell as utility-, industrial-, and financial-related issuers all generated negative returns for the quarter. Lower quality, higher yielding corporate securities bucked the trend in fixed income and ended the year on a positive note. Returns in municipal bonds were negative enough to bring the return for the year into modestly negative territory.

International markets were mostly lower as the MSCI EAFE Index declined 0.7%. Among the largest European markets, the UK fell 0.9%, while Germany and France rose by 1.5% and 3.1%, respectively. Within the Pacific region, Japan declined 0.1%, while Australia gained 0.8%. In the emerging markets, the MSCI EM Index ended 4.1% lower.

### Asset Class Returns



Source: Bloomberg

Key: Left Bar: Recent Quarter  
Right Bar: Year-To-Date

Hedge fund returns not available at time of production

## World Market Recap

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### Economy

- According to the third and final estimate of economic growth released by the Bureau of Economic Analysis (BEA), third quarter GDP increased at an annual quarter-over-quarter rate of 3.5%. This reflected positive contributions from personal consumption expenditures (PCE), exports, private inventory investment, nonresidential fixed investment and federal government spending. This was partially offset by negative contributions from residential fixed investment, and state and local government spending. The advance estimate of fourth quarter GDP is due out on January 27, 2017.
- The Federal Open Market Committee (FOMC) unanimously approved a quarter-point rate hike to 0.50 – 0.75% in their December meeting and indicated a more aggressive path moving forward. The committee's expected path for monetary policy appears to be driven largely by expectations of more expansionary fiscal policy in the coming years as well as an economy that continues to show signs of strength. The FOMC will hold its next scheduled meeting on January 31 – February 1, 2017.

### Fixed Income

- U.S. Treasury yields increased during the quarter as the yield on the 10-year rose by 85 basis points to end the year at 2.45%. Yields surged after U.S. elections resulted in Republican control of the White House and majorities in both the Senate and House of Representatives.
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- Investment grade corporate securities were generally negative for the quarter despite positive December returns. The financial sector declined by 1.9% and was the best performing corporate credit sector. Industrial-related credits followed with a loss of 3.1%, while utility-related issues fell by 4.2%. Rising interest rates were the primary reason for the broad decline in investment grade credit.
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- Lower quality, higher yielding corporate securities finished higher. For the quarter, BB-rated issues increased by 0.4%, B-rated securities gained 2.0%, while CCC-rated credits rose 4.7% as a yield advantage in the lowest quality enticed investors with expanding risk appetites. A "risk-on" quarter combined with further stabilization in the oil markets helped high yield outperform its fixed income counterparts.
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- Fixed rate MBS declined by 2.0% during the quarter. According to the National Association of Realtors (NAR), existing home sales dipped in November, reaching their lowest level in nearly a year. A sharp upswing in mortgage rates and low inventory caused some would-be-buyers to retreat. According to NAR chief economist Lawrence Yun, the quick rise of rates immediately following the election reduced the number of successful contract signings in addition to November's climbing home prices and minimal listings in the affordable price range.
- Municipal bonds ended the quarter lower with shorter dated municipals faring better. Longer-term municipals continued to struggle given uncertainty surrounding President-Elect Donald Trump's infrastructure plan and tax cuts. The plan is expected to increase private investment, which is an atypical approach to increased infrastructure spending, and therefore calls into question whether municipal bonds would be utilized as a primary financing vehicle. Lower taxes, all-else-equal, would make the relative value of municipal bonds less attractive to taxable bonds which could put additional strain on the asset class.

## U.S. Equity

- U.S. stocks finished mostly higher during the quarter as the S&P 500 Index rose 3.8% and the technology-heavy NASDAQ Composite increased by 1.7%. The Dow Jones Industrial Average gained 8.7%, a major quarter contributing to the index's 16.5% annual return which marked the best annual gain in three years.
- Financials were the best performing equity sector for the quarter rising by 12.7%. Banks were the largest contributor within the sector as investors were drawn to the industry sparked by speculation of reduced taxes and less regulation under a Republican led government. Higher interest rates were also beneficial as investors anticipated higher net interest margins to accompany higher rates.
- Energy was next in line among equity sectors, gaining 6.5% in the quarter. Recovering oil prices lifted exploration & production companies along with the sector as a whole as the Organization of the Petroleum Exporting Companies (OPEC) agreed to cut crude oil production for the first time since 2008 in January by 1.2 million barrels a day according to Bloomberg.
- The basic materials sector increased by 5.3%, which added to an already strong year-to-date return and the sector finished the year 17.6% higher. Almost all industries contributed to returns for the quarter with the exception of mining. Names in this industry fell slightly during the quarter after leading the group through the first three quarters of the year.
- The healthcare sector was the worst performing sector for the quarter and declined by 4.2%. As the transition of the Presidency continues, speculation surrounding President-Elect Trump's intentions to repeal and replace the Affordable Care Act (ACA) remains. Mr. Trump has insinuated that an "appeal" may be more likely than a full-scale repeal, as his plan shares many similarities with the ACA.

## International Developed Markets

- Canadian equities rose 3.4%, largely the result of stronger oil prices and mostly upbeat economic data. Statistics Canada, the country's statistical agency, announced that the economy grew by 0.9% during the third quarter of 2016. However, October GDP was slightly lower (down 0.3%) as the momentum in the goods-producing industries stalled at the beginning of the fourth quarter. Despite this, the unemployment rate fell from 7.0% to 6.8%, with employment for the 25-54 year old demographic notably strong.
- Eurozone equity returns were mixed for the quarter as many markets rebounded in December following a more volatile November. Following the resignation of Italy's Prime Minister Matteo Renzi in early December, Paolo Gentiloni, was named the country's new Prime Minister. Mr. Gentiloni will be charged with forming a new government that will guide Italy going forward. More broadly, Euro area GDP rose by 0.3% during the third quarter according to Eurostat, the statistical office of the European Union. Household consumption expenditures was the most positive contributor to GDP while net exports detracted.
- The UK equity market lost 0.9% for the quarter. According to the Office of National Statistics, third quarter GDP rose 0.6% in the third estimate, released in December. This is the first full quarter of GDP since the referendum, which continues to be a topic both politically and economically. Inflation rose to 1.2% for the year through November compared to 0.9% in October. This is the highest inflation level the UK has seen since October 2014.
- Within the Pacific region, Australia rose 0.8%, while New Zealand declined 10.9%. After reaching all-time highs in the third quarter, New Zealand's market declined severely in the fourth following a sharp decline in dairy prices, the country's largest export, combined with a stronger currency. Japanese equities were largely unchanged, losing just 0.1%. The Bank of Japan's December meeting yielded no immediate policy changes. The BOJ's economic outlook was upgraded, noting that exports have picked up, business fixed investment has been moderately increasing in step with high corporate profit levels and

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business sentiment has improved. A declining yen against the U.S. dollar helped boost exports and was generally seen as a positive for business prospects going forward. Despite this, inflation continues to be front of mind for the BOJ for 2017.

## International Emerging Markets

- Within Asia, China declined 7.1%. Chinese regulators began to crack down on insurance companies which conduct short-term trading and also own significant stakes in companies. In two moves, the country's insurance regulator banned Evergrande Life from further investing in stocks due to its short-term trading activities while Foresea Life made a pledge to reduce ownership of certain holdings. These actions follow strong disapproval from regulators of the large percentage of ownership the insurance company held in certain stocks. Elsewhere in the region, India fell 8.0% for the quarter. November services PMI was released by Nikkei India and reported a value of 46.7 (with any number below 50 indicating a contraction). The poor economic readings follow a move by the government to remove 500 and 1,000 rupee notes from circulation, showing evidence that the cash crunch being experienced has had an effect on economic growth. The government is due to release annual growth estimates in early January. Among other large Asian markets, Taiwan fell 2.2%, while South Korea ended 5.3% lower.
- In Latin America, Brazil gained 2.2% during a volatile quarter that saw significant gains in October followed by nearly equivalent decline in November. Stronger oil prices over the past three months have been a strong contributor towards stabilizing the Brazilian economy. Mexico declined 7.8% throughout the quarter with the month of November accounting for the entire decline as a result of trade uncertainty following the U.S. election.
- Among EMEA countries, South Africa declined 4.0%. In the Middle East, Turkey lost 13.7% with rising oil prices increasing the nation's current account balance and the failed coup attempt in July hurting foreign direct investment. Within Eastern Europe, Hungary gained 9.3% on the back of strong performance in December, while Poland rose 3.4%. Russia gained 18.7% during the quarter as sentiment toward the country improved following the U.S. election and the increase in oil and gas prices, which favor the production-heavy nation. The country agreed to cut overall production along with OPEC despite not being a member in the organization. These developments outweighed the potential ramifications following allegations that the country meddled in the U.S. election.



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Each index is unmanaged and investors can not actually invest directly into an index: Cash - Citigroup 90 Day T-Bill; TIPS - Bloomberg Barclays US Treasury TIPS; Aggregate Bond - Bloomberg Barclays US Aggregate Bond Index; Municipal Bond - Bloomberg Barclays Muni Bond 5 Year; High Yield - Bloomberg Barclays US Corporate High Yield; Foreign Bond - Bloomberg Barclays Global Aggregate Ex USD; Emerging Debt - JPMorgan GBI-EM Global Diversified Unhedged Index; Large Value - Russell 1000 Value; Large Blend - S&P 500; Large Growth - Russell 1000 Growth; Small Value - Russell 2000 Value; Small Blend - Russell 2000; Small Growth - Russell 2000 Growth; International - MSCI EAFE; Emerging Markets - MSCI EM; US RE - FTSE NAREIT Equity REITs; International RE - S&P Developed World Property; Commodities - Bloomberg Commodity Index; MLP - Alerian MLP; Hedge Funds - HFRI Fund of Funds Composite Index; Balanced - 5% Bloomberg Barclays US Treasury TIPS, 10% Bloomberg Barclays US Aggregate Bond Index, 4.5% Bloomberg Barclays Global Aggregate Ex USD, 4.5% Bloomberg Barclays Global Aggregate Ex USD (Hedged), 9% Bloomberg Barclays US Corporate High Yield, 2% JPMorgan GBI-EM Global Diversified Unhedged Index, 16% S&P 500, 5% Russell 2000, 12% MSCI EAFE, 7% MSCI EM, 5% FTSE NAREIT Equity REITs, 5% Bloomberg Commodity Index, 5% Alerian MLP, 10% HFRI Fund of Funds Composite Index

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