

CAPITAL MARKET REVIEW

Fourth Quarter 2016



The Economy

President Trump. It is hard to argue that there was a bigger story in the fourth quarter of 2016 than the election of Donald Trump as the President of the United States. To be honest I wish there was but as they say, "it is what it is."

October was just wait and see and once the election was over the markets were off to the races. Much of this in our opinion was simply a continuation of the rally which started in the third quarter. However, there is no doubt that the election had an impact.

Most in the market have focused on the potential for regulatory and tax reform. If done, and done thoughtfully, these could be a big boost to the US economy. On the other hand there is the worry of protectionism and anti-immigrant policies which would be hurtful.

Of course, nothing actually happens until he takes office. In the meantime there tends to be this huge reaction to every comment and every tweet that comes from the Trump camp. We try to stay clear of politics as much as possible, but one thing we have said over and over is that what the politicians do is more important than what they say. Trump is not the standard politician. He says things that shock us at times. However, what this administration does will still be more important. For that we will just have to wait and see.



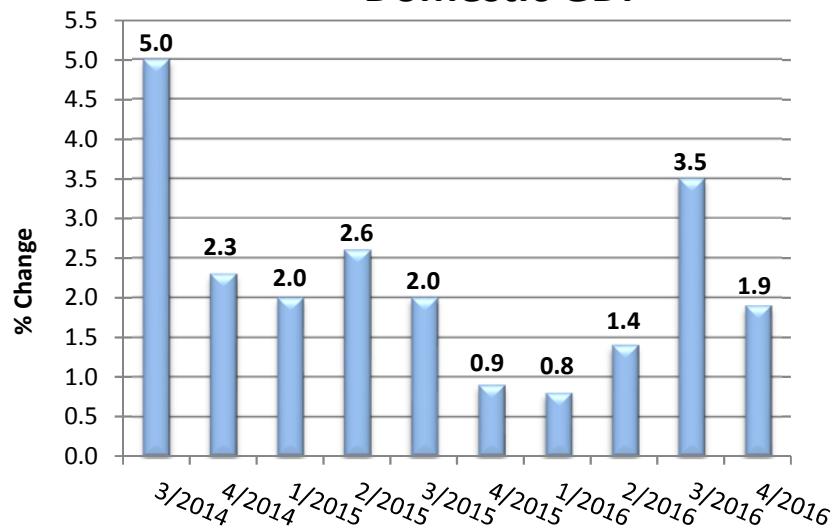
The Economy

The third quarter GDP growth came in at 3.5 percent. That is the highest reading since 2014. The fourth quarter was not as strong but still up 1.9 percent. There is optimism that pro-growth policies could be coming and faster growth may be ahead.

The official unemployment rate dropped to 4.7 percent in December. Jobs growth has picked back up after slowing during the summer.

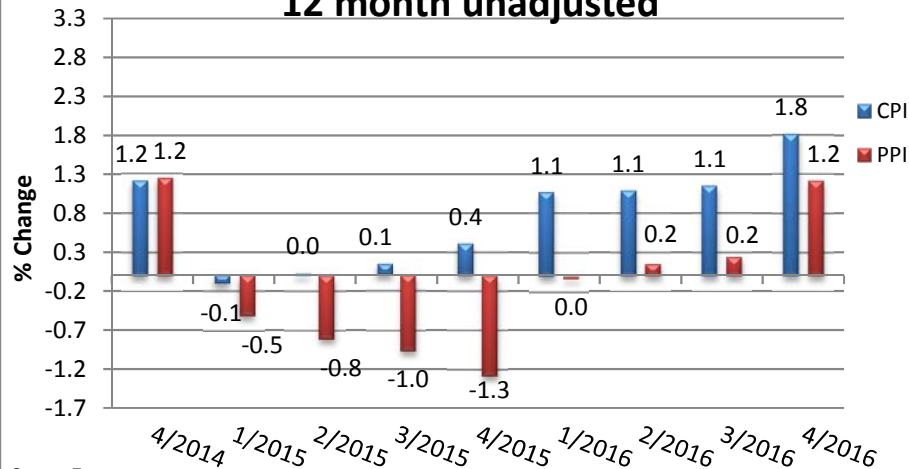
Inflation has been flat with CPI coming in at 0.2 percent again in November. The Fed has started to raise rates. Thus far that has gone along with greater optimism. Time will tell if that continues.

Domestic GDP



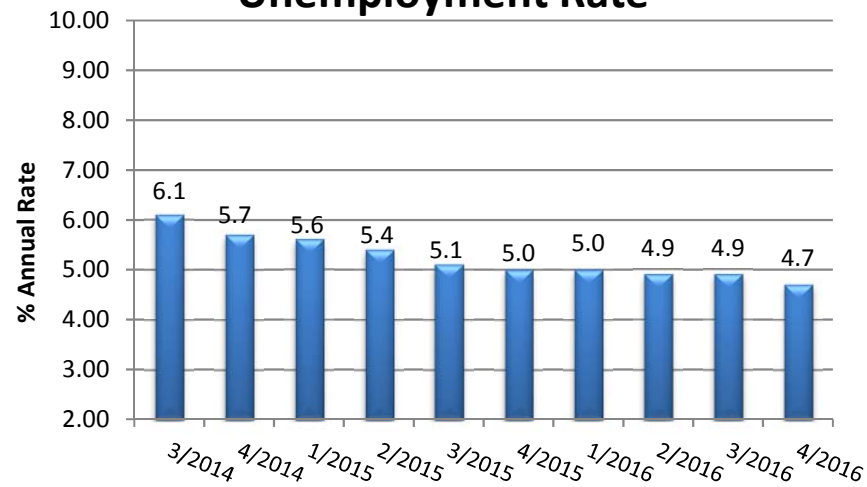
Source: Factset

Inflation Indicator 12 month unadjusted



Source: Factset

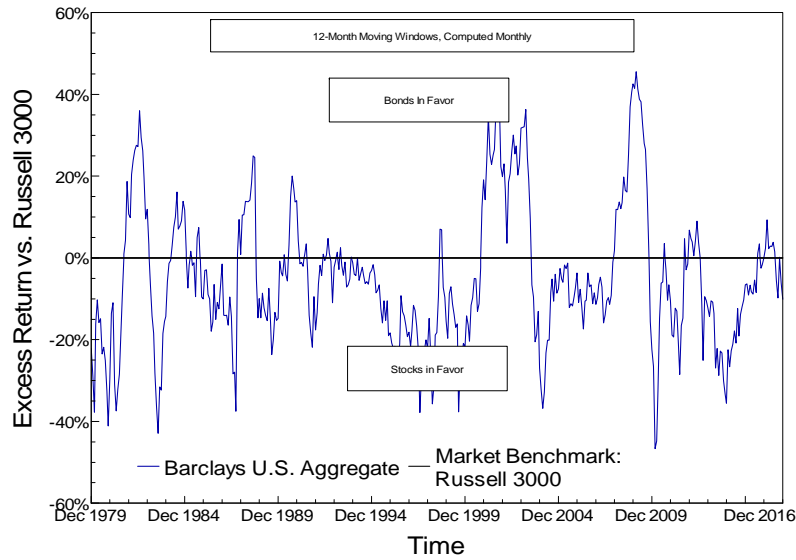
Unemployment Rate



Source: Factset

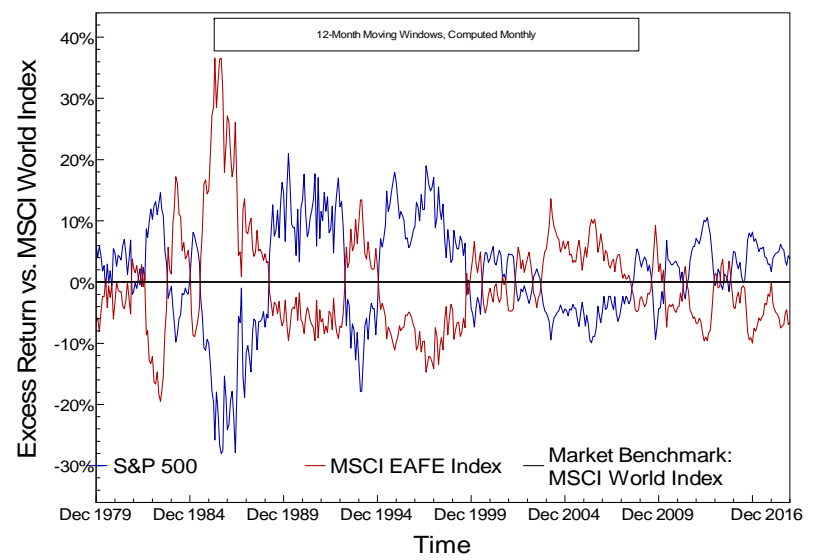
Bonds vs. Stocks

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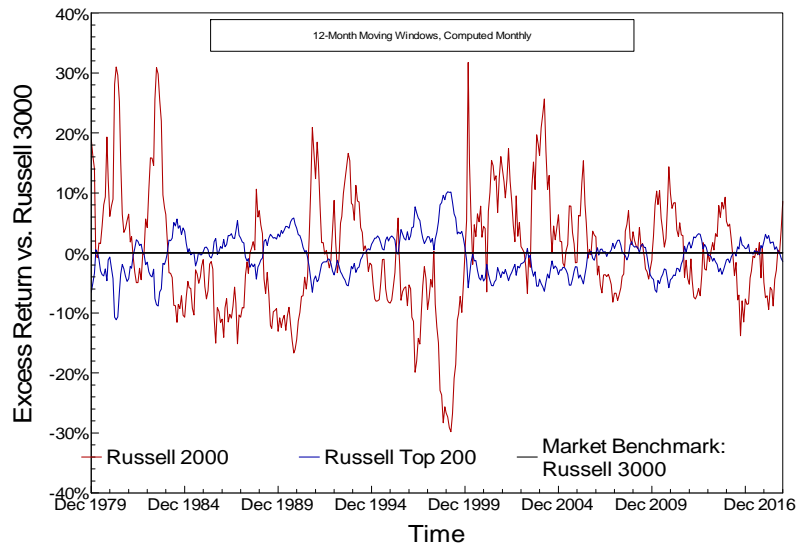
International Vs. Domestic

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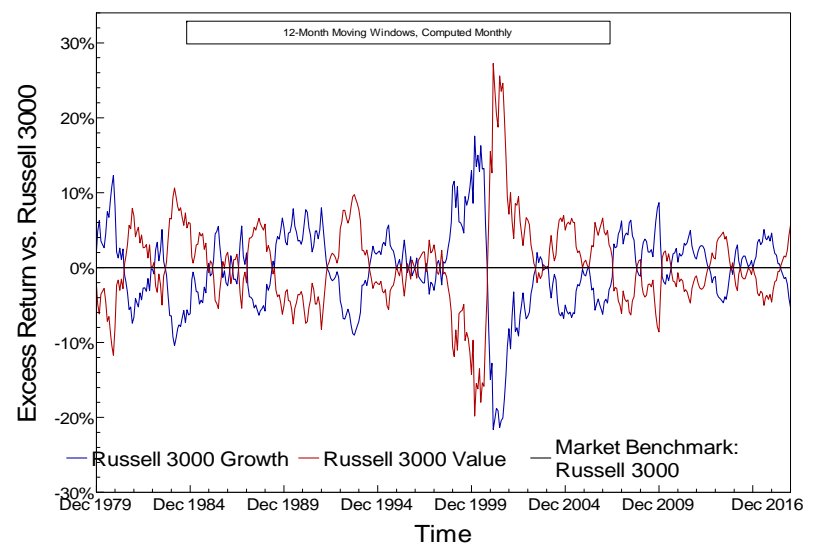


Large vs. Small

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Value vs. Growth



Domestic Equity Markets

The third quarter rally paused in October and then took off again in November. For the quarter the S&P 500 was up 3.8 percent. Value investors did better with the Russell 1000 value up 6.7 percent and small company stocks were the best place to be up 8.8 percent as measured by the Russell 2000.

Financials led the way as there is hope of normalizing interest rates. The rally was wide spread helping almost every sector. The only sectors that were down were consumer staples and health care.

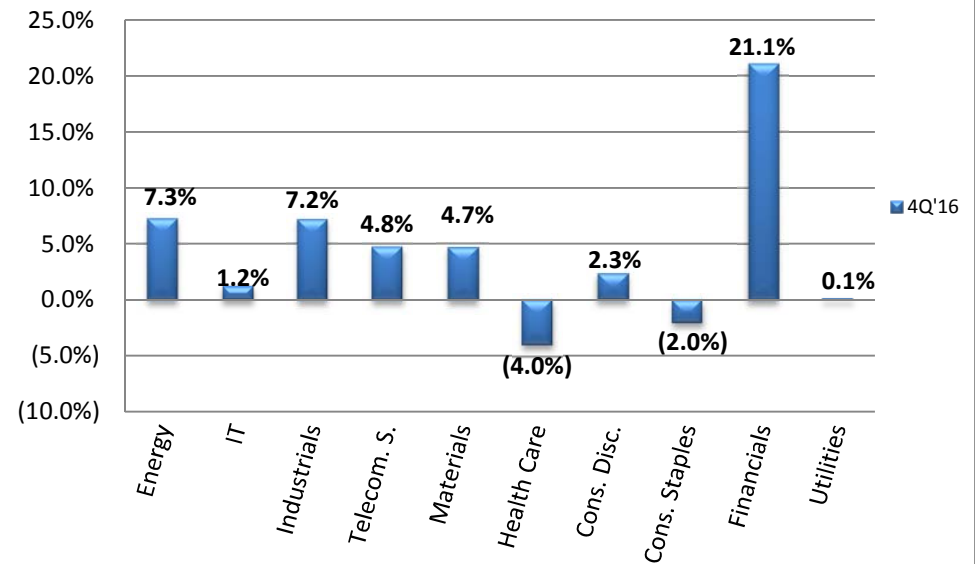
Staples were hurt by the threat of higher interest rates inducing investors to dump dividend paying stocks for bonds. That is more worry than reality as of now, but could happen if rates continue to rise.

Health care was hurt by the uncertainty caused by the election. The future of the affordable care act is at risk to say the least. The real question is what will replace it?

Domestic Indices Three Months Ending December 31, 2016

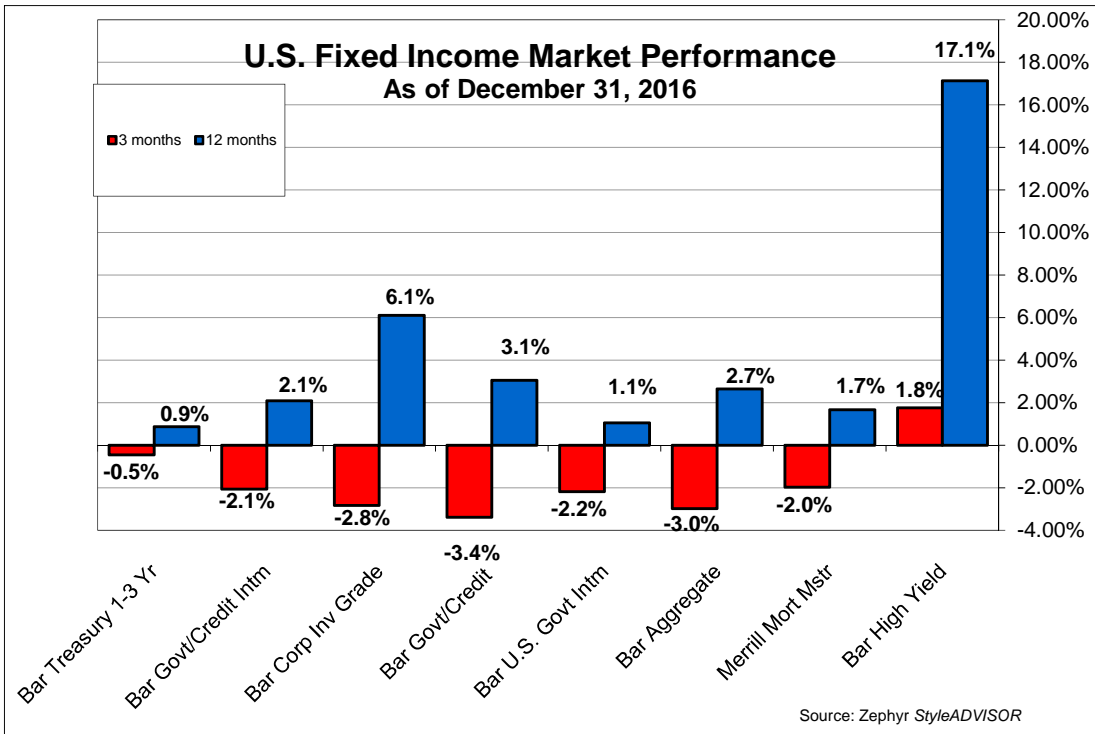
	Yield	Price/Earnings	Price/Book
S&P 500	1.95%	20.6	2.78
Russell 1000 Gr	1.49%	22.3	5.36
Russell 1000 Val	2.38%	20.1	1.82
Russell Midcap	1.80%	25.2	2.56
Russell 2000 Gr	0.78%	59.8	3.92
Russell 2000 Va	1.87%	35.1	1.60

S&P GICS Sector Returns

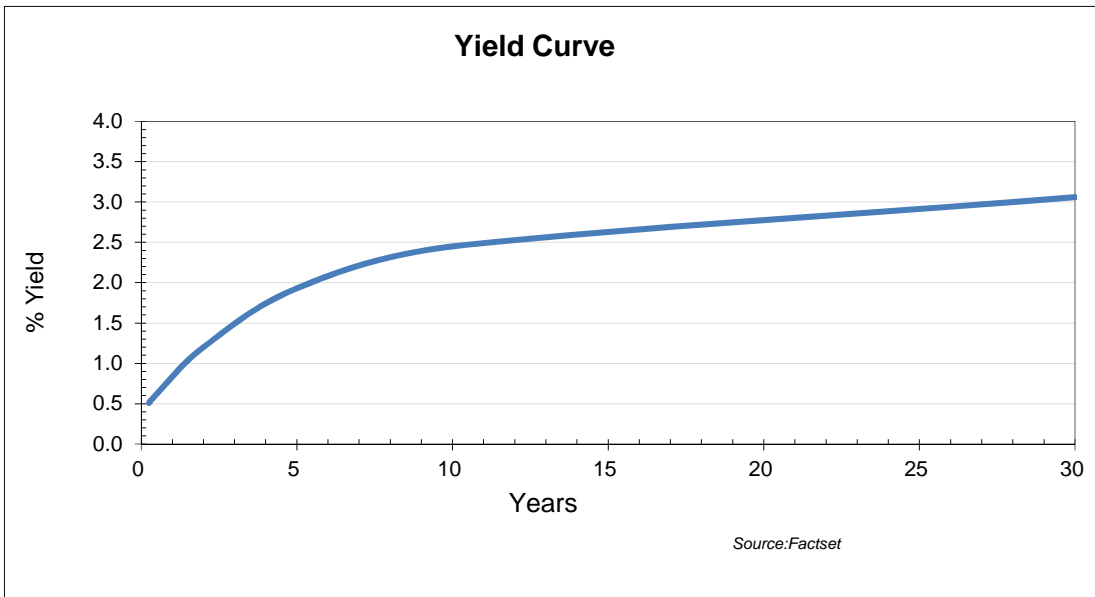


Source: Factset

DOMESTIC FIXED INCOME MARKET



Bonds were down as interest rates rose. The Barclays US Aggregate Bond index ended down 2.98 percent. High yield bonds ended the quarter up 1.85 percent. The search for yield and a more stable economic mood translated to big returns for the high yield market which ended the year up 17.1 percent.



Yield Curve as of December 31, 2016

Time to Maturity	Interest Rate
3 Month	0.51
6 Month	0.62
2 Year	1.20
5 Year	1.93
10 Year	2.45
30 Year	3.06

INTERNATIONAL MARKETS

International stocks did not participate in the rally. The EAFE index finished down 0.68 percent and the MSCI Emerging Markets index ended the quarter down 4.08 percent.

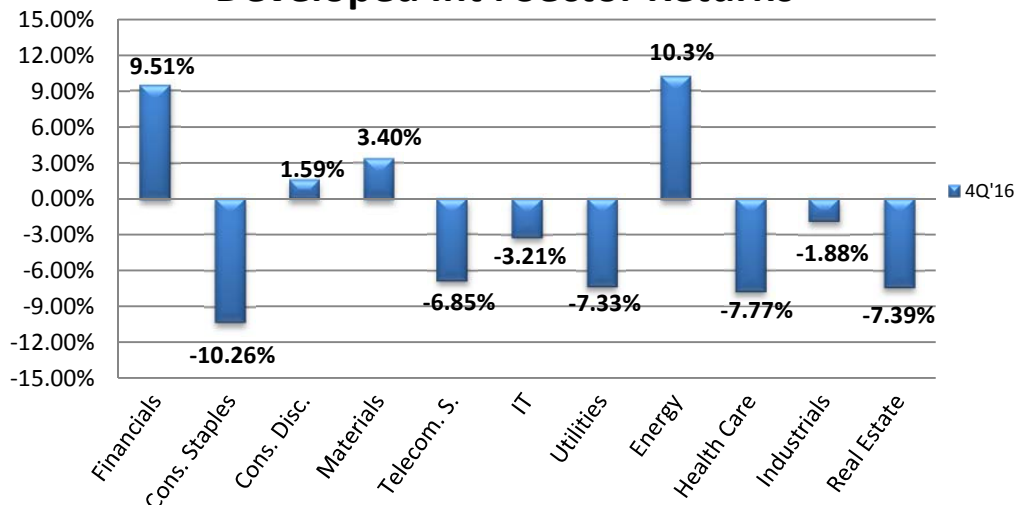
While the domestic markets welcomed the idea of regulatory and tax reform, the international markets were concerned about the potential higher growth in the US might lead to a stronger dollar. The currency effect explains the majority of the losses in international markets.

The other concern is the potential of protectionist policies. The increase in nationalism is a global phenomenon. The Brexit vote in the UK. The election of Donald Trump. The rise of nationalist parties throughout Europe. All these factor lead to the potential slowing of globalism and the freer trade that had supported over the last few decades. How much of this is real is still to be determined. However, there is no doubt that moods have changed towards trade.

MSCI Country Returns Three Months Ending December 31, 2016

	Return US\$ (%)	Return Local Currency (%)	Currency Effect(%)
Austria	6.51%	13.48%	-6.97%
Belgium	-11.52%	-5.72%	-5.80%
Denmark	-8.69%	-2.86%	-5.83%
Finland	-4.40%	1.86%	-6.26%
France	3.05%	9.79%	-6.74%
Germany	1.45%	8.10%	-6.65%
Ireland	0.15%	6.70%	-6.55%
Italy	10.82%	18.08%	-7.26%
Netherlands	-2.07%	3.74%	-5.81%
Norway	2.62%	10.52%	-7.90%
Portugal	-2.92%	3.44%	-6.36%
Spain	2.31%	9.01%	-6.70%
Sweden	-0.75%	5.24%	-5.99%
Switzerland	-3.86%	0.80%	-4.66%
UK	-0.88%	4.20%	-5.08%
Europe Total	-0.36%	5.48%	-5.84%
Australia	0.75%	6.48%	-5.73%
Hong Kong	-8.97%	-9.00%	0.03%
Japan	-0.02%	15.15%	-15.17%
New Zealand	-10.87%	-7.05%	-3.82%
Singapore	-3.63%	2.03%	-5.66%
Pacific Total	-1.01%	10.19%	-11.20%
Brazil	2.20%	2.39%	-0.19%
Canada	3.43%	5.54%	-2.11%
China	-7.07%	-7.10%	0.03%
Greece	15.40%	22.96%	-7.56%
Hungary	9.26%	16.33%	-7.07%
India	-7.99%	-6.20%	-1.79%
Indonesia	-7.71%	-4.73%	-2.98%
Korea	-5.28%	3.87%	-9.15%
Mexico	-7.82%	-1.88%	-5.94%
Poland	3.43%	12.81%	-9.38%
Russia	18.72%	15.71%	3.01%
Thailand	-1.75%	1.54%	-3.29%
Emerging Markets	-4.08%	-1.36%	-2.72%

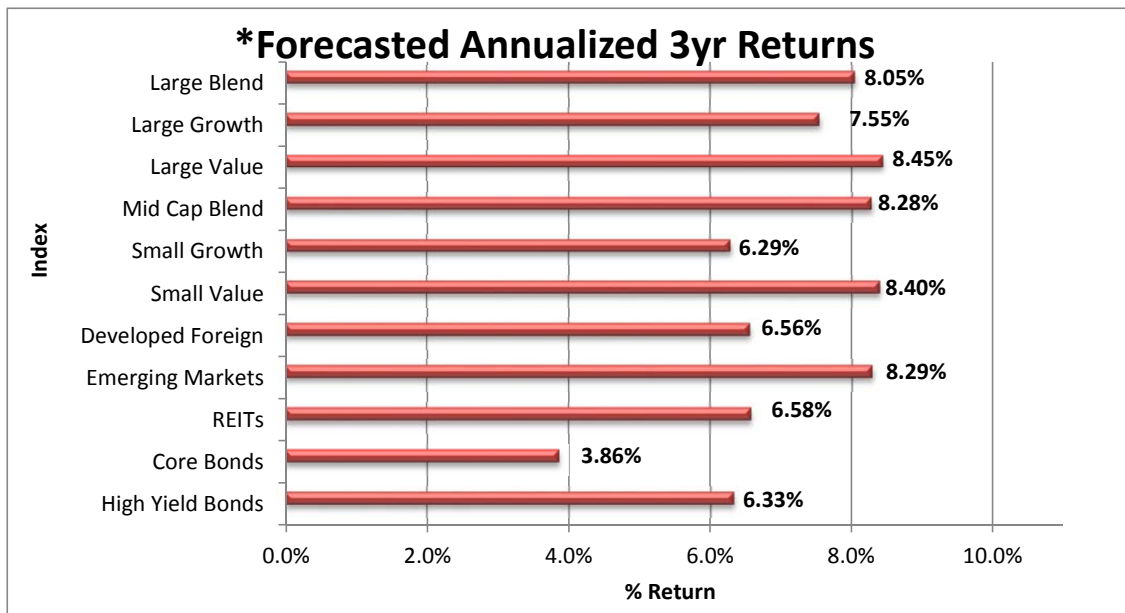
Developed Int'l Sector Returns*



Source: Harbor Capital

* MSCI EAFE Index

Market Forecast



The long awaited rotation to beaten down areas of the market arrived in the third quarter and has continued. The question is, have we gone too far too fast? Perhaps, a pause would seem in order but we are optimistic for 2017 as a whole.

Emerging markets look attractive as do small company stocks. Large company stocks look expensive to many but that is skewed due to the FANG outliers. Overall stocks are attractive.

Bonds remain our biggest concern over the long term and will until the yield on the 10 year treasury exceeds 3 percent. The run in high yield bonds will likely slow down, but not stop.

Indices Three Months Ending December 31, 2016

	Yield	Frwd Earnings Yield	**Hist. Return	***Hist. Risk Prem. + RF Rate
Large Blend	1.95%	7.86%	10.33%	6.01%
Large Growth	1.49%	7.00%	9.81%	6.01%
Large Value	2.38%	8.54%	10.76%	6.01%
Mid Cap Blend	1.80%	7.21%	11.96%	6.01%
Small Growth	0.78%	4.08%	8.51%	7.01%
Small Value	1.87%	6.98%	11.70%	7.01%
Developed Foreign	2.10%	9.29%	5.35%	4.14%
Emerging Markets	1.70%	8.60%	10.54%	5.64%
REITs	2.50%	4.88%	10.86%	4.58%
Core Bonds	2.61%	2.61%	6.46%	2.91%
High Yield Bonds	6.46%	6.46%	8.40%	4.08%

* Weighted average using 40% earnings yield, 30% historic return and 30% historic risk premium + RF rate

**Annualized 29 Yr return

***Hist. risk premium of domestic and international equity as defined by Zephyr Style Advisor's GFD Long Term Index database except for REITs and High Yield which are based on average 20 year rolling returns of the NAREIT Equity REIT Index and the Barclays Corporate High Yield Index minus the average 20 year rolling returns of the 3-month T-Bill and scaled using proprietary data. The Current 3-month T-Bill yield (as of 12-31-2016) is added back to each risk premium.

SELECTED INDEX RETURNS - PERIODS ENDING December 31, 2016

	Quarter	Year-to-Date	One Year	Three Years	Five Years	Ten Years
US EQUITIES						
Broad Stock Market - Russell 3000	4.21%	12.74%	12.74%	8.43%	14.67%	7.07%
Large Stocks - S&P 500	3.82%	11.96%	11.96%	8.87%	14.66%	6.95%
Dow Jones Industrial Average	8.66%	16.50%	16.50%	8.71%	12.92%	7.52%
Medium-Size Stocks - Russell Mid-Cap	3.21%	13.80%	13.80%	7.92%	14.72%	7.86%
Small Stocks - Russell 2000	8.83%	21.31%	21.31%	6.74%	14.46%	7.07%
Small Value Stocks- Russell 2000 Value	14.07%	31.74%	31.74%	8.31%	15.07%	6.26%
Small Growth Stocks- Russell 2000 Growth	3.57%	11.32%	11.32%	5.05%	13.74%	7.76%
Large Value Stocks - Russell 1000 Value	6.68%	17.34%	17.34%	8.59%	14.80%	5.72%
Large Growth Stocks - Russell 1000 Growth	1.01%	7.08%	7.08%	8.55%	14.50%	8.33%
US FIXED INCOME						
1-3 Yr Treasury (Gov't) Bonds - Barclays Capital	-0.46%	0.86%	0.86%	0.68%	0.57%	2.13%
US Government Bonds Int - Barclays Capital	-2.18%	1.05%	1.05%	1.58%	1.04%	3.42%
US Corporate Inv Grade Bonds - Barclays Capital	-2.83%	6.11%	6.11%	4.23%	4.14%	5.47%
Government/Credit (Corp) Bonds - Barclays Capital	-3.39%	3.05%	3.05%	3.04%	2.29%	4.40%
Int Govt/Credit (Corp) Bond - Barclays Capital	-2.07%	2.08%	2.08%	2.09%	1.85%	3.84%
US Aggregate Bond Market - Barclays Capital	-2.98%	2.65%	2.65%	3.03%	2.23%	4.34%
Mortgage Master - Merrill Lynch	-1.98%	1.67%	1.67%	3.04%	2.05%	4.28%
US Corp High Yield Bonds - Barclays Capital	1.75%	17.13%	17.13%	4.66%	7.36%	7.45%
INTERNATIONAL (Measured in US Dollars)						
Non-US Stocks - MSCI EAFE	-0.68%	1.51%	1.51%	-1.15%	7.02%	1.22%
World Stocks (includes US) - MSCI World	1.97%	8.15%	8.15%	4.38%	11.04%	4.41%
European Stocks - MSCI Europe	-0.36%	0.22%	0.22%	-2.63%	6.88%	0.96%
Japanese Stocks - MSCI Japan	-0.14%	2.73%	2.73%	2.82%	8.45%	0.73%
Asian Stocks (Ex-Japan) - MSCI Pacific ex-Japan	-2.68%	8.00%	8.00%	-0.46%	5.38%	4.23%
Chinese Stocks - MSCI China	-7.07%	1.11%	1.11%	0.37%	5.29%	3.96%
Indian Stocks - MSCI India	-7.99%	-1.43%	-1.43%	4.65%	6.78%	2.74%
Emerging Markets - MSCI EM	-4.08%	11.60%	11.60%	-2.19%	1.64%	2.17%
Int'l Gov't Bonds -Citi World Gov't Bond (Non USD)	-10.84%	1.81%	1.81%	-2.18%	-1.94%	2.54%
REAL ESTATE						
FTSE NAREIT Equity-Reits Index	-2.89%	8.52%	8.52%	13.38%	12.01%	5.08%
SHORT TERM INTEREST RATES						
T-Bills	0.08%	0.27%	0.27%	0.11%	0.09%	0.73%

Note: Returns for periods longer than 12 months are annualized.