

DEAVEL WEALTH ADVISORS

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January 9, 2017

Dear Valued Client,

CBS News recently dubbed 2016 as “The Year of Surprises.” Most people would agree. As the year unfolded, there seemed to be one stunning event after another. In January, a decline in Chinese growth pushed down oil prices and rattled global markets. The European Union faced a major defection that caused wild currency swings. The Zika virus threatened to spread. After the most contentious Presidential election in recent history, the outcome was finally determined. Even the Nobel Committee got into the act: they named Bob Dylan as the 2016 Nobel Laureate for literature.

The investment markets in 2016 had their own share of surprises. The beginning of 2016 claimed a dubious distinction. In the first five trading days, the Dow Jones Industrial Average fell over 1,000 points. This marked the worst five-day start in market history. The media and market pundits sounded shrill warnings. By March, equity markets stabilized and turned positive. Then, another surprise appeared. British citizens stunned the world by voting to withdraw from the European Union. The market reaction was swift and predictable. In the two days following the vote, the S&P 500 slumped 5.3% and the MSCI Developed Market Index dropped almost 10%. Again, the sell-off didn't last. By August, domestic stocks had recovered to new highs.

Probably the biggest surprise of the year was the U.S. Presidential election. After months of unsettling leaks, accusations and attacks, the day finally came. Media pollsters had their ever-confident predictions in hand. Much of Wall Street readied their forecasts as well. Many predicted that in the unlikely event of a Trump

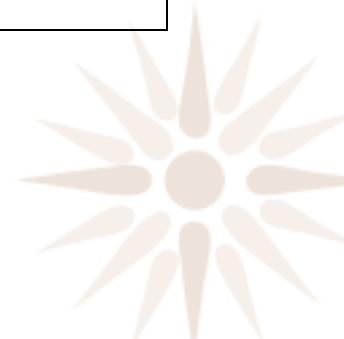
% Return as of 12/31/2016

<u>Equity Indexes</u>	<u>4th Q</u>	<u>1 Yr</u>	<u>3 Yr</u>
S&P 500	3.8	12.0	8.9
Russell 2500	6.1	17.6	6.9
MSCI EAFE	-0.7	1.0	-1.6
Emerging Market	-4.2	11.2	-2.6
Wilshire REIT	-2.3	7.2	13.8
<u>Bond Indexes</u>			
TIPS	-2.4	4.7	2.3
Aggregate	-3.0	2.6	3.0
Governments	-3.7	1.0	2.3
Mortgages	-2.0	1.7	3.1
Investment Corporate	-2.8	6.1	4.2
Long Corporate	-5.0	11.0	7.0
Corporate High-Yield	1.8	17.1	4.7
Municipals	-3.6	0.2	4.1
<u>Cash Equivalents</u>			
3-Month T-Bill	0.1	0.3	0.2
<u>Consumer Price Index</u>			
	0.9	1.7	1.1

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victory, we could expect a quick and deep sell-off in the stock market.

Throughout the evening of November 8th, state by state, results slowly revealed a Trump victory. Panic in the investment markets set in quickly. Stock market futures, which trade globally throughout the night, plunged as much as 5%. That level was very near trading limits – typically referred to as “limit down” – where trading restrictions would be enforced. This could result in even more panic. For once, it appeared, Wall Street’s opinion would be correct.

Then, in the small hours of the night, yet another surprise began to unfold. Battered stock futures began to stabilize, then slowly claw their way back. By the open on November 9th, stocks were roughly unchanged. By the end of the trading day, the market actually rose over 1%.

A wise person once said, “In the short-term, the markets will do whatever is necessary to make the largest number of people look foolish.” We do not make short-term political or market forecasts. The market movements around the election show why. It is our job to be disciplined and prudent stewards of long-term wealth. The benefits of that approach are obvious. As Mr. Dylan once said, “You don’t need a weatherman to know which way the wind blows.”

We are certainly not saying the election is not important. Many people understandably held strong opinions on both sides. We respect that. As noted in the last quarterly letter, an examination of the math is helpful. Dr. Jonathan Lemco studied stock market returns from 1853-2015. He compared the average return of equity markets and the party controlling the White House. He found that over this 162-year period, the returns were ... are you sitting down? ... identical for each party! It is the ingenuity and industry of the people that drive markets, not politics.

Domestic Equities: On January 22, 2016, during a very weak month, CNBC ran a story touting the accuracy of what they called “The January Barometer.” It held that as the S&P 500 goes in January, so goes the year. The article called the indicator a “high probability ratio.” Despite all of the jolting reactions to world events, an improving economy drove U.S. stocks to a solid year. The S&P 500, a gauge of large stocks, jumped 12%. Smaller stocks, an underperformer in 2015, sprinted to a 17.6% gain. The markets defied the CNBC ratio in four of the last eight years despite a considerable head start due to the free look. We can only assume some people define “high probability” differently than others.

International Equities: Foreign stocks turned in significantly different returns than their domestic counterparts. While the “Brexit” issues affected world markets in a secondary manner, the effect on European stocks was more direct. Political uncertainty coupled with large swings in currencies made for a choppy environment. Given the difficult environment, international stocks still ended with positive returns. The MSCI EAFE made it into positive territory, edging out a 1% return. Emerging markets did significantly better with an 11.2% increase.

Given yet another year of international equities underperforming domestic markets, we are hearing more and more talk about whether this underperformance is permanent. This is unlikely. Asset classes change positions of relative performance often and without notice. After a significant bout of underperformance, it is often the worst time to give up on diversification.

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Fixed-Income: Bond investors went through their own roller-coaster ride in 2016. It was, however, a different path than equities took. In the first half of the year, the same macro-economic events that pressured stocks also pushed bond prices higher. As each of these threats faded and the Fed finally raised interest rates, bonds came back down. In the end there was little change. The Barclay's Aggregate Bond Index ended the year up 2.6%.

There has been much discussion regarding whether bonds should be avoided altogether given that interest rates might be moving higher. A longer-term perspective might help. History has shown the value bonds can provide in a portfolio in terms of diversification as well as an important generator of regular income. Further, to regular investors with longer time frames, a rising rate environment can result in increased long-term returns as income is reinvested at higher rates. So, for many bondholders, rising rates can actually be a good thing.

The media may have mislabeled 2016 as the "Year of the Surprise." Unfortunately, there have been international intrigues, threats from disease and contentious elections many times before. A 5% decline in the S&P 500 occurs, on average, about every five months. A 10% correction occurs about every 1.3 years. So, from a market perspective, maybe 2016 wasn't so surprising. Perhaps it could be more accurately described as the "Year of Change," just like most years before it.

Change will likely be a major factor in 2017 as well. There will be challenges and opportunities. To paraphrase Robert Kennedy, "Few have the ability to bend history; but each of us can work to change a small portion of events that can make a difference."

We cannot alter the inevitable events and market reactions to them. We can work to understand your unique situation and carefully examine your goals. Then, we can construct mathematically informed portfolios designed to help grow and protect your assets. That is the value of advice and our commitment to you. We take it seriously, whatever 2017 may bring.

Please let us know if you need anything. We are here and ready to help.

Sincerely,

Cindy Deavel, CFP

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