

Nauset Market Commentary Third Quarter 2016

Market Performance Recap: Summer Markets Heat Up

US stock market indices rose to new highs to match the soaring summer heat. During Q3 the Russell 1000 gained +4.0%, and the tech-heavy NASDAQ Index rallied up +10.7%. The international stock MSCI EAFE recovered after the Brexit sell-off to post gains of +6.4%. Tech and financials were leading sectors, while utilities and real estate lagged on rate concerns. Although the Fed remained on hold, future rate concerns kept bond returns flat for Q3 as the Barclays Intermediate Gov't/Credit Index inched up +0.2%.

Economic & Market Discussion: Calm Before the Event Storm?

With the US stock market near all-time highs, several fall events may create market turmoil that can both cause temporary sell-offs as well as opportunities. We will be closely monitoring these events and assessing their potential impact.

- A Cloudy Election – The early November US Presidential election looms as the most obvious event risk on the Q4 calendar. We expect some short-term volatility regardless of who wins. And while markets may prefer Clinton due to her known policy leanings, the election may not have as significant a market impact as many expect. The larger economic picture will likely be the key driver.
- Will the Fed Rain? – The Fed has indicated that a December rate hike is on the table. Given their intent and lack of any hikes throughout this year, we feel this is a better than 50% probability. While a negative for the markets, we believe a ¼ point hike will be absorbed with minor price volatility as long as the Fed signals that the pace remains slow for additional hikes.
- Italian Ice – The Italian referendum scheduled for late November will determine if the current government can consolidate power to promote structural economic reform in Italy. A yes vote would be positive, and a no vote could set the stage for an Italian exit from the euro. While an Italian euro exit is not a high probability, a no vote on this referendum would likely hurt European stocks.

Portfolio Strategy: Ready for All Weather

Monitoring event risk and responding to volatility is part of our usual portfolio management activities. Here is how our managed-risk approach is prepared for the possibility of rockier markets:

- Diversify and use Alternatives – We invest across diverse asset classes to provide protection against volatility in any specific sector such as emerging market stocks. And we use alternative investments that are uncorrelated to stock or bond indices. These alternatives are both a buffer to market declines, as well as a source of funds to rebalance into attractive opportunities.
- Search for Opportunities – Volatility is a natural market occurrence. While it can be unnerving, it also creates undervalued situations and lower price entries to areas that we find attractive. In our approach, we actively seek these opportunities to rebalance portfolio allocations as market levels shift. Over the long term, this can lower risk and improve returns.

Market Index	Market Performance				
	Third Quarter	2016 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	4.03	7.92	14.93	10.78	16.41
MSCI EAFE – Non-US	6.43	1.73	6.52	0.48	7.39
Russell 2000	9.05	11.46	15.47	6.71	15.82
MSCI Emerging Markets Equity	9.03	16.02	16.78	-0.56	3.03
DJ US Real Estate	-1.15	11.01	19.04	12.97	14.72
NASDAQ 100	10.71	7.19	18.13	16.32	19.44
Barclays Gov't/Credit Interm. Bond	0.16	4.24	3.52	2.79	2.45
IQ Hedge Multi-Strategy	0.95	3.90	3.65	3.26	3.99
3-Month T-Bill	0.07	0.19	0.20	0.09	0.08