

## Nauset Market Commentary Fourth Quarter 2016

### Market Performance Recap: US Financials Rally, Other Areas Fall on Election Outcome

US stocks jumped to record highs following the Trump election paced by financial and industrial sectors. During Q4, the Russell 1000 gained +3.8% to finish the year at +12.0%. The tech-heavy NASDAQ was flat and the international stock MSCI EAFE lost ground, off -0.7% during Q4. Negative Q4 returns were also posted by health care, real estate, and emerging markets stock sectors. With the Fed raising rates in December, bond prices took a hit in Q4, as the Barclays Intermediate Gov't/Credit Index fell -2.1%.

### Economic & Market Discussion: 2017 Outlook

The election of Donald Trump shifts the outlook for 2017 from the expected view several months ago. The big themes we will focus on over the next twelve months are: (1) Markets are tied to policy change; (2) Will higher rates limit growth? and (3) Change creates unexpected consequences and thus, volatility.

- Markets are Tied to Policy Change – US equity prospects rely on three key factors. Right now, two factors are usually judged to be negatives to stocks – historically high valuations and rising interest rates. The third factor, earnings growth, is the critical one. Earnings are expected to improve based on anticipated policies aimed at promoting US economic growth. Whether new tax, trade and infrastructure policies do actually drive higher earnings will be the key to stock returns in 2017.
- Will Higher Rates Limit Growth? – The expected policy changes geared to boosting economic growth will likely be accompanied by higher interest rates. As the Fed rate cycle continues to lift short-term rates, we will closely watch for the negative effect of rates on economic activity. This will be a delicate balancing act that could result in GDP growth falling short of more optimistic projections.
- Change Creates Volatility – Anticipated policy shifts are creating strong positive sentiment for the markets. What actually happens and how markets react to that reality will definitely create volatility. And it could cut both ways – helping some stock sectors, disappointing others. As always, we will monitor these developments to manage risk and seek opportunities.

While we are following this scenario, we are constantly monitoring market developments, and remain flexible to adjust to new data as the year unfolds.

### Portfolio Strategy: Navigating Change

In an environment of policy change, positive market sentiment, rising rates and a fully valued equity market, our managed-risk approach is focused on the following strategies:

- Favor Equities – We are emphasizing equity over fixed income in our allocations. We believe certain stock sectors are attractive if growth improves and rates rise, such as financials, tech and energy.
- Manage Rate Risk – Rising rates can have a negative impact on income-producing positions. We are underweighting the income asset class and shifting allocations toward holdings less affected by rising rates, such as hedged income, high yield bond and business development corp. investments.
- Diversify and use Alternatives – Despite recent challenges, we will continue to invest across diverse asset classes to dampen volatility and manage risk. And we use alternative investments as both a buffer to market declines, as well as a source of funds to rebalance into attractive opportunities.

| Market Index                       | Market Performance |          |        |                |                | % Change for Periods Ended 12/31/2016 |  |  |  |  |
|------------------------------------|--------------------|----------|--------|----------------|----------------|---------------------------------------|--|--|--|--|
|                                    | Fourth Quarter     | 2016 YTD | 1-Year | 3-Year Annual. | 5-Year Annual. |                                       |  |  |  |  |
| Russell 1000                       | 3.83               | 12.05    | 12.05  | 8.59           | 14.69          |                                       |  |  |  |  |
| MSCI EAFE – Non-US                 | -0.71              | 1.00     | 1.00   | -1.60          | 6.53           |                                       |  |  |  |  |
| Russell 2000                       | 8.83               | 21.31    | 21.31  | 6.74           | 14.46          |                                       |  |  |  |  |
| MSCI Emerging Markets Equity       | -4.17              | 11.19    | 11.19  | -2.55          | 1.28           |                                       |  |  |  |  |
| DJ US Real Estate                  | -3.11              | 7.56     | 7.56   | 11.81          | 11.09          |                                       |  |  |  |  |
| NASDAQ 100                         | 0.08               | 7.27     | 7.27   | 12.02          | 17.90          |                                       |  |  |  |  |
| Barclays Gov't/Credit Interm. Bond | -2.07              | 2.08     | 2.08   | 2.09           | 1.85           |                                       |  |  |  |  |