JB MERIDIAN ADVISORS

Financial & Economic Review

The fourth quarter of 2016 ended with both a multitude of surprises and expectations. Arguably, the largest revelation during the quarter was the election of Donald J. Trump as the 45th President of the United States. A new U.S. President would normally not come as a shock if it were not the opposite of the predominant wisdom around the nation and worldwide. The broader futures markets initially dropped over 5% on election night, but rapidly digested the information and responded positively to the bevy of positive market implications inherent. Promises of lower corporate tax rates, reduced corporate regulations, increased infrastructure spending and pressure on corporations to keep manufacturing jobs in the U.S., rallied markets broadly higher to end the year. Partly due to OPEC's deal to cut production, oil markets realized an anticipated recovery in 2016 from approximately $30/barrel of WTI crude early in the year to $53 at year-end. This outcome may be temporary, as an increase in shale production, on hold throughout much of 2016, could resume this year. With the Fed increasing interest rates less than expected in 2016, we ended the year with a Federal Funds Rate of 0.50-0.75%. We do not feel that this rate is sustainable given the current rising inflation outlook and expect two to four increases in 2017, approaching a more historically normal rate. Fueling this assumption is our expectation that inflation will begin ticking upward. One potential negative consequence of higher inflation would be Social Security payments providing less purchasing power to retirees, as their disposable income shrinks.

The S&P 500, Dow Jones Industrial Average and NASDAQ Composite Index returned 3.3%, 7.9% and 1.3% in the fourth quarter respectively. Industrials rallied notably in the quarter due to an increased expectation of government infrastructure investment, a key component of the incoming administration. Financials, Energy and Industrials were the best performing equity sectors in Q4, rising 19.0%, 7.3% and 7.0%. The worst performing sector returns were in Healthcare, Real Estate and Consumer Defensive losing -4.2%, -2.7% and -1.2% respectively. In fixed income, the U.S. Aggregate Bond index dropped -3.0%, while the 10-year Treasury bond yield increased to 2.5%, a 56% increase from Q3 2016. The most overvalued sectors at year-end were once again Basic Materials and Energy, trading at approximately 1.25 and 1.14 times Morningstar's coverage universe. Healthcare and Real Estate were the most undervalued at 0.87 and 0.93 respectively[1]. Diversification remains important as investment performance is historically unpredictable during late stages in the business cycle.

We appreciate your business and continued referrals as we digest the market and the many changes we are likely to encounter in 2017. We look forward to continually earning your business, growing your investments and earning your trust in the year ahead.

Jack A. Kennedy
Chief Investment Officer

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[1] Results referenced from Morningstar.com

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