

Economic & Market Review
~ Y E A R - E N D 2 0 1 6 N E W S L E T T E R ~

EXECUTIVE SUMMARY

For many investors, 2016 was a serpentine journey from hopeless to hopeful. The year's roller coaster ride began on day one when heavy-handed stock market controls by the Chinese government caused swift market declines. By the time newly minted circuit breakers were deemed a poor idea, the Chinese stock market had suffered two declines of 7% in the first week. Investors, globally, inferred such market behavior could only suggest an all out collapse of the Chinese economy. Pandemonium reigned, investor sentiment plummeted, and global stock markets fell by double digit percentages over several weeks.

Eventually pacified by aggressive central banks and the reality of solid economic fundamentals, investors next faced a previously deemed impossibility — a referendum for Britain to exit the European Union. In response, foreign currency markets had their single most volatile day in history, British sterling experienced its greatest one-day decline ever, and global stock markets lost \$3 trillion over two days.

Once again, cooler heads prevailed, markets did an about face, and losses morphed into gains only days later. The U.S. stock market hit new highs early in the third quarter, and a calm yet positive tone fell over markets into the fall. As a case in point, August had the lowest volatility many have seen in their lifetimes. During the month, the S&P 500 index traded within its tightest 30-day range since December 1965, and the yield on the 10-year Treasury note moved in its narrowest range in over a decade.

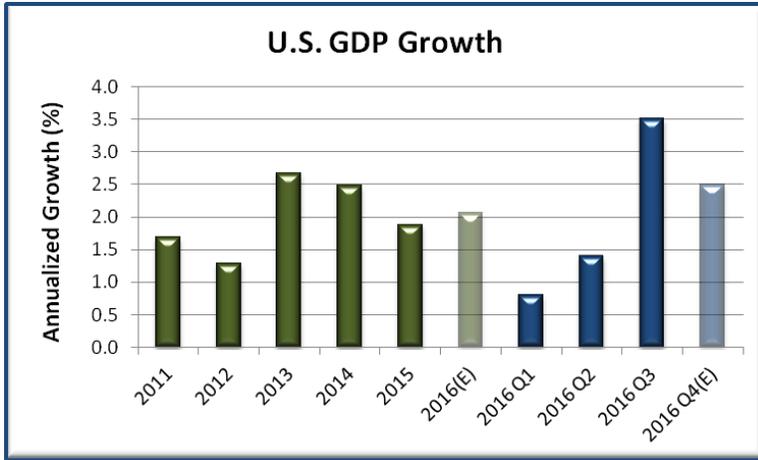
Nature abhors a vacuum, and investment markets reject calm. November began by completing the longest streak of consecutive down days (9) for the S&P 500 since 1980. The month ended with the longest string of consecutive up days (15) for the Russell 2000 in 20 years. The decline was out

of fear Donald Trump might become the nation's 45th president. The rally was out of jubilation that he actually did. Following the election, investors swiftly assessed the potential ramifications of the Trump platform, namely lower taxes, reduced regulation, and fiscal support through infrastructure spending. The dollar, interest rates, and inflation expectations all catapulted higher. Financial, energy, and industrial stocks rose dramatically, and domestic-centric small capitalization shares performed exceptionally well. On the flipside, capital flowed out of emerging markets, foreign investments were hammered by currency moves, and bonds suffered uncharacteristic losses. It is these realities one must consider when evaluating the totality of the election's impact on diversified portfolios. Media outlets, which tend to narrowly focus on U.S. stocks, obfuscate the fact that most of what investors *actually* own was *hurt* by the election results.

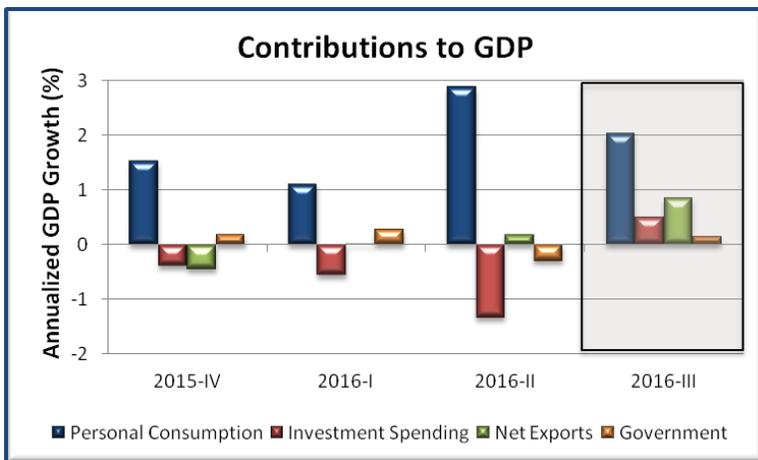
Going forward, it is nearly impossible to assess how actual governance will deviate from campaign rhetoric. Likewise, exuberant investors seem to be grossly downplaying material challenges. For example, dollar strength acts as a headwind to economic growth. Higher interest rates challenge corporate profits, can depress stock market valuations, and weigh on debt reliant economic sectors such as housing and autos. Tighter borders drive up labor costs and slow population growth, a key requirement for economic growth. Moreover, fiscal spending takes time, acts with a lag, and fiscally minded Congressional leaders are unlikely to provide President Trump with a blank check. Lastly, the potential for, and risk of, protectionist driven trade wars is not insignificant. In short, for excited stock holders and agitated bond investors, the future is unlikely to be quite so rosy or dismal, respectively.

ECONOMIC REVIEW AND OUTLOOK

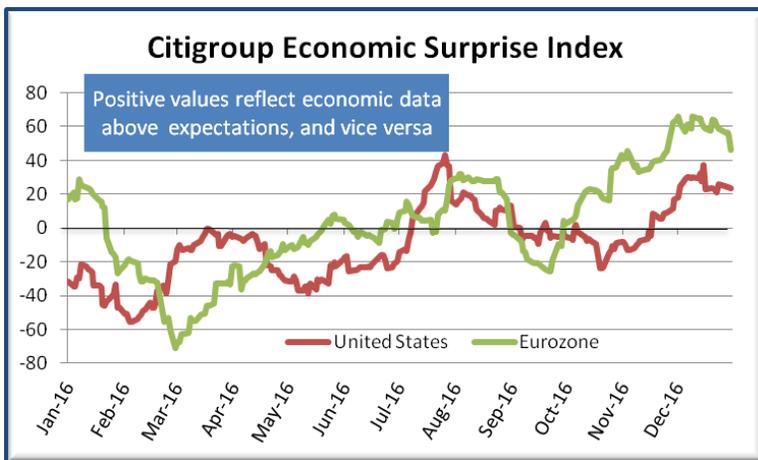
Key Economic Fundamentals



Data Source: U.S. Department of Commerce



Data Source: U.S. Department of Commerce

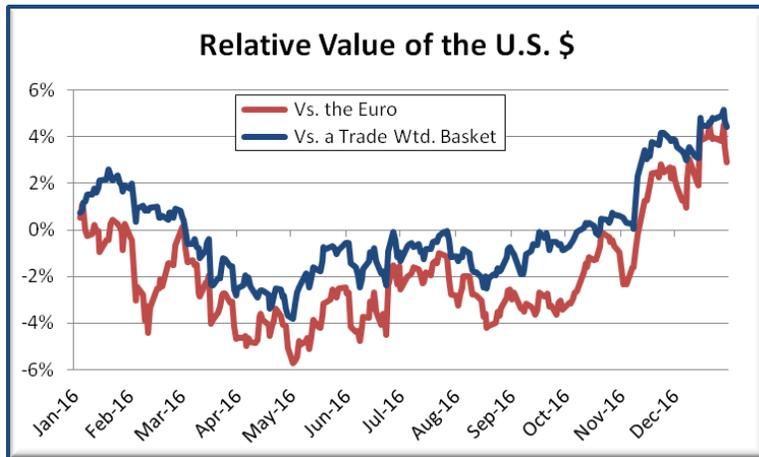


Data Source: Citigroup

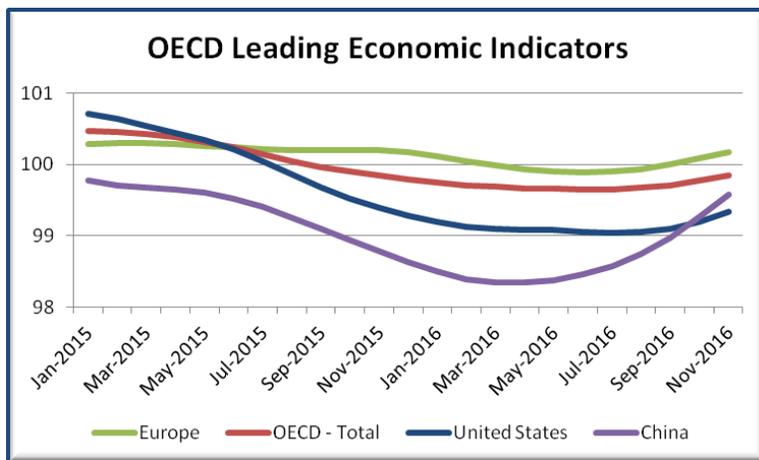
U.S. economic growth accelerated in the third quarter following a weak start to the year. All told, for the full year 2016, U.S. GDP growth should come in just over 2%. This pace is in line with the average growth rate experienced throughout the present expansion — the slowest since WWII.

The U.S. economy fired on all cylinders in Q3. This was the first quarter in two years when all major components of GDP were positive. Broad based business spending offset slight weakness in housing. Trade had its most significant contribution to growth since 2013, and Federal spending offset a state and local decline.

After bottoming in February, economic results began to improve relative to forecasts. By mid-year, economic results for Europe and the U.S., the two largest economic entities in the world, generally met or exceeded expectations. Clearly, widespread pessimism early in the year was unwarranted.



Data Source: U.S. Federal Reserve



Data Source: Organization for Economic Cooperation and Development

Global Growth Rates¹ (%)

	Q3 2016	Q4 2016	Q1 2017	2015	2016	2017
Advanced	1.7	1.8	1.9	2.2	1.6	1.9
Euro²	1.4	1.4	1.5	1.9	1.6	1.4
U.S.²	3.5	2.1	2.0	2.6	1.6	2.3
Japan²	1.3	0.7	1.1	1.2	1.0	1.2
U.K.²	2.0	1.7	1.2	2.2	2.1	1.4
Canada²	3.0	1.6	2.1	1.1	1.1	1.8
Emerging	4.5	4.1	4.7	4.4	4.4	5.3
China	6.7	6.7	6.5	6.9	6.7	6.5
India	7.3	4.0	7.0	7.2	6.6	8.4
Russia	-0.4	1.0	1.6	-3.7	-0.2	2.6
Brazil	-2.9	-1.8	-0.8	-3.8	-3.4	1.1
World	3.1	3.0	3.3	3.3	3.0	3.6

Data Source: Goldman Sachs, Central Intelligence Agency

¹Q3 2016 and 2015 are actual, all others are forecasts

²Quarterly numbers are sequential annualized, others are year-over-year

After material strengthening in recent years, the U.S. dollar showed weakness during the first half of 2016. Following U.S. elections, however, the dollar spiked to finish the year higher than where it started. Dollar strength weighs on U.S. competitiveness and negatively impacts international investments.

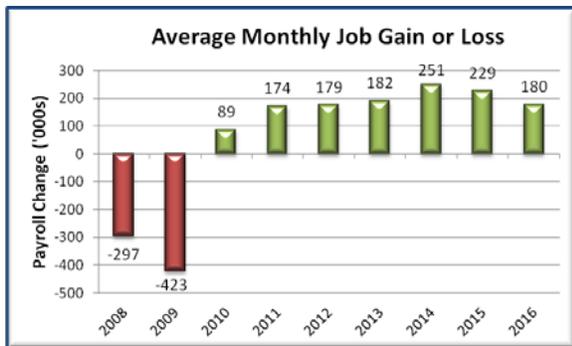
Neutral to negative trends across major economies in 2015 gave way to improvement in 2016. China is of particular note. Early on in 2016, many believed China was headed for something between economic weakness and outright disaster. Albeit fueled by debt, the nation looks to have hit its growth target for the year.

Led by the U.S. and Canada, growth in advanced economies is expected to tick higher in 2017. The U.K. is forecast to be an outlier, but negative Brexit predictions have thus far been wrong. Emerging economies are also expected to grow faster this year. Growth in India is a key factor as is resumption of growth in Brazil and Russia.

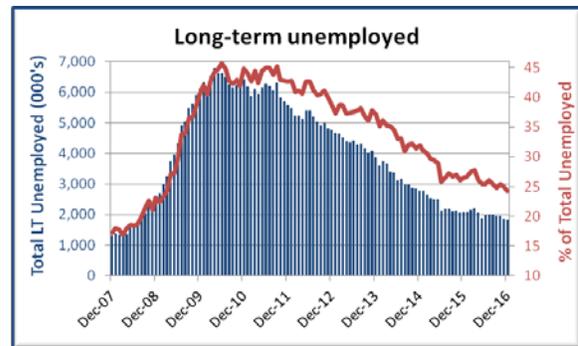
Employment

The labor market persistently improved in 2016. Payrolls continued to grow, albeit at a slower pace than in recent years, and the percentage of long-term unemployed continued to tick lower. Initial jobless claims fell to a multi-decade low, and modest nominal wage pressure, which began in 2015, continued. The labor force participation rate has also stabilized. Workers once believed to be out of the workforce are returning as the labor market tightens and wages rise.

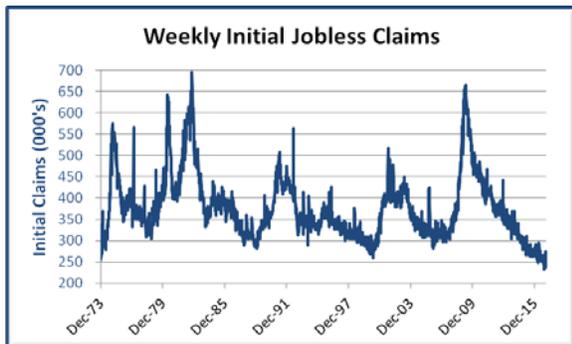
Burgeoning wage growth, at least in nominal terms, and a diminished unemployment rate were no doubt key drivers behind the Federal Reserve's December decision to once again raise U.S. interest rates following a similar action the prior year.



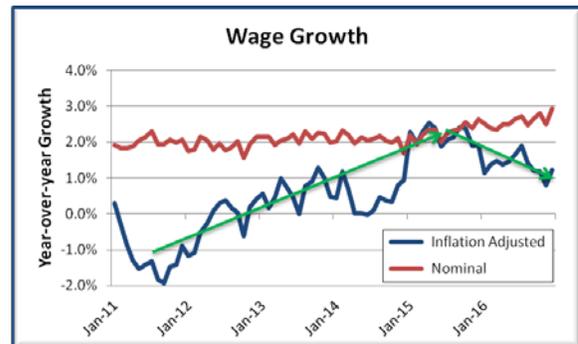
Data Source: U.S. Department of Labor



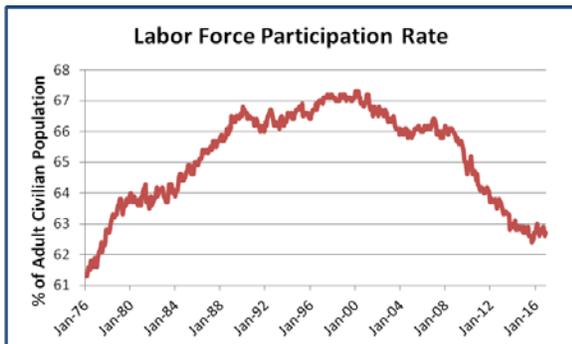
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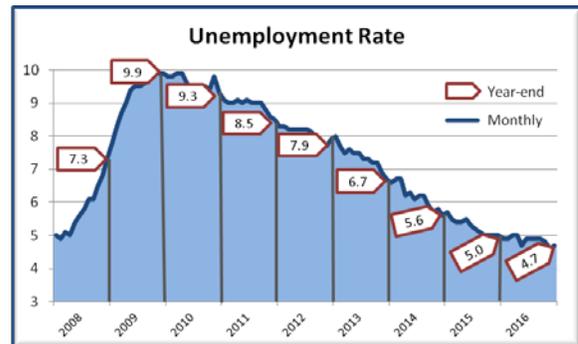
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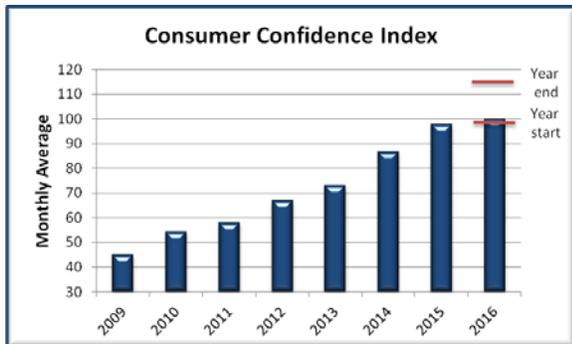
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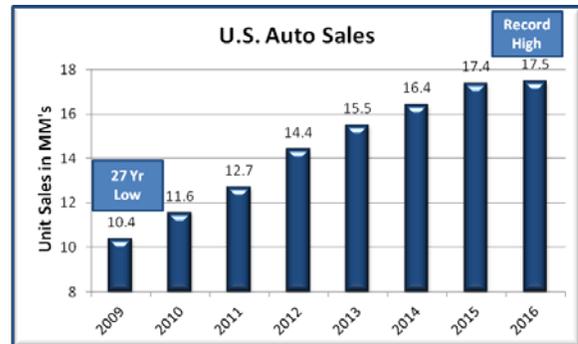
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Consumer

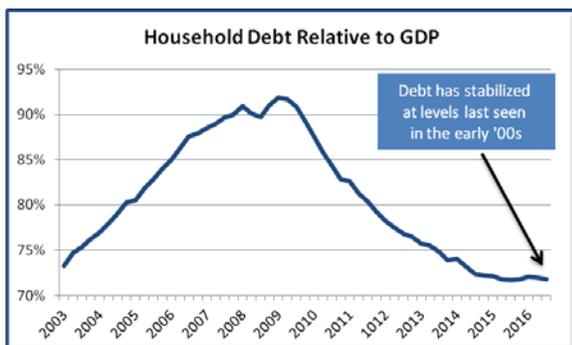
A 2.2 million boost in jobs, continued wage growth, stock market gains, and widespread expectations of accelerating growth in 2017 kept consumers confident, if not exuberant, in 2016. Of course, gasoline is still fairly cheap and interest rates, although a bit higher, remain near historic lows. Consumers continue to be fiscally conservative with their newfound wealth. Yes, spending on big ticket items rose and car sales hit a new all time high, but consumers kept debt in check and maintained an attractive savings rate.



Data Source: The Conference Board



Data Source: Bloomberg



Data Sources: U.S. Bureau of Econ. Analysis/ U.S. Federal Reserve



Data Source: U.S. Federal Reserve

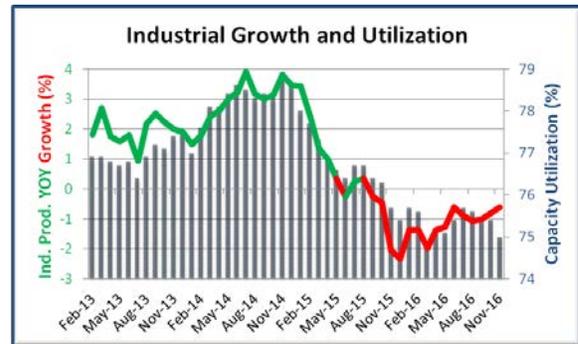
Business Activity

As shown by the ISM graph on the following page, service and manufacturing each accelerated into year end. Both segments of the economy appear poised for strong growth to start 2017.

Juxtaposed against ISM numbers, the continued decline in capacity utilization is somewhat perplexing. Plumbing depths last seen in the early days of the recovery, the utilization of the nation's manufacturing, mining, and utility infrastructure continues to falter. That said, expectations are high for an acceleration of growth with new leadership in Washington. Likewise, following a doubling of oil prices from the bottom last February, signs point to a rejuvenation in U.S. oil and gas production.



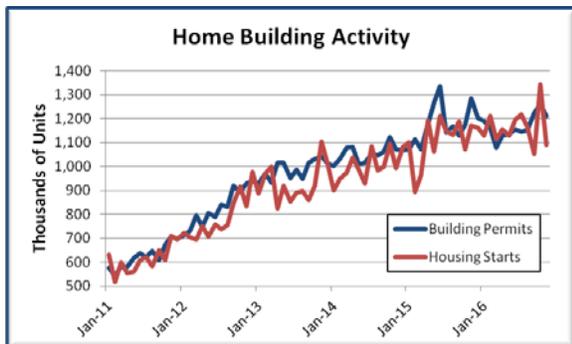
Data Source: Institute for Supply Management



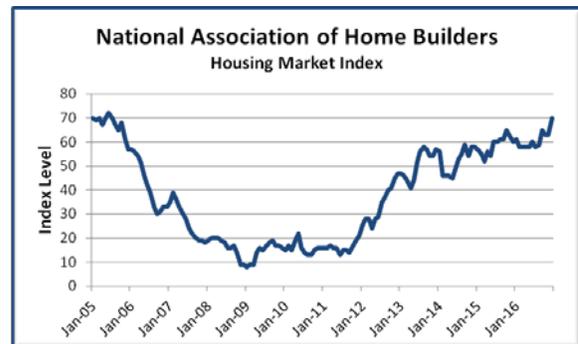
Data Source: U.S. Federal Reserve

Real Estate

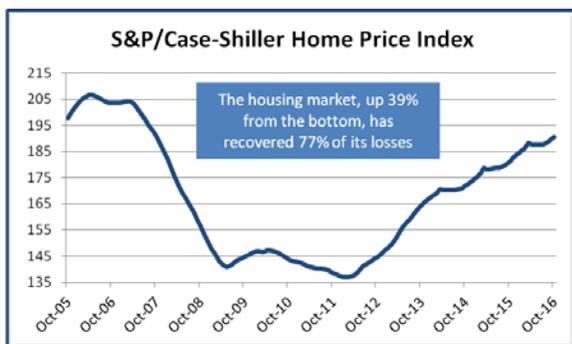
The housing market continued to improve in 2016. Building activity remained healthy and home builder sentiment closed the year at the highest level since the previous housing peak. Home prices also continued to rise at about a 5% clip. Going forward, the path for housing is clouded. Mortgage rates have risen to levels from three years ago. Likewise, adjustable rate mortgages have begun to reset, and decade old interest only home equity loans are beginning to require principal pay down. Builders have also reported shortages in both labor and land, and inventories are at unhealthy lows. Going forward, housing may not prove to be the growth driver it has been for much of the recovery.



Data Source: U.S. Census Bureau



Data Source: National Association of Home Builders



Data Source: S&P/Case-Shiller



Data Source: U.S. Federal Reserve

CAPITAL MARKETS REVIEW

Returns

	4 th Qtr 2016	Full Year 2016
Cash and Fixed Income		
U.S. Treasury Bills	0.1%	0.3%
Barclays U.S. Aggregate Bond	-3.0%	2.6%
Barclays Municipal Bond	-3.6%	0.2%
Barclays Global Agg. ex. U.S.	-10.3%	1.5%
Hedge Funds and Alts.		
Bloomberg Commodity	2.7%	11.8%
DJ US Real Estate	-3.1%	7.6%
HFRI FOF Composite	0.8%	0.5%

Data Sources: Morningstar & Hedge Fund Research, Inc.

	4 th Qtr 2016	Full Year 2016
Domestic Equities		
Wilshire 5000	4.5%	13.4%
S&P 500	3.8%	12.0%
Russell 2000	8.8%	21.3%
International Equities		
MSCI ACWI ex. U.S.	-1.6%	4.4%
MSCI EAFE (Developed)	-0.7%	1.0%
MSCI EM (Emerging)	-4.2%	11.2%

Equity Markets

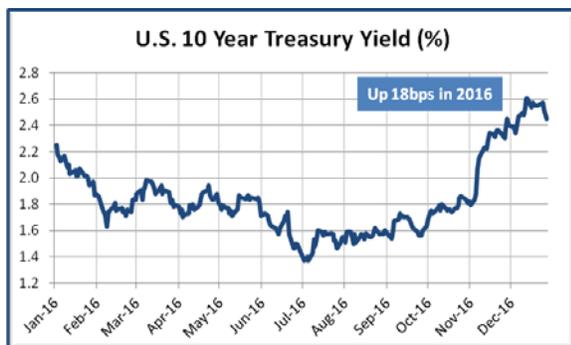


Data Source: S&P Dow Jones Indices LLC

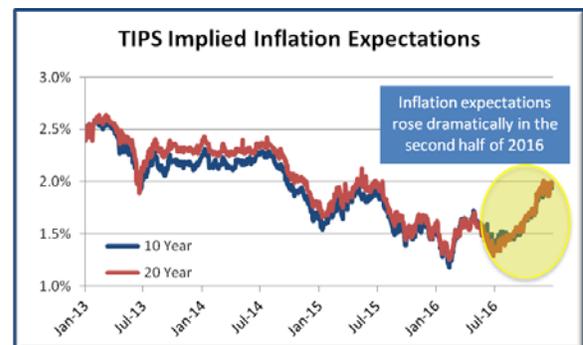


Data Source: Morningstar

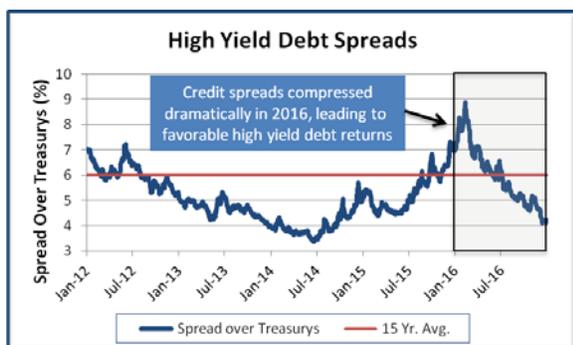
Fixed Income Markets



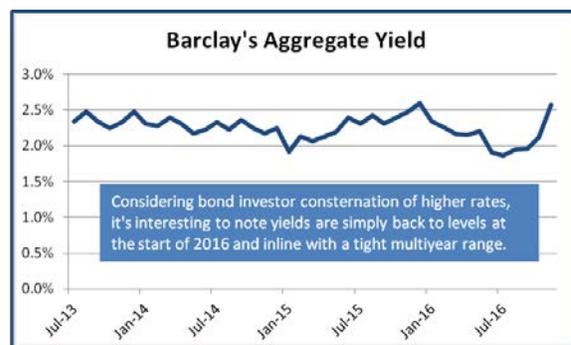
Data Source: U.S. Department of the Treasury



Data Source: U.S. Department of the Treasury

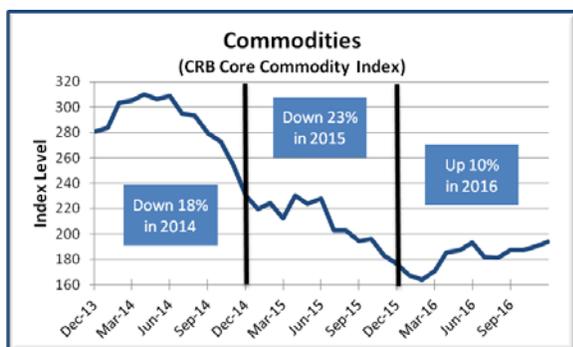


Data Source: BofA Merrill Lynch

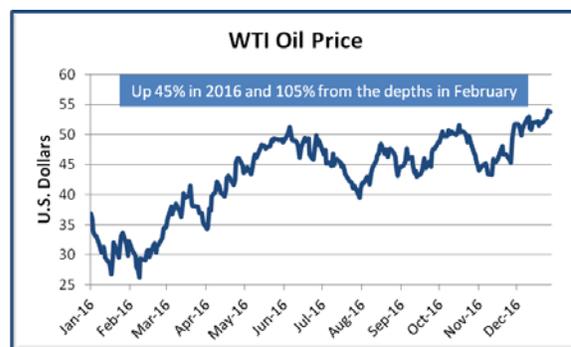


Data Sources: Bloomberg

Alternatives



Data Source: Thomson Reuters



Data Source: US. Energy Information Administration

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