Integral Financial Solutions

Market Summary 2016

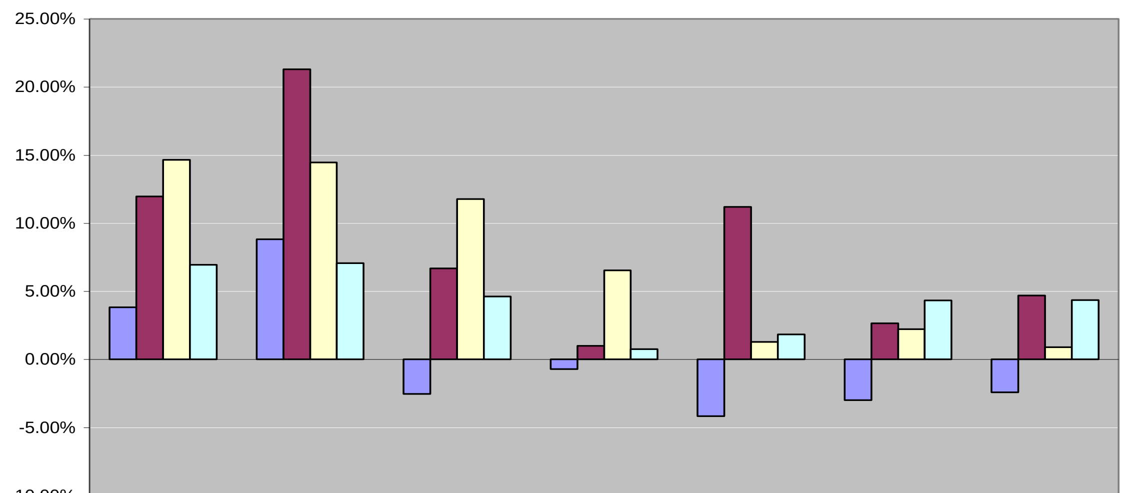
Hello, and Happy New Year; we hope January finds you in good health!

Despite some global volatility in political quarters, 2016 turned out to be a decent year, refuting another old wives' tale (in this case the unfounded belief that a negative January bodes poorly for the entire year).

Although it seems long ago, the Dow Jones Industrial Average dropped over 1,000 points in the first few trading days of January 2016, and by mid-February the S&P 500 was down over 10%. Fears over China's influence on our economy and a possible recession stoked fears. The markets stabilized somewhat in the spring, until Britons voted in favor of exiting the European Union (The "Brexit" vote) at the end of June. The equity markets dropped precipitously for about a week before abruptly rallying. The final shock of 2016 was the November election of Donald Trump. The futures market on election night predicted the Dow Jones Industrial Average would drop by 800 points the next day, but the markets stabilized on the open on November 9, resuming their steady increase upward, breaking records along the way and ending 2016 on a positive note.

As you can see from the chart below, all of the equity markets finished up in 2016. Despite the dramatic increase in bond yields post-November 8, high quality bonds also finished the year in positive territory. Cash continued flat, with returns near or at 0%.

Benchmark Returns through 12/31/16



	S&P 500	US Small Cap	US REITs	Foreign Developed	Emerging Markets	US High Quality Bonds	TIPS
4Q16	3.82%	8.83%	-2.53%	-0.71%	-4.16%	-2.98%	-2.41%
YTD	11.96%	21.31%	6.68%	1.00%	11.19%	2.65%	4.68%
5 Year (ann.)	14.66%	14.46%	11.77%	6.53%	1.28%	2.23%	0.89%
10 Year (ann.)	6.95%	7.07%	4.63%	0.75%	1.84%	4.34%	4.36%

Source: DFA

There were many instances of pundit predictions in 2016 that were spectacularly wrong, with regard to market investor behavior and otherwise. Even Nate Silver, the American statistician with an impressive record of correctly predicting election outcomes, bet on the wrong horse (so to speak).

You have heard us say this many times before: no one can predict with any consistency and skill which asset classes will outperform - 2016 was a strong example of this, and there is no reason to believe 2017 will be an exception.

Market Outlook 2017

Uncertainty Going Forward

We were as surprised as anyone else by the election results. Clearly expectations of deregulation, infrastructure spending, and tax reform are positives for domestic equity markets.

Rather than recommend you pile into equities, however, we recommend exercising caution, since valuations are higher than their long-term averages after this recent post-election run-up. Also, President-elect Trump's actions are hard to predict. He may back down from campaign promises which promote protectionism and a potential trade war. Alternatively, he could double down and aggressively pursue these policies; no one really knows. In addition, most of the actions he ultimately pursues will require the approval of Congress and can be influenced by other agencies.

Federal Reserve

Bond yields rose after the election in anticipation of a business-friendly Trump administration that would propel markets and nudge the Federal Reserve to finally raise interest rates. The Fed Board met in mid-December and did just that, raising rates by .25%. They anticipate raising rates another 2-3 times in 2017.

Inflation is likely to become a concern in the coming years. According to a very thoughtful discussion by a PIMCO economist, it could reappear in either a bull or bear scenario:

- Bull – if the labor market continues to improve and wages increase, stronger demand will push up prices
- Bear – if protectionism drives trade policy, the cost of imports will rise through tariffs

Taxes

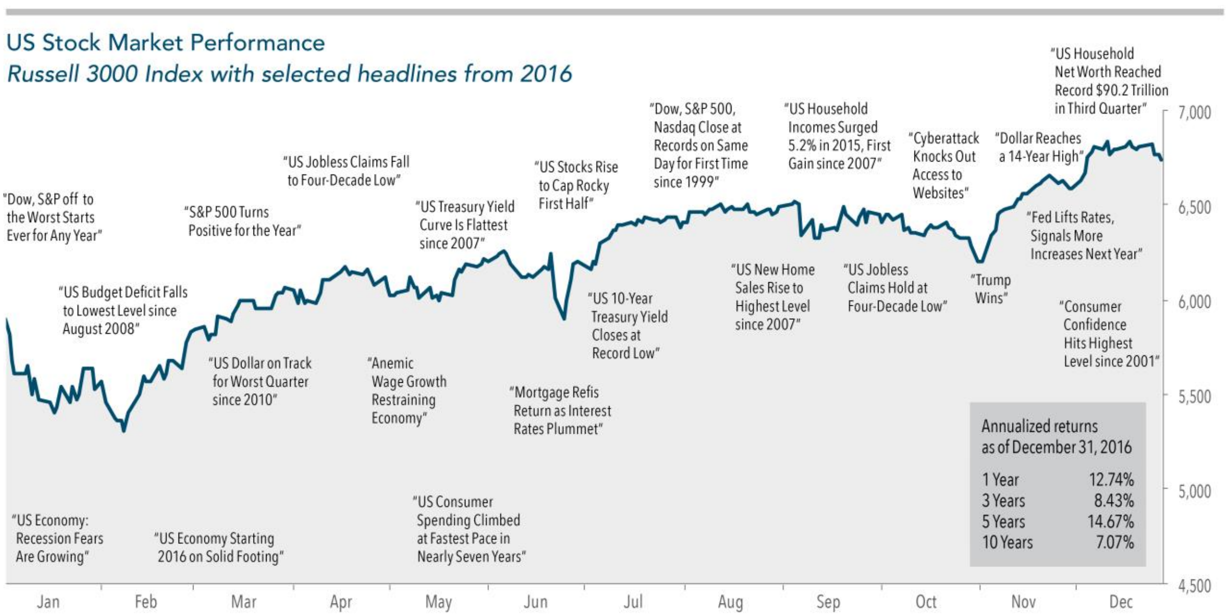
We are quite confident that a Republican President and Republican-controlled Congress will introduce significant changes to our tax code. There will likely be fewer tax brackets. Income tax levels will go down for most taxpayers, especially for the very wealthy (39.6% to 33% as the top bracket). What we don't know is whether these changes will be offset by modifications to deductions and capital gains taxes.

There will likely be changes to the estate tax code. The current exemption is about $5.5M per person (or $11M per married couple) which we assume will be increased or estate taxes may be totally eliminated.

Long Term Outlook

The leading economic indicators are strong, but there are many unknown actions that could affect the markets in 2017 and during this new presidency. Now, more than ever, we recommend maintaining your long-term outlook. This is not the time to try and guess which asset classes are going to outperform the market.

We think the chart below with the major headlines of 2016 is a great illustration of how difficult it is to predict the markets. Too many investors focus on the last half of the 4th quarter, during which the markets rose steadily, but forget that the markets were down in October. In aggregate, 2016 was good, but there was a tremendous amount of volatility and seemingly we approach 2017 with much less certainty.



Source: Frank Russell Company.
Past performance is not a guarantee of future results. In US dollars. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.

CONCLUSION

In a perfect world, there would be no uncertainty and every asset class be predictable (or, better yet, ever increasing!). Each quarter's performance chart illustrates why we do not try to guess which asset class will outperform; this one is no exception As always, we stress that maintaining a prudently diversified portfolio is the best course through uncertain times.

We thank you, as always, for your confidence in us, and encourage you to call us anytime.

Janet & Barry

Sources: DFA, Wall Street Journal, JP Morgan, PIMCO, Morningstar, Frank Russell Company.