Marino Financial Advisors
Innovative Wealth Solutions

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2016: A Fourth Quarter Review

A quick summary of economies & markets for you.

Dear Friends,

Two events strongly influenced U.S. and foreign financial markets in the fourth quarter – one unexpected by many, the other widely anticipated. Neither of them particularly upset investors. Donald Trump's win in the presidential election led to a rally on Wall Street, and the Federal Reserve's December interest rate hike was taken in stride, even as our central bank's monetary policy stood out globally for its hawkishness. The S&P 500 ended up gaining 3.25% in three months. The United Kingdom scheduled its Brexit, and OPEC elected to trim oil output for the first time in eight years. Oil rallied, and so did the dollar; precious metals retreated. The housing sector showed strength even as mortgage rates ascended. On the whole, the most-watched U.S. economic indicators were encouraging.[1]

Domestic economic health. On December 14, the Federal Reserve announced its second quarter-point rate hike in two years. The federal funds rate was reset at the 0.50-0.75% range, and the central bank's latest dot-plot forecast showed three planned rate moves in 2017 instead of the previously projected two. Fed officials emphasized that oncoming tightening will be "gradual."[2]

By November, monthly payroll gains were averaging 180,000 for the year. The main U-3 jobless rate was at 4.9% in October and at 4.6% in November. The U-6 rate that included the underemployed fell from 9.5% in October to 9.3% a month later. In November, the U-3 rate was at its lowest level since August 2007, and the U-6 rate had not been so low since April 2008.[3]

As Q4 ended, consumer confidence indices looked very impressive. The Conference Board's monthly index was well over the 100 mark at 109.4 by November, and then it pushed further north to 113.7 in December. The University of Michigan's household sentiment gauge sat at 87.2 in October, then rose to 93.8 in November and 98.2 for December.[4,5]

Both the service and factory sectors expanded during fall 2016. The Institute for Supply Management's non-manufacturing index rose to 57.2 in November from 54.8 in October. November marked the 82nd straight month of service sector growth in America. ISM's purchasing manager index for the factory sector advanced to 53.2 in November from the prior mark of 51.9, indicating an improved pace of growth. In related news, factory orders rose 0.6% in October and 2.7% in November.[6,7]

Consumer spending accelerated 0.4% in October, but only half that in November. Consumer incomes rose 0.5% in October, and then flattened a month after that. Core retail sales (minus car and gasoline purchases) followed a similar pattern: up 0.5% in October and 0.2% in November. (Perhaps the December numbers will show more upside.)[7]

As energy costs rose, the annualized gain in the headline Producer Price Index went from 0.8% in October to 1.3% in November. (By November, the core PPI showed a 1.6% yearly gain.) Consumer inflation remained beneath the Federal Reserve's 2% target. As of November, the Consumer Price Index was up but 1.7% in 12 months, with the core CPI up 2.1%. The

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Federal Reserve's core PCE price index was 1.8% higher year-over-year in October, but that number declined to 1.6% in November.[7]

Global economic health. The eurozone economy had expanded only 0.3% in Q3, and by November, euro area yearly inflation was still at 0.6%, with six member nations (among them Greece and Ireland) experiencing year-over-year consumer price deflation. Populist movements in France, Germany, and Italy gained traction, most notably Italy's Five Star Movement. Italian Prime Minister Matteo Renzi resigned in November after his party's attempt at constitutional reform was voted down by the electorate; the Five Star Movement has vowed to hold a national vote on whether or not Italy should stay in the European Union if it assumes power in 2018.[8,9]

Teresa May, the United Kingdom's prime minister, announced her country would make its Brexit from the E.U. as early as the summer of 2019, by invoking Article 50 of the Lisbon Treaty no later than the end of March. May expected the U.K. to have a full role in E.U. policymaking through 2019. The European Central Bank made a policy decision to keep easing – in December, it announced an extension of its asset-purchase program through the end of 2017; though the amount of monthly bond buying would be trimmed from €80 billion to €60 billion beginning in April.[8,10]

The long-awaited OPEC accord to reduce oil production finally came to pass in late November. A 1.2-millon-barrel-per-day cut (effective in January) was eventually agreed to by OPEC and non-OPEC oil producers; though, some analysts felt not all parties to the agreement would comply with its terms. In the Asia-Pacific region, Japan continued its weak economic growth, while the latest statistics showed China's GDP holding steady at 6.7% in Q3.[11,12]

World markets. Looking at foreign benchmarks, the best price returns of the fourth quarter were largely in Europe. The DAX rose 9.23% during Q4, and the CAC 40 advanced 9.31%. The 13-week gain for the FTSE 100 was not quite so large: 3.53%.[13]

All that said, those big gains paled next to that of the Nikkei 225. Japan's major equity index added 16.20% in Q4. Other indices in the Asia-Pacific region and the Americas fell far short of that kind of quarterly performance, but there were other nice Q4 advances. The TSX Composite rose 3.81%; the All Ordinaries, 3.51%. The Shanghai Composite improved 3.29%; the MSCI World, 1.48%. MSCI's Emerging Markets index and the Sensex both fell 4.56%, while the Hang Seng retreated 5.57%.[13,14]

Commodities markets. Lean hogs led the pack in commodity futures in Q4, with prices rising 35.28%. Oats gained 22.19% in Q4. Among the major commodities, unleaded gasoline led the way with a 15.83% advance; natural gas and copper were close behind, respectively adding 13.71% and 12.75%.[15]

West Texas Intermediate crude had a fine quarter, gaining 7.59%; oil settled at $53.89 a barrel on the NYMEX on December 30, capping off an advance of 46.12% for the year.[15,16]

The dollar rally was one factor that turned Q4 into a subpar quarter for precious metals. Palladium sank 5.49% in the final three months of 2016; gold, 12.81%; platinum, 12.85%; and silver, 17.28%. Gold and silver did have a nice year – gold prices rose 7.18% on the COMEX in 2016; silver prices, 15.04%. In crops, the leading Q4 loser was sugar, which fell 15.17%; coffee futures slumped 11.52%.[15,16]

Real estate. Mortgages grew more expensive in Q4. As the quarter ended, Freddie Mac said that the average interest rate on a 30-year conventional home loan was 4.32%. Mean interest on the 15-year FRM was 3.55%; mean interest on the 5/1-year ARM, 3.30%. Look at how those December 29 numbers compare with the ones from Freddie's September 29 Primary Mortgage Market Survey: 30-year FRM, 3.42%; 15-year FRM, 2.72%; 5/1-year ARM, 2.81%.[17]

As home loans became costlier, more buyers stepped forth: existing home sales rose 1.5% during October and another 0.7% in November. That data comes from the National Association of Realtors, whose pending home sales index rose just 0.1% in October and slipped 2.5% the next month. The national S&P/Case-Shiller home price index measures year-over-year price gains for existing homes; its annualized increase reached 5.6% in October, up from 5.4% in September. New home buying rose 5.2% in November after a 1.4% October fall, the Census Bureau reported.[4,7]

Real estate construction surged in October, but waned with colder weather in November. The Census Bureau said that groundbreaking increased 27.4% in the tenth month of 2016, with a 2.9% boost for building permits. A month later, starts were down by 18.7%, with permits reduced by 4.7%.[7]

Looking back … looking forward. The fourth-quarter performances, noted in the accompanying table, left the big three U.S. equity indices at the following year-end settlements: Dow Jones Industrial Average, 19,762.60; NASDAQ Composite, 5,383.12; S&P 500, 2,238.83. While the big three all posted Q4 gains, their advances were matched or surpassed by some other benchmarks. The U.S. Dollar Index rose 7.32% for the quarter, and the Russell 2000 gained 8.43%. Unsurprisingly, given some of the quarter's major commodity gains, the PHLX Oil Service index added 12.33%, and the S&P GSCI index improved 9.25%. Amid all this, the CBOE VIX rose 5.64% to end the trading year at 14.04.[1]

Treasury yields moved north, especially after the election. The 10-year note's real yield rose half a percentage point during Q4; it was 0.00% on September 30.[19,20]

% CHANGE	2016	Q4 CHG	Q3 CHG	10-YR AVG
DJIA	+13.42	+7.94	+2.11	+5.86
NASDAQ	+7.50	+1.34	+9.69	+12.29
S&P 500	+9.54	+3.25	+3.31	+5.79
REAL YIELD	12/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.50%	0.77%	-0.07%	2.41%

Sources: barchart.com, cnbc.com, bigcharts.com, treasury.gov – 12/30/16[1,18,19,20,21]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

Investors are entering the first quarter with a good deal of optimism, but also with an awareness that anything could happen. Wall Street has been bullish on the incoming Trump administration, and that confidence will likely continue as it begins to shape policy in Washington. At the same time, market participants are keeping a cautious eye on the Fed, the strong dollar, and the possibility of a stock bubble inflated by euphoria. Economic signals have looked much better of late than they did a year ago, and the stock market appears to be on much sturdier legs than it was at the beginning of 2016, when it fell precipitously. With the earnings recession having faded away, perhaps the market will get a boost this next earnings season that will lift the Dow above 20,000. For this best-case scenario to emerge, domestic and global belief in the new president and his administration needs to be strong and sustained, and geopolitical events from overseas need to be tolerable for the bulls. It will be an interesting first quarter.

A new year may come with new priorities, new objectives – things to plan for or plan to accomplish. If you have one, two, or maybe a few financial goals on your mind as we enter 2017, feel free to call us. There are always options to explore that might help you amass more savings or generate more after-tax retirement income. We will be sending you our Q1 wrap-up in early April; in the meantime, we wish the very best to you and your family.

All the Best,

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Featured in Boston Magazine as Five Star Wealth Manager in 2011, 2012, 2013, 2014 and 2015.

We are never too busy to help those you care about.

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