LAUTENTIDE
ADVISORY

Market Commentary
3rd Qtr 2016

In the hot summer weather of 2016, the markets generated positive returns for most stock and bond investors. With the unknown of Brexit removed, global stocks returned 4.9% in the 3rd quarter as measured by the MSCI World Index. Emerging markets stocks were the best performers for the most recent three-month period.

Investors 'Picked' International Stocks and 'Panned' US Treasuries in 3Q16:

Benchmark	3Q16	Year-to-Date	1 Year	3 Years	5 Years
Emerging Markets Stocks	9.0	16.0	16.8	-0.6	3.0
Non-US Stocks	6.4	1.7	6.5	0.5	7.4
High Yield Bonds	5.5	15.3	12.8	5.3	8.2
Global Stocks	4.9	5.6	11.4	5.9	11.6
US Stocks	3.9	7.8	15.4	11.2	16.4
Investment Grade Bonds	0.5	5.8	5.2	4.0	3.1
US Treasuries	-0.3	3.4	2.5	2.2	1.6

Source: Morningstar. Returns expressed in USD %. 3Q16 and Year-to-Date are actual returns for the period. 1 Year, 3 Years and 5 Years are annualized returns as of 9/30/2016. See Disclosure section for reference to specific benchmark used in the table.

Bond prices moved higher during the quarter. The yield grab in riskier parts of the fixed income market, such as high yield bonds, was pronounced. Corporate bonds, high yield, foreign debt and structured finance sectors all outperformed similar duration US Treasuries. US Treasury bonds have underperformed other major asset classes for the last five years. This will probably continue until investors sense a weakening US economy and declining consumer spending.

In the current environment of loose monetary policy, investors seem comfortable with low growth rates, low inflation, and low-interest rates. Financial assets and real estate benefited in the 3rd quarter as these trends persisted. The US Federal Reserve continues to posture for a rate hike, but this an old story and we believe any move will be relatively small. The dilemma: how can the Fed hike rates with growth rates so low? Fiscal stimulus—aimed at boosting growth—now seems likely post-election. More government spending might be good for stocks, but we think this could lead to higher Treasury yields and ultimately be painful for bondholders.

Our investment themes remain intact and our convictions strengthened over the course of the past three months. We repositioned client portfolios and our models accordingly. Fixed income portfolios remain long spread products—like corporate bonds—and short Treasury duration relative to the Barclays US Aggregate Index. We have increased exposure to non-US equities through emerging markets stock and developed-country mid- and small-capitalization equity funds. We reduced positions in Real Estate Investment Trust (REIT) and Minimum Volatility US Equity funds because we think both are now very expensive.

Summary of our three main Market Themes and the corresponding Investment Views:

Market Theme	Investment View
Bond price (duration) risk is extreme in many markets	Little to no Treasury market duration, and focus on short/intermediate maturity bond funds
We are living in a low-return world and the US economic engine is the main driver of growth	Significant exposure to stocks, corporate bonds, and structured credit
A new consumer class in developing economies is on the rise	Moderate exposure to emerging markets and to European companies that service global consumers