Market Commentary
4Q 2016

A Good End to 2016. Owning equities last year was like grabbing a bull by the horns: uncomfortable if you held on, but worse if you let go. Earlier in the year, substantial price swings were driven by global developments, including a sharp drop in the price of oil to below $30 per barrel, Chinese exchange-rates, and UK politics. The US presidential election provided the capstone volatility event in the capital markets for the year. But Trump quickly got the thumbs up from investors.

Equities in 4Q16 realized a strong quarterly return, while Treasury bonds struggled. For the full year 2016, risky assets did very well, as US stocks gained 12%. Moderate risk assets performed OK, with investment-grade corporate bonds returning close to 3%. Less risky Treasuries did less well and returned just over 1% for the year.

Positive Context for a New Year. Several sources of economic and market drag waned during 2016. The US corporate profit recession ended in the third quarter. Business, consumer, and investor confidence improved throughout the year. Wages increased, and employers added jobs at a healthy clip. These trends remain in place. Fiscal stimulus, lighter regulation, and tax policy change – now on the agenda in Washington – would likely provide additional momentum for economic growth.

Our 2017 Expected Returns (ER) for Asset Classes vs 2016 Actual & 10-Year Average Returns:

Benchmark	2017 ER	2016 Act	10Y Ave	Risks
Emerging Markets Stocks	8.0	11.2	1.8	1. US dollar strengthens further; commodity rally stalls
US Stocks	6.0	12.0	7.0	2. Economic growth & earnings stall; policy mistakes
Global Stocks	5.0	7.5	3.8	3. Combination of 1, 2 & 4
Non-US Stocks	4.0	1.0	0.8	4. Political surprises in Europe; poor policy decisions
High Yield Bonds	3.0	17.5	7.3	5. Oil prices head south; liquidity conditions tighten
Investment Grade Bonds	0.5	2.7	4.3	6. Little earnings growth; higher Treasury rates
US Treasuries	-1.5	1.1	3.5	7. Federal Reserve tightens policy faster than expected

Notes: Returns expressed in USD %. Morningstar is a source for historical data. 2016 Act (Actual) and 10Y Ave (Average) are annualized returns as of 12/30/2016. See Disclosure section at end of this letter for reference to specific benchmarks used in this table. 2017 ER are Laurentide Advisory forecasts.

However, a failure by the Trump administration and the Republicans to enact a pro-growth agenda likely would undermine economic confidence. Policy missteps out of the Federal Reserve or other major central banks or rising tensions associated with global trade also could hurt the markets. Our sense is that positives will outweigh downside risks, producing a constructive backdrop for the US economy and asset returns in 2017.

Outlook for 2017. Our base case regarding expected returns is: more of the same, but less of it. That is, we expect the return relationships among asset classes to be similar to last year (i.e., stocks beat bonds) but we look for the magnitude of returns to be lower. For example, the near 18% return posted by High Yield bonds as the energy sector improved is unlikely to be repeated. And, in our view, there is a pretty good chance that returns for parts of the bond market may even be negative. Treasuries, especially, are at risk as interest rates rise.

We also think that investors pulled forward some stock price upside into 2016 as they anticipated positive fiscal and tax policy changes. That's why we expect a 6% return for US equities, lower than the long-term average. Segments of the equity market that we like include value stocks and small-capitalization stocks. We think the wind is in the sails of these two sectors, and outperformance is likely to continue into 2017. And if the US dollar doesn't appreciate too much, Emerging Markets equities may have another strong year.

Market Themes & Investment Views. Our broad perspective on important market-related issues and how our views are expressed in portfolios generally remains intact from 2016. For Fixed Income exposure, we favor shorter-dated investment grade corporate bonds and High Yield bonds over US Treasury bonds. We reduced duration further in 4Q and selectively added positions in floating rate notes because of our concern about the possibility of higher interest rates in 2017. Our conviction toward US stocks has strengthened, particularly in light of our constructive reading of US earnings and economic growth trends. Fiscal stimulus or tax cuts from the new US Congress likely would be an added benefit for US equites holders.

Our Market Themes and Corresponding Investment Views for 2017:

Market Theme	Investment View
Bond price (duration) risk is extreme	'No thanks' to longer-dated bonds & bond funds
The US economic engine is the main driver of growth	Good potential for US stocks; corporate bonds look OK
Consumerism in developing economies is on the rise	Emerging markets may surprise to the upside

Following the US presidential election, we lowered international equities exposure and boosted the allocation to US stocks. While solid return opportunities exist outside of the US, we think the case for US stock outperformance will persist for some time. As a final point, we think the investment environment this year is shaping up to be a constructive one for active portfolio management.

Global Stocks is the MSCI World Index, a market capitalization weighted index that is designed to measure the equity market performance of developed markets. US Stocks is the S&P 500 index, a market capitalization weighted index consisting of a basket of 500 stocks that are widely held. Non-US Stocks is the MSCI EAFE Index, which represents the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. Emerging Market Stocks is the MSCI Emerging Markets Index, which represents 23 countries and 10% of world market capitalization. Investment Grade Bonds is the Bloomberg Barclays US Aggregate Bond Index, which measures the total return of the investment grade, US dollar, fixed-rate taxable bond market. U.S. Treasuries is the Bloomberg Barclays US Treasury Intermediate Index, which measures the total return of USD denominated, fixed rate 1-10-year nominal debt. High Yield Bonds is the Banc of America/Merrill US Master HY Index total return of high yield US corporate bonds

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