January Update | As of December 31, 2016

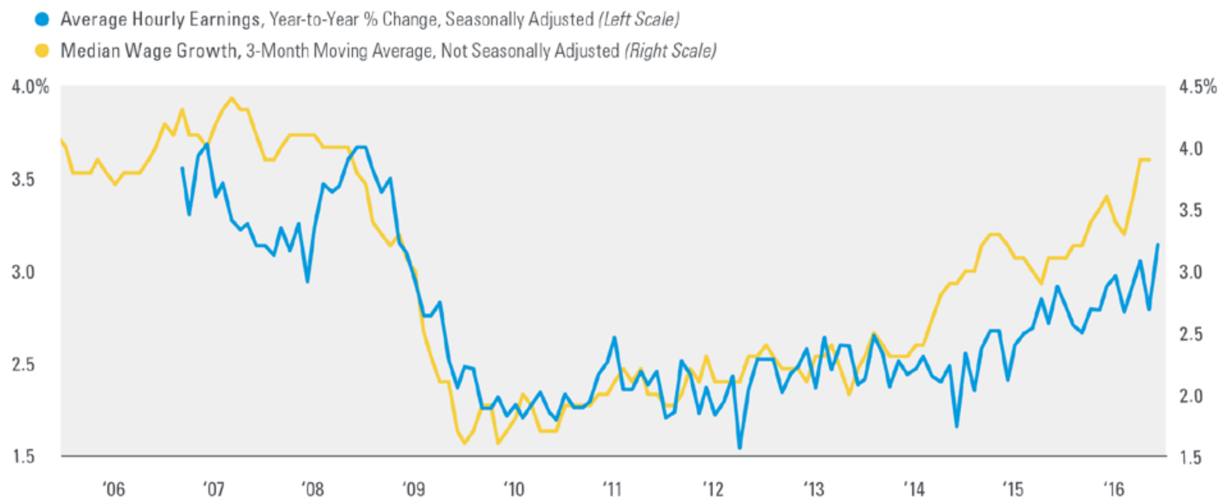
DECEMBER 2016 IN REVIEW

ECONOMY:
GROWTH ACCELERATES IN THIRD QUARTER

Economic Data

Economic reports received in December 2016, which mostly reflect economic activity in November and early December 2016, were generally mixed relative to consensus expectations, which have moved higher since the November 8, 2016 U.S. presidential election. On the upside, reports on consumer sentiment, housing, and manufacturing were all notably better than expected. While not as timely as the data for November and early December, the revised estimate of 2016 third quarter gross domestic product growth (GDP), released on December 23, surprised to the upside, accelerating to 3.5% annualized growth from 1.4% in the second quarter, above economists' consensus expectations of 3.2% and solidly above the initial reading of 2.9%. Despite the pickup in GDP, growth remains at a tepid 1.7% year over year.

Aside from the better than expected reading on third quarter GDP, the month's economic releases were highlighted by ongoing improvement in the manufacturing sector. The Institute for Supply Management's (ISM) Purchasing Managers' Index (PMI) for manufacturing continued to accelerate in late 2016 after a nearly two year slump related to falling oil prices. Many of the regional Federal Reserve (Fed) surveys on manufacturing also exceeded expectations in December, including the Dallas Fed's index, which is heavily dependent on oil and energy. Readings released on consumer sentiment in November and December were also strong, with the University of Michigan's consumer sentiment reading hitting a 12-year high. Consumer



spending remained firm as 2016 ended, with vehicle sales hitting an all-time high.

Despite the better than expected tone of the manufacturing, housing, and consumer data released in December, not all the data exceeded expectations. Noteworthy disappointments included payroll employment, average hourly earnings, inflation, net exports, inventories, home sales, and construction spending.

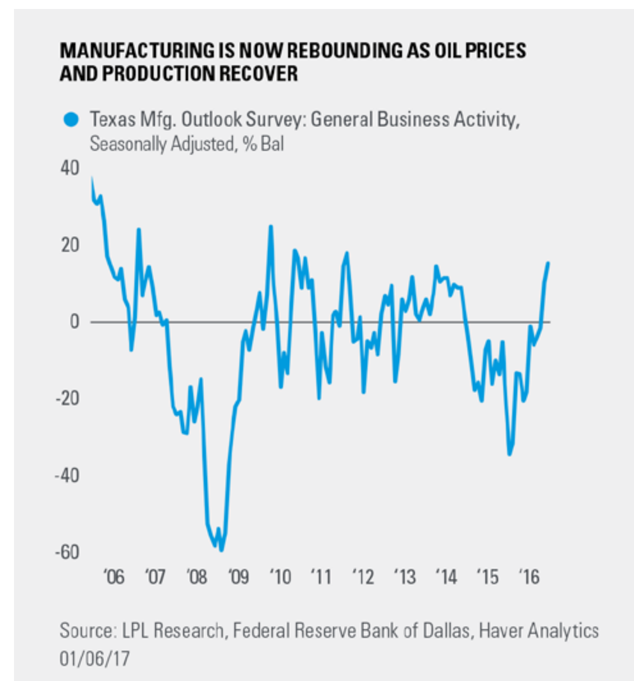
Despite the mixed data, leading economic indicators continued to signal low odds of a recession. The level of the Conference Board's Leading Economic Index (LEI), an aggregate of economic indicators that tends to lead the overall economy, was unchanged between October and November and its year-over-year value decelerated from +1.1% to 0.7%. However, with December data for market returns, the yield curve, and new manufacturing orders already posting solid numbers, the LEI is poised to accelerate in early 2017. Historically, when the change in the LEI has been at this level or higher, the economy has been in a recession a year later less than 10% of the time.

Although the inflation reports released in December largely matched expectations, inflation, as measured by the Consumer Price Index (CPI), continued to accelerate, from a 1.6% year-over-year gain in October to 1.7% in November. Wage gains decelerated between October and November from +2.7% year over year to 2.5%, but most other measures of wages and compensation continued to point to higher wage inflation as 2016 ended.

Central Banks

The big news for central banks in December was that the Federal Reserve (Fed) raised rates by 0.25% at its final meeting of 2016. The move was widely expected by market participants, but the Fed's guidance for 2017 surprised market participants. Prior to the December meeting, the market was expecting the Fed to guide to two 0.25% rate hikes in 2017. Instead, the Fed guided to three hikes.

Outside of the U.S., December was a busy month for central banks. Notably, the European Central Bank held rates steady at its mid-month meeting but said that it would extend its bond buying plan, originally slated to end in March 2017, to the end of 2017. However, the ECB also said they would begin tapering their bond purchases, which surprised markets. Elsewhere, the Bank of Japan and the Bank of England met and made no changes to rates or on their bond buying programs. Mexico's central bank matched the Fed's 0.25% hike, but India's central bank held its ground despite market expectations of a rate cut.



GLOBAL EQUITIES:

STOCKS CAP OFF STRONG 2016 WITH TRUMP-FUELED DECEMBER RALLY

U.S.

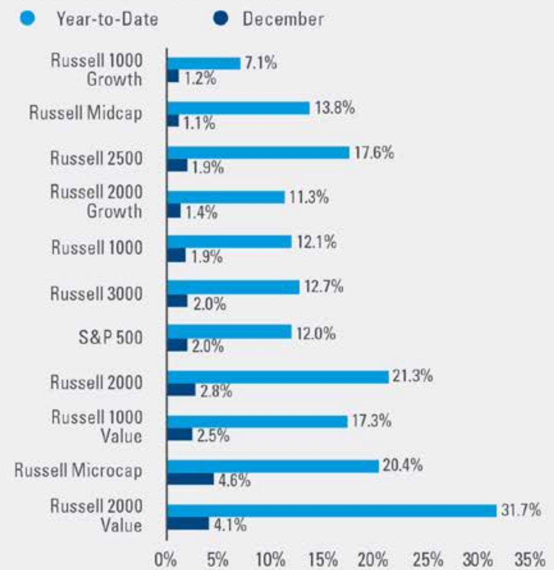
Stocks capped off a very strong year with a 2% return in December of 2016, bringing the S&P 500's 2016 total return to a solid 12%. The year's gains came with solid consistency, with the S&P 500 producing a positive return in nine of the final ten months of the year. As was the case during November when stocks gained nearly 4%, the biggest drivers of the move were improving economic conditions and optimism surrounding potential pro-growth policies under a Trump presidency with Republican control of Congress, including tax reform, infrastructure spending, and deregulation.

December also brought the Fed's widely anticipated rate hike (on December 14), the second of the current economic expansion. The limited market reaction was attributed to the news being expected (the index fell 0.8% on December 14, 2016, and quickly recovered those losses, while even the move in the bond market was well contained), despite the FOMC's unexpected forecast of three rate hikes in 2017. The related upward pressure on the U.S. dollar, and its expected drag on earnings and exports, did little to slow the stock market's ascent.

The election theme remained evident amongst sector performance in December. Financials (+3.9%) continued to outperform amid expectations for less regulatory burden and higher interest rates under Trump. Telecom, which is interest rate sensitive but also highly regulated and therefore may benefit from a smaller regulatory burden under a Trump administration, was the month's top performer with an 8.1% gain. And weakness in consumer discretionary (+0.1%) likely partially reflected the potential for higher tax rates on imports, in addition to traditional retailers' struggles to compete with internet retailers. Defensive sector outperformance is not likely a reflection of deteriorating macroeconomic conditions.

Value outperformed growth for the third straight month

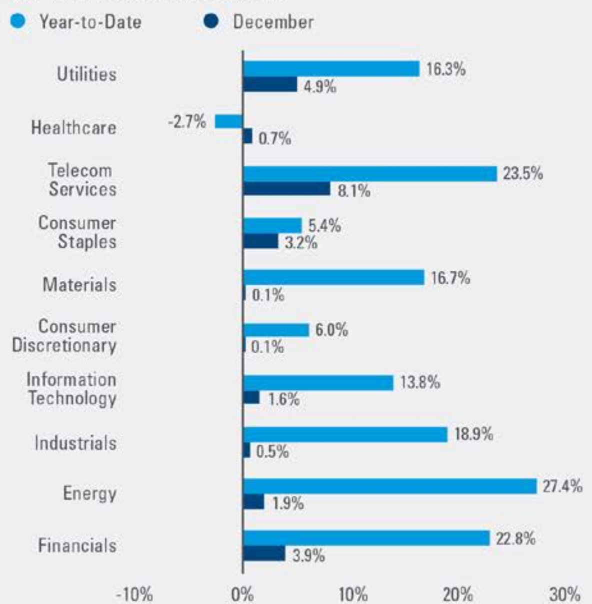
DOMESTIC INDEX PERFORMANCE



Source: LPL Research, FactSet 12/31/16

Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

S&P 500 SECTOR PERFORMANCE



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Stock investing involves risk, including loss of principal.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

due primarily to the strong performance from financials, the biggest value sector, although solid gains for income oriented telecom and utilities also buoyed value. The growth style, based on the Russell indexes, was weighed down by underperformance of the growth-oriented consumer discretionary sector. For the year, value beat growth handily as value sectors energy, telecom, and financials finished atop the sector leaderboard.

Small caps* continued to show their approval of the election results in December by outperforming both the large and midcap Russell indexes. Smaller companies generally have higher tax rates than their larger counterparts, so they have more to gain from lower tax rates, and they are generally less impacted by trade policy (or by tweets from the president-elect).

International

Developed international equity markets rebounded solidly in December after lagging U.S. markets during November, as the MSCI EAFE Index gained 3.4% for the month. Still, international equities had a challenging year, as the EAFE index returned just 1.5% and trailed the U.S. indexes significantly.

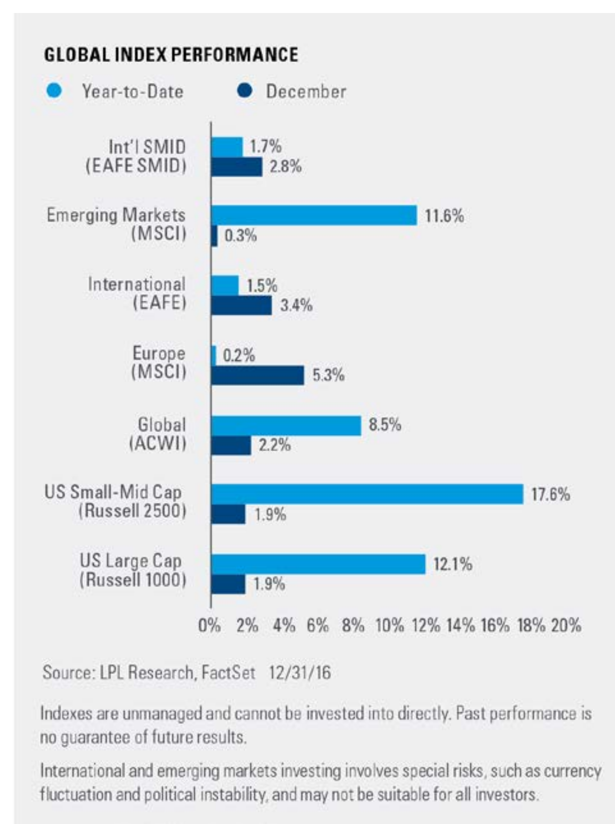
Emerging market (EM) equities continued to struggle with the potential for souring trade relations with China and/or Mexico and gained only marginally in December (0.3%) based on the MSCI Emerging Markets Index. But it was still a good year for EM equity investors, with the EM Index having returned 11.6% in 2016, essentially matching the S&P 500.

In developed international markets and globally, the Italian constitutional referendum in early December was a big focus. After surprising votes in the U.K. with Brexit and the U.S. presidential election, markets were braced for another surprise ahead of the vote in Italy. Despite the political uncertainty, Italian equities led the EAFE Index performance for the month with a 13.4% jump, followed by several other Eurozone countries (Spain, Germany, Portugal and France) that each produced gains of more than 5%. The ECB's decision to extend its quantitative easing program, though at a smaller monthly amount, may have also supported European markets as 2016 came to a close.

For evidence of the potential impact of Trump's trade policy on EM, look no further than the sharp declines for the Chinese and Hong Kong stocks within the MSCI EM Index which fell 5.6% and 3.5% in December. Mexico fared better, gaining 0.6% after falling more than 12% in November, but still lagged the U.S. and Europe. EM also tends to be interest rate and U.S. dollar sensitive, so some of the underperformance compared with the U.S. was likely attributable to the Fed's more hawkish rate outlook, a strong U.S. dollar, and the move higher in the U.S. 10-year Treasury yield. On the flip side, a near 9% gain in oil prices in December provided support, particularly through double-digit gains in Russian equities.**

* Based on Russell 2000 Index.

** All country market performance measurements are taken from constituents in the MSCI EAFE Index and MSCI Emerging Markets Index.



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International and emerging markets investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

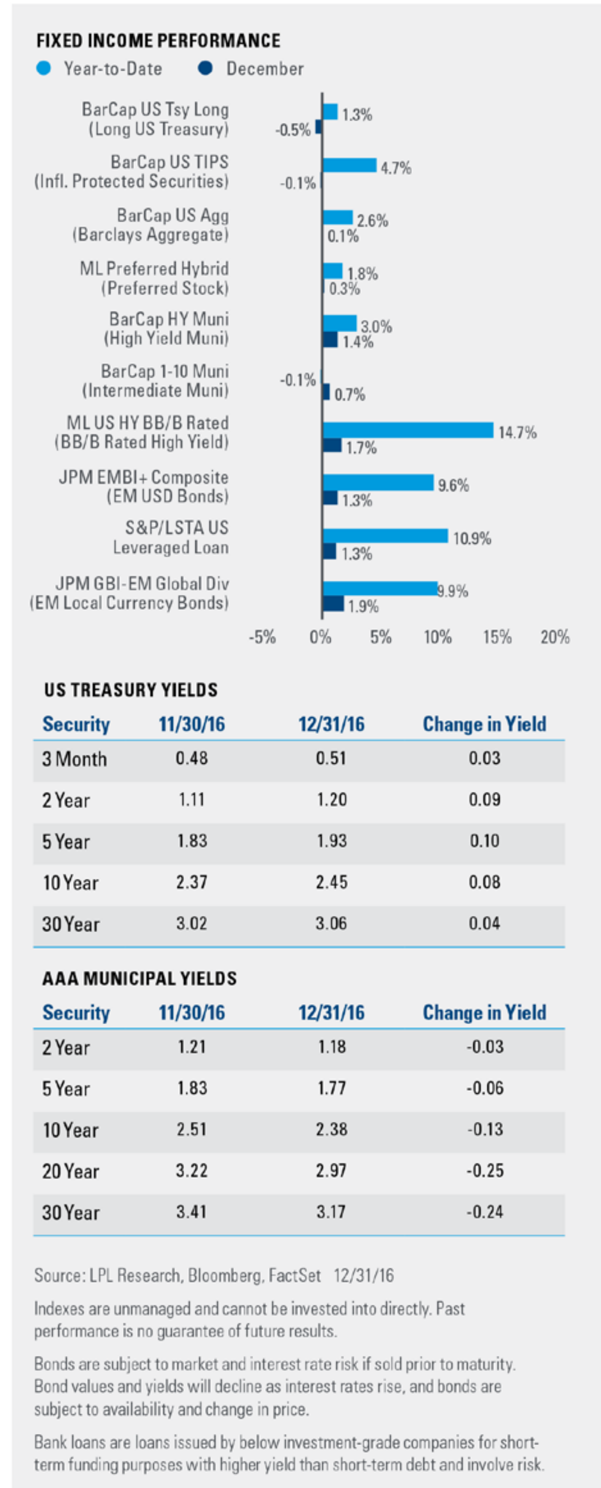
FIXED INCOME:

RATES RISE AS MARKETS CONTINUE TO PRICE IN IMPLICATIONS OF TRUMP POLICIES

Treasury yields rose across the yield curve during December. The 2-year Treasury yield rose by 0.08% and the yield on the 10-year Treasury by 0.6%. Treasury yields increased as markets continued to digest the implications of President-elect Trump's policies. Increasing economic growth expectations drove longer-term yields higher, while inflation expectations ended December little changed from a month prior. Short-term interest rates were pushed higher by the Fed's decision to raise the fed funds rate during its December meeting, in addition to laying out a more aggressive path of future rate hikes than previously anticipated.

The slight rise in yields across the maturity spectrum was a modest headwind for high-quality fixed income. The broad Bloomberg Barclays Aggregate Bond Index returned 0.1% during the month, outperforming Treasuries, which returned -0.1%, based on the Bloomberg Barclays U.S. Treasury Index. Municipals rebounded after significant weakness in November, leading to a 1.2% return during December, based on the Bloomberg Barclays Municipal Bond Index.

The rise in short-term interest rates continued to help drive up Libor (the London interbank offered rate), a short-term global benchmark interest rate. This rise was a benefit for bank loans, which returned 1.3% during December. Emerging market debt (EMD), which was hurt during November amid concerns of the impact of Trump's protectionist trade policies on emerging markets (EM), rebounded in December to return 1.3%. The dollar moved 0.7% higher during the month, hurting unhedged foreign bonds, which returned -1.0% amid globally rising rates. High-yield rallied with equities on economic optimism, leading to a strong 1.7% return during the month.



US TREASURY YIELDS

Security	11/30/16	12/31/16	Change in Yield
3 Month	0.48	0.51	0.03
2 Year	1.11	1.20	0.09
5 Year	1.83	1.93	0.10
10 Year	2.37	2.45	0.08
30 Year	3.02	3.06	0.04

AAA MUNICIPAL YIELDS

Security	11/30/16	12/31/16	Change in Yield
2 Year	1.21	1.18	-0.03
5 Year	1.83	1.77	-0.06
10 Year	2.51	2.38	-0.13
20 Year	3.22	2.97	-0.25
30 Year	3.41	3.17	-0.24

Source: LPL Research, Bloomberg, FactSet 12/31/16

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Bank loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

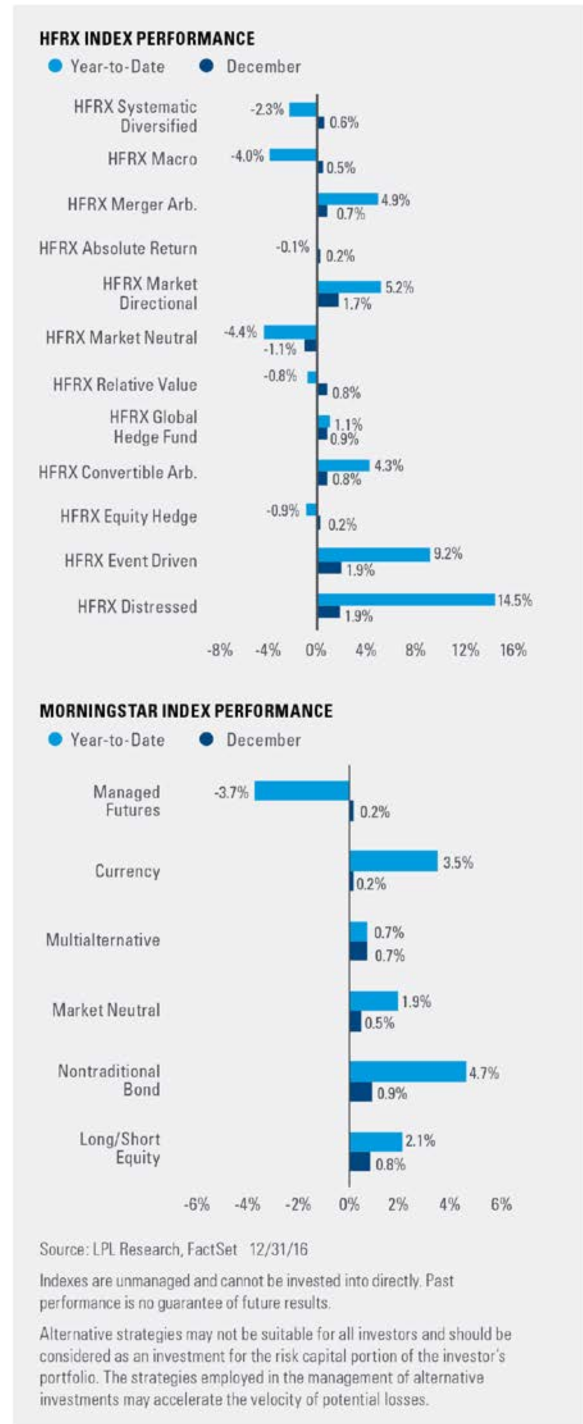
ALTERNATIVES:

DISTRESSED DEBT RALLY CONTINUES INTO YEAR-END

Distressed debt strategies ended the year on another positive note, as the HFRX Distressed Index gained 1.9% during December, resulting in a 2016 return of 14.5%. Exposure to the energy sector continued to support returns, as commodity prices once again moved higher during the month. Additionally, managers employing portfolio hedges through the use of short U.S. Treasury exposure saw further gains, as the post-election backup in rates continued into December. This strategy of hedging out the risk of higher interest rates had previously been a consistent drag on portfolios for much of the year.

Managed Futures strategies rebounded after a difficult November, as the HFRX Systematic Diversified Index gained 0.6%. Long domestic and international equity exposure supported returns, as did several trends in the agriculture markets. Short exposure to cocoa and coffee futures provided gains, as cocoa prices continued to decline on stronger than expected supply from West Africa, which accounts for over 70% of global production. After reaching a 2016 peak in early November, coffee prices have also continued to move lower; as higher than expected output and declining concerns over droughts in South American have led prices lower. Of note, many strategies have now completely eliminated their long Treasury exposure, an area that weighed heavily on portfolio returns earlier in the fourth quarter.

In the equity space, performance was broadly lackluster, as the HFRX Equity Hedge Index gained 0.2%. Gains from long holdings were offset by losses experienced on short positioning, specifically due to short exposure in the Utility and Telecom sectors. For the year, the HFRX Equity Index returned -0.9%, underperforming the 12% total return of the S&P 500.



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Alternative strategies may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

LIQUID REAL ASSETS MOSTLY POSITIVE IN DECEMBER

As the post-election risk-on rally continued in December, liquid real assets were mostly stronger as well. The U.S. dollar trade-weighted index was up 0.7% for the month as the 10-year Treasury yield moved modestly higher from 2.37% to 2.45%.

MLPs & Global Listed Infrastructure

The positive sentiment around master limited partnerships (MLPs) continued into December as the Alerian MLP Index returned 4.4%. The market continued to focus on the likelihood of higher U.S. crude oil production as a means for pipeline operators to realize higher volumes of shipments. This backdrop is also supported by what should be an energy-friendly administration in the U.S. coming into power in January. The asset class remains attractively valued with the index yielding above 7%, still well wide of corporate bonds and Treasuries.

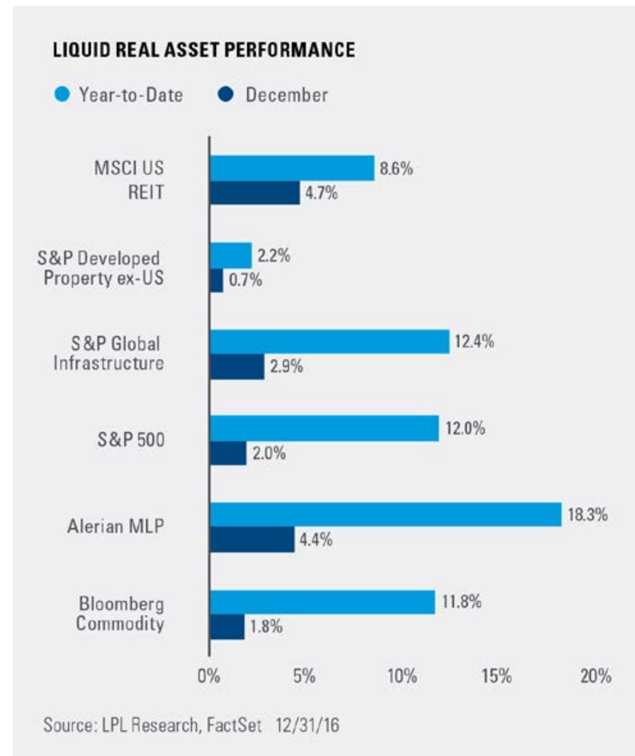
Global listed infrastructure, as measured by the S&P Global Infrastructure Index, returned 2.9% in December to end a streak of two straight negative months. In light of the recent focus on the potential for fiscal stimulus in the U.S., it should be noted that this index is comprised primarily of ex-U.S. companies. As of the end of the year, U.S. companies made up 39.9% of the index.

REITs

After being impacted negatively by rising rates in November, the MSCI US REIT Index bounced back and produced a return of 4.7% for December. Hotel REITs again outperformed supported by the broader risk-on equity rally.

Commodities

Oil prices followed through on their rally post-OPEC meeting as WTI crude prices increased 8.7% in December. It now remains to be seen how quickly the market returns back to balance and how true OPEC agreement participants stay to their quotas. Precious metals retreated as interest rates rose modestly and equities rallied. The more positive market sentiment of late and lack of any clearly identifiable downside catalyst events have decreased investors' appetite for gold and silver, which were down 1.6% and 2.5%, respectively, for the month. Agricultural commodity prices broadly decreased, as measured by the -2.3% return for the Bloomberg Agriculture Subindex. This was led by declines in most constituents but belied strong performance in the grain complex. Industrial metals declined and took a pause from the recent rally as copper prices decreased by 4.4%.



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