CORRIGAN FINANCIAL, INC.

Market Update: December 2016

Global stock markets closed on a high note, returning just over 2% for the month of December, and finishing ahead by 8% for the year. U.S. stocks, with returns in excess of 12% for 2016, far outpaced their foreign counterparts. Overall, it was quite a turnaround for the markets, which took a sizable tumble to start the year.

The broad U.S. bond market held on to gains of 2.65% for the year, after declining 3% during the fourth quarter alone. Foreign bonds were rocked by double-digit losses during the fourth quarter, leaving investors with gains of less than 2% for the year.

It was a remarkable year to say the least:

- U.S. stocks hit two-year lows in early February over concerns about China's economy, slowing growth in the U.S., and declining oil prices.
- Crude-oil futures fell to $26 a barrel on February 11, their lowest level since 2003. **U.S. crude is now nearly $54 a barrel, up 45% for the year.**
- After the U.K. voted to leave the European Union, the yield on the U.S. 10-year Treasury note fell to 1.366% on July 8, its lowest level on record.
- Donald Trump's victory in November helped propel stock prices in the fourth quarter. I**n November, the Dow Industrial average reached 19,000 for the first time and is currently flirting with the 20,000 mark.**
- Investors are anticipating the new administration will deliver more business friendly policies in the form of fiscal stimulus, lower taxes, and regulatory relief. Higher fiscal spending is generally funded by the issuance of more Treasury bonds, and more supply should push yields higher.

> **A lot of assumptions that have been made over the past few months are pure speculation, and we have no idea what's going to happen. The first few months of 2017 are going to be more important, as we read the tea leaves, than the last few months.**
>
> **Jim Tierney, AllianceBernstein CIO – WSJ 12/31/16**

The yield on the 10-year U.S. Treasury ended 2016 at 2.446%, up from 2.273% at the end of 2015. (Some of us may still remember the 10-year Treasury's record close of 15.819% on September 30, 1981. So, historically speaking, interest rates remain quite low.)

The Federal Reserve raised interest rates in December by 0.25%, and communicated their intention for 3 additional quarter-point increases during 2017.

> **The Federal Reserve needed to stop treating the U.S. economy as if it were a patient in the ER.**
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> **Liz Ann Sonders, Charles Schwab – Barron's 1/2/17**

The prospect of stronger U.S. growth helped boost the dollar late in the year. The WSJ Dollar Index, which measures the dollar against a basket of other currencies, advanced 3% during 2016. Foreign bond investors got absolutely crushed by the combination of rising interest rates and a rising dollar. **During the fourth quarter, foreign bond investments (unhedged) lost 10.26% … amazing!**

The *big-picture* economic highlights have been generally positive:

- According to the Commerce Department, U.S. economic growth (GDP) advanced by 3.5% in the third quarter. Growth during the previous three quarters had been less than 2 percent.
- The unemployment (headline) rate currently stands at 4.6 percent.
- U.S. corporate earnings are now growing after declining for several quarters. (A rising dollar, now at 14-year highs, could become a headwind for companies with significant international revenues.)

We have been investing in an artificial environment for some time. Massive (and unorthodox) monetary stimulus has distorted prices, making it very difficult to anticipate market movements. 2016 will be remembered for the many twists and turns in stocks, bonds, and currencies:

- Stock declines seemingly foretold an economic recession to start the year … the recession did not occur.
- Stocks rallied expecting the U.K. would vote to remain in the European Union … voters elected to leave.
- Markets rose in anticipation of a Hillary Clinton victory … she lost.
- Many pundits, touting gold as a safe haven, made some *bad calls*. Gold was up 8.5% in 2016, but ended the year down more than 15% from the highs reached in July.

And by the way, the S&P 500 fell 5.3% during the two sessions after the U.K. vote. Two weeks later, it rallied to record highs. S&P futures fell 5% in overnight trading (Nov 8) when it became clear that Donald Trump would win the presidential election.

When the markets closed on November 9, the index had actually gone up by 1.1% … and continued to climb thereafter.

> **The so-called Trump trade could be setting up investors for the latest whiplash.**
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> **Kuriloff & Zeng – WSJ 12/29/16**

Investors should recognize that U.S. stock valuations are at very high levels. According to FactSet, S&P 500 companies are now trading at 21 times their previous 12 months of earnings – well above the 10-year average multiple of 16 times earnings. In any case, this is good time to be globally diversified.

> **Predicting events is challenging enough, even for the most veteran of analysts. Second, predicting how the markets will react to such events is equally challenging (if not impossible). And positioning a portfolio as if we knew with confidence how it would all play out is downright irresponsible.**
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> **GMO, Market Commentary – December 2016**

Euphoric market expectations will eventually have to be backed up by fundamentals. After what we saw in 2016, expect the unexpected. More importantly, accept the fact that no one can time the market.

So, as always … Be humble, stay diversified, and stick to the plan.

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