Market Review

Fourth Quarter 2016

While the year began with pessimism and fears of a recession, the fourth quarter of 2016 brought optimism and improved economic data. Markets rallied on the so-called "Trump-trade," wherein investors viewed the President-Elect's platform of deregulation, infrastructure spending, and tax cuts as a source of tailwinds. In large part due to sector biases, such as the Value Index's larger weighting in Financial Services stocks (which rallied due to rising interest rates and hopes for deregulation), Value outperformed Growth, with the Russell 1000 Value index climbing 6.7%, versus a 1.0% rise in the Russell 1000 Growth Index. Small-cap stocks (as measured by the Russell 2000 Index) rose 8.8%, while large-cap stocks (as measured by the S&P 500 Index) returned a more modest 3.8%.

Though markets rose sharply immediately after the presidential election, positive economic news may have solidified the rally. The Commerce Department revised its estimate for third-quarter GDP growth to 3.5% (seasonally adjusted), up from its initial estimate of 3.2%. Although the consumer has been strong for some time, it was notable that business investment—which has been anemic in recent quarters—rose at a revised 1.4% rate, up significantly from an initial estimate of a 0.1%. In addition, December's jobs report showed that employers added 156,000 jobs (seasonally-adjusted), according to the Bureau of Labor Statistics (BLS). Unemployment actually ticked up slightly to 4.7%, reflecting the positive news that more workers entered the workforce, leading to a corresponding decline in number of individuals who have given up their job search or settled for part-time work. A previous strong employment report in November gave cover for the Federal Reserve Open Markets Committee to raise interest rates by 0.25% in its December meeting.

News in November that members of the Organization of the Petroleum Exporting Countries (OPEC)—along with non-member states such as Russia—plan to reduce daily production by over 1 million barrels per day was well-received. Reversing October's losses, oil prices rallied, with crude rallying nearly 10% following the announcement, and finishing up 45% for the year. Higher prices could spur greater investment in the sector, which could be a plus for labor markets.

The move from monetary to fiscal stimulus could mark a significant paradigm shift, but as we have noted previously, a balanced mindset is in order. A review of minutes from the Federal Reserve Open Market Committee's (FOMC) meeting in December reveals the "considerable uncertainty" the Committee felt about the President-Elect's proposed stimulus. Doubts raised include when, if, and how the implementation of such a package may impact economic growth, labor markets, and the inflation rate. Separately, pundits have pointed to a cooling off of the Trump trade since December 9th through year-end, during which Financials and Industrials have corrected more than the broader market, and bond yields have fallen.

On balance, these macroeconomic developments seem encouraging, though we remind our clients that we are not macro-driven. As always, our process is bottom-up, identifying stocks with relatively attractive valuations, and the ability to exceed consensus expectations. This approach has served us and our investors well over the long-term.

R. Daniel Oshinskie, CFA

Chief Investment Officer, U.S. Equities

Rothschild Asset Management Inc.

January 11, 2017

Disclaimer