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# M Wealth Perspective

**Offering value-added wealth services, including turnkey asset management and investment consulting.**

## 2016 Market Review

In 2016, the U.S. market reached new highs and stocks in a majority of developed and emerging market countries delivered positive returns. The year began with anxiety over China's stock market and economy, falling oil prices, a potential U.S. recession, and negative interest rates in Japan. U.S. equity markets were in steep decline and had the worst start of any year on record. The markets began improving in mid-February through midyear. Investors also faced uncertainty from the Brexit vote in June and the U.S. election in November.

Many investors may not have expected global stocks and bonds to deliver positive returns in such a tumultuous year. This turnaround story highlights the importance of diversifying across asset groups and regional markets, as well as staying disciplined despite uncertainty. Although not all asset classes had positive returns, a globally diversified, cap-weighted portfolio logged attractive returns in 2016.

Consider that global markets are incredible information-processing machines that incorporate news and expectations into prices. Investors are well served by staying the course with an asset allocation that reflects their needs, risk preferences, and objectives. This can help investors weather uncertainty in all of its forms. The following quote by Eugene Fama describes this view.

> **"If three or five years of returns are going to change your mind [on an investment], you shouldn't have been there to begin with."**
>
> *—Eugene Fama*

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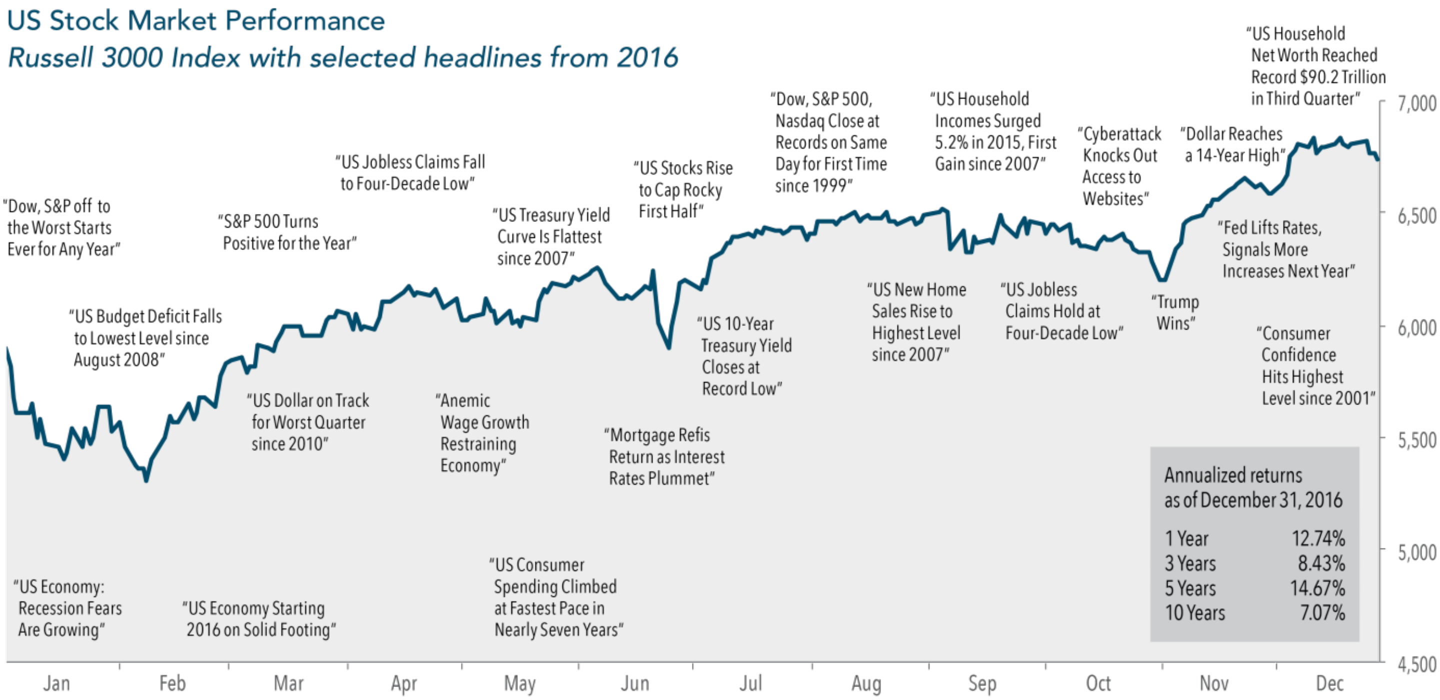
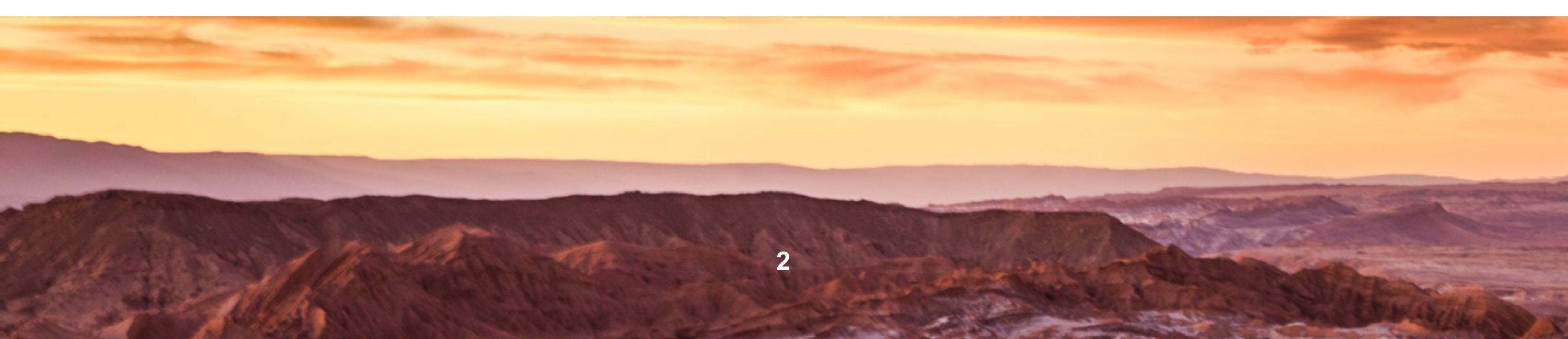
## *2016 Market Review*




*Source: Frank Russell Company.*
*Past performance is not a guarantee of future results. In US dollars. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.*

The chart above highlights some of the year's prominent headlines in context of broad U.S. market performance, measured by the Russell 3000 Index. These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.



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## *2016 Market Review*

The chart below offers a snapshot of non-U.S. stock market performance (developed and emerging markets), measured by the MSCI All Country World ex USA Index (in USD, net dividends). The headlines should not be viewed as determinants of the market's direction, but as examples of events that may have tested investor discipline during the year.

**Non-US Stock Market Performance**
*MSCI All Country World ex USA Index with selected headlines from 2016*


*Source: MSCI.*
*Past performance is not a guarantee of future results. In US dollars, net dividends. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.*

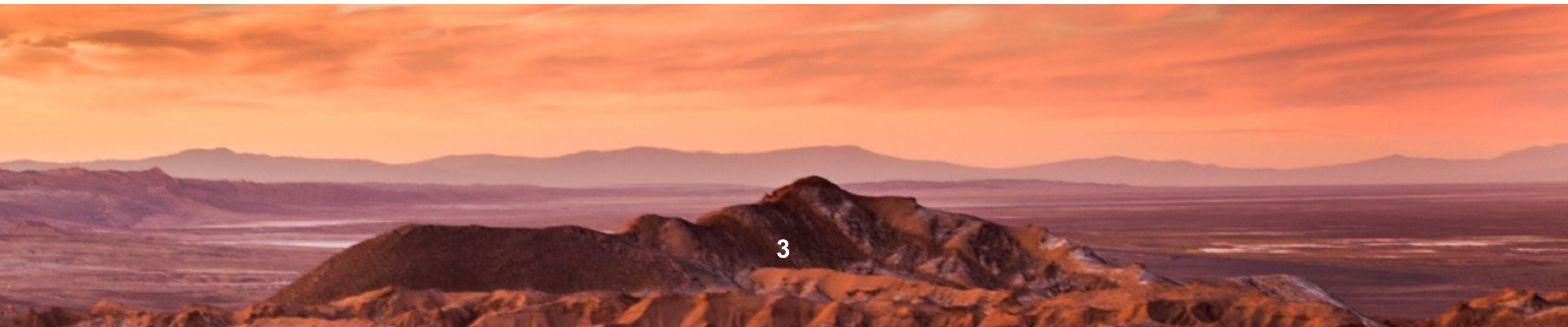
## 2016 Market Perspective

### Equity Market Highlights

After a rocky start, the U.S. stock market had a strong year. The S&P 500 Index logged an 11.96% total return and small cap stocks, as measured by the Russell 2000 Index, returned 21.31%.

Overall, performance among non-U.S. markets was also positive: The MSCI World ex USA Index, which reflects non-U.S. developed markets, logged a 2.75% return and the MSCI Emerging Markets Index an 11.19% return.[1]

1 All non-U.S. returns are in USD, net dividends.



## Global Diversification Impact

Overall, U.S. equities outperformed equities in the developed ex U.S. markets and emerging markets. As a result, a market cap-weighted global equity portfolio would have underperformed a U.S. equity portfolio. Investors generally benefited from emphasizing value stocks around the world, as well as U.S. small cap stocks.

Brazil offers a noteworthy example of market prices at work and the difficulty of trying to forecast and time markets. Despite a severe recession, Brazil was the top-performing emerging market country in 2016. Brazil's GDP was projected to shrink 3.4% in 2016, according to the OECD in November, yet its equity market logged strong performance. The lesson is that prices incorporate a rich set of information, including expectations about the future. One must beat the aggregate wisdom of market participants in order to identify mispricing. The evidence suggests that this is a very difficult task to do consistently.

## Volatility

In 2016, equity market volatility, as measured by the CBOE Volatility Index (VIX),[2] was below average. There were, however, several spikes—as you might expect—as new information was incorporated into prices. The high was reached in early February, and spikes occurred following the Brexit vote in June and again in November preceding the U.S. election.

## Premium Performance

In 2016, the small cap and value premiums[3] were mostly positive across U.S., developed ex U.S., and emerging markets, while the profitability premium varied by market segment.[4] Though 2016 marked a generally positive year, investors may still be wary following several years of underperformance for value and small cap stocks. Taking a longer-term perspective, the premiums remain persistent over decades and around the globe despite recent years' headwinds. The small cap and value premiums are well-grounded in financial economics and verified using market data spanning decades, but pursuing those premiums requires a consistent, long-term approach.

## Fixed Income

Both U.S. and non-U.S. fixed income markets posted positive returns. The Bloomberg Barclays U.S. Aggregate Bond Index gained 2.65%. The Bloomberg Barclays Global Aggregate Bond Index (hedged to USD) gained 3.95%.

Yield curves were generally upwardly sloped in many developed markets, indicating positive expected term premiums.[5] Indeed, realized term premiums were positive in the U.S. and globally as longer-term maturities outperformed their shorter-term counterparts.

Corporate bonds were the best performing sector, returning 6.11% in the U.S. and 6.22% globally, as reflected in the Bloomberg Barclays Global Aggregate Bond Index (hedged to USD). Credit premiums were also positive in the U.S. and globally as lower quality investment grade corporates outperformed their higher quality investment grade counterparts.

## Currencies

The British pound, euro, and Australian dollar declined relative to the U.S. dollar, while the Canadian dollar and Japanese yen appreciated relative to the U.S. dollar. The impact of regional currency differences on returns in the developed equity markets was minor in most cases. U.S. investors in both developed and emerging markets generally benefited from exposure to certain currencies.

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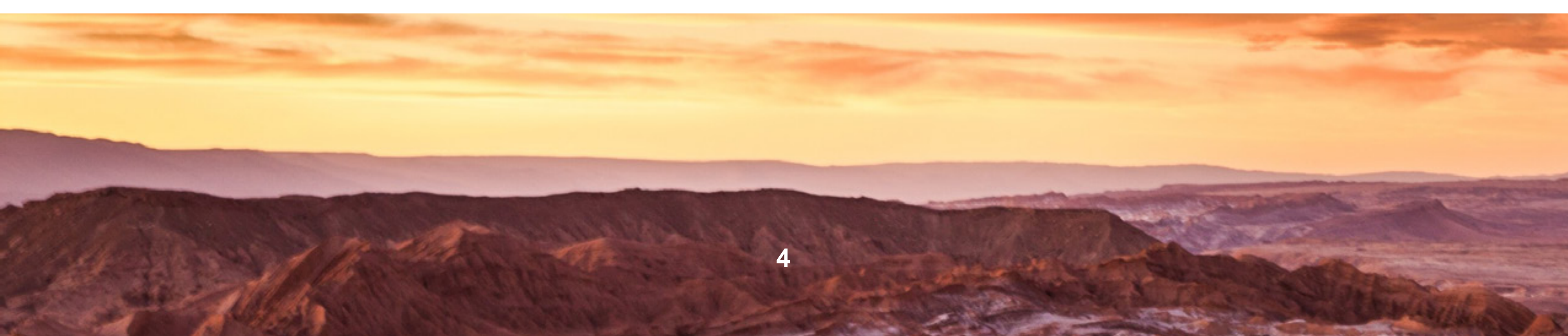
2 The VIX is a measure of implied volatility using S&P 500 option prices. Source: Bloomberg.

3 The small cap premium is the return difference between small capitalization stocks and large capitalization stocks. The value premium is the return difference between stocks with low relative prices (value) and stocks with high relative prices (growth).

4 Profitability is measured as a company's operating income before depreciation and amortization minus interest expense scaled by book equity. The profitability premium is the return difference between stocks of companies with high profitability over those with low profitability.

5 A yield curve is a graph that plots the interest rates at a specific point in time of bonds with similar credit quality but different maturity dates.



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## *2016 Market Review*

**"There's no information in past returns of three to five years. That's just noise. It really takes very long periods of time, and it takes a lot of stick-to-it-iveness. You have to really decide what your strategy is based on long period of returns, and then stick to it."**

*—Eugene Fama*

### Contact Information

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