

The year that began with a notable stock market sell-off, ended with a notable stock market rally. The S&P 500, including price appreciation and dividends, returned almost +12% for the year. International stocks were down -1.88% in US dollar terms, but up +2.5% in local currency terms. The strong US dollar was a reflection of strong global demand for US debt, as yields stayed low and broad bond indexes were positive (+2.7%) for the year. The stock market rally may be sufficient to impact the real economy in a positive way. Recent economic data show a stronger economy and the Fed's decision to raise rates another +25 basis points supports the view.

Investors' preference for US dollar assets was a clear investment theme for 2016, as the US dollar rally from 2015 continued through 2016. In retrospect, the trend can be understood as a result of increased political and economic uncertainty, in which case, the US has always been a place to "hide" during periods like these. Starting with the mid-year BREXIT vote and ending the year with the US election, it became clear the world is beginning a shift away from "globalism", or the near completely free cross-border trade, towards a "nationalistic", or bi-lateral environment of quotas, tariffs and/or closed borders. The implications of this shift are not yet known, but a change from the current economic environment is almost certain. With this view, a strengthening US dollar makes sense – for the short term. We have been in the camp of those who believed that the US dollar was overvalued and was likely to weaken (for more on this please see the market view on our website). This was the correct view for the first half of 2016. Our portfolios were well positioned to avoid the weak sectors of the economy and remain positioned for further weakness in stocks. However, that positioning contributed to a performance lag in the second half of the year, as the shifts previously described revealed the possibility that a new economic environment is upon us.

We believe that the technology enhancements in communications and transportation we have all experienced means that globalization is almost assured to continue for the long haul. However, the extent of globalization ebbs and flows on long cycles historically, and we have entered a period where the terms of globalization are likely to be re-negotiated. As local investors are turning inward, US equity market investors will be focused on how the relationship between the new administration and congress develops. The popular reaction post-election tells us many investors expect the administration will put forth policies that will successfully stimulate economic growth. If this is the case, inflation will return and rates will rise.

While predicting the economic environment ahead is a challenge, we find ourselves becoming more optimistic. For example, we are finding US stocks that are trading at prices reflecting a base case of 5-7% returns. While that may seem low by historical standards, those are attractive returns when compared with any another asset class. Most importantly, these returns are a *base case*, and opportunities from market volatility and/or upward surprises in global growth rates could boost this return. At the same time, the companies we are looking at have stable balance sheets and proven track records of operating through tough economic periods. We continue to add to companies that offer these qualities. Thank you for your trust and confidence.