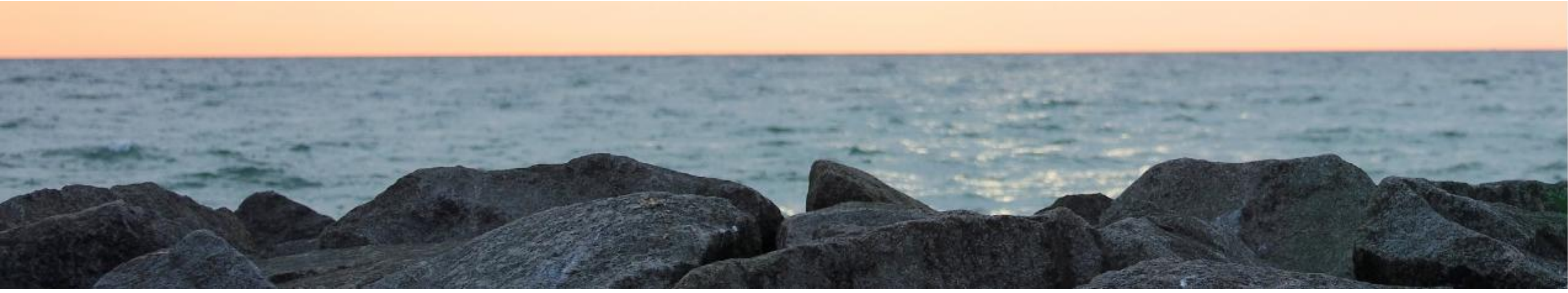

BALLENTINE PARTNERS

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2016 Market Review and 2017 Outlook

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The Year in Review

Despite a number of stomach-churning events throughout the year, the US stock market (as measured by the S&P 500) posted a solid 12% return last year, exceeding its long-term average and most strategist predictions (including ours). The broader global stock index, the MSCI ACWI, gained 8.5%, dragged lower by the 1.6% gain of non-US developed market stocks.

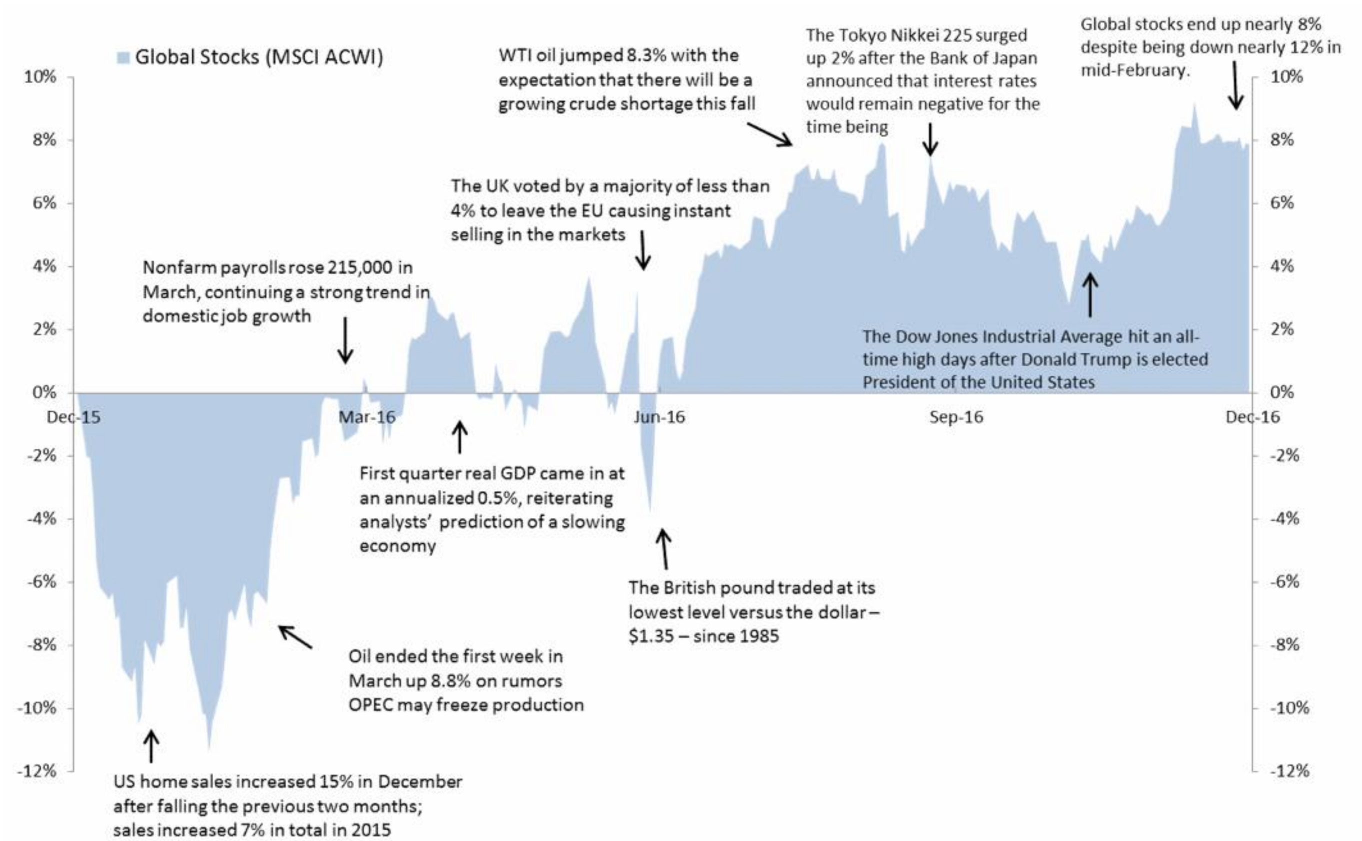
The full-year outcome was even more remarkable when you consider that concerns over an impending US recession led to the worst two-week start for the S&P 500 in history. By mid-February, US stocks were down 10%, oil prices had fallen to a 13-year low, and the Chinese Shanghai Composite Index had fallen 25%. But as recession fears subsided, US stocks recovered all that ground by mid-March and oil prices were rising.

The next confidence-testing event was the surprising British vote in mid-June to leave the European Union. The S&P 500 fell 5.3% in two days, the British pound hit a 31-year low, and the 10-year US Treasury yield fell to its lowest level since 1962. Although predictions for the British economy were grim, global equity markets quickly recovered. The S&P 500 hit a new all-time high on July 11.

And then of course there was the US presidential election. This time, the correction lasted only hours. The Dow futures fell by 600 points overnight as the results became clearer, but Trump's victory spawned a stock market rally that carried through the remainder of 2016. It was truly a remarkable turnaround.

While the US stock market was again the standout performer versus other regions, other asset classes also posted gains. Big reversals from weak 2015 performances were staged by emerging market stocks (up 11.2%), Master Limited Partnerships (MLPs, up 18.3%) and oil prices (up 42%). Anticipating higher inflation ahead, interest rates rose sharply in the fourth quarter. This reduced high-grade bond returns for the year to low single-digits, about in line with our expectations.

2016 Global Equities and Headlines



Source: Bloomberg

Worse hit were municipal bonds, which suffered the double whammy of higher interest rates and the possibility of lower tax rates in 2017, diminishing their appeal versus taxable investments. In contrast, credit securities that benefit from higher rates (such as floating-rate notes and direct loans) generated returns near 10%.

Putting all this together, a diversified investor with a portfolio of 60% global equities and 40% US investment-grade municipal bonds should have generated about a 5% return in 2016. While not exceptional on an absolute basis, a real return of more than 3% (after inflation, with inflation running below 2%) should leave moderate risk investors pleased.

A diversified investor with a portfolio of 60% global equities and 40% US investment-grade municipal bonds should have generated about a 5% return in 2016.

2017 Outlook: Great Expectations

The US economic expansion is now entering its eighth year, the third longest period of growth since 1920. Investors are right to ask how much longer this can go on before the inevitable downturn.

Fortunately, economic expansions (and associated bull markets) do not typically die of old age. Growth usually turns negative after a period of rising interest rates, sharply higher commodity prices, or a geopolitical event that causes business owners to aggressively pull back their plans for the future. Oftentimes, excesses build up in the economy as corporations add capacity in advance of future growth that doesn't materialize. Then they are forced to close plants and reduce headcount, which leads to the next downturn in the cycle.

Businesses and consumers have been much more cautious during this expansion, which has delayed the excesses that typically build up during this phase of the cycle. This may partially account for the unusual length of this expansion.

One of the positive aspects of the oft-maligned 2% growth rate of the US economy since the Great Recession of 2008-2009 has been a restraint on the animal spirits typically associated with an economic recovery. Businesses and consumers have been much more cautious during this expansion, which has delayed the excesses that typically build up during this phase of the cycle. This may partially account for the unusual length of this expansion. But the business cycle has not been repealed. Investment managers need to be vigilant in monitoring the indicators that might presage the next downturn. Importantly, since economic forecasting remains an inexact science, investors need to develop a mindset that prepares them for a period of lower returns that usually accompanies a period of economic weakness. Holding a diversified portfolio that is aligned to an investor's tolerance for risk is a critical factor in being able to weather the coming storm, whenever it arrives.

With all that said, we see little on the economic horizon that would indicate a high probability of recession in the coming quarters. In fact, most economists expect a pickup in growth in 2017 as the new administration's "pro-growth" policies are enacted. These include a reduction in both corporate and personal tax rates, an increase in government spending geared to rebuilding the nation's infrastructure and defense capabilities, and an earnest attempt to bring lost manufacturing jobs back onshore. The timing and ultimate success of the Trump administration's ability to get all this done is a great unknown, as is the economic impact of some of his other policies such as limiting immigration and imposing tariffs on foreign imports.

Nonetheless, the stock market's behavior since the election indicates that investors have high expectations for these policies to tilt US GDP growth and corporate earnings sharply upward. As a result, we remain positive on the outlook for US equities, but are concerned that investor expectations may be set too high.

One of the critical factors shaping the outlook for non-US equities will be the direction of the dollar. According to Ned Davis Research, the US dollar rose 3.7% last year, on top of 2015's 9.4% rise. A strong dollar crimps international market returns when translated back to US currency, and it makes it harder for foreign borrowers to repay their dollar denominated debt. Most analysts expect the dollar to remain strong in 2017 as growth reaccelerates in the US and the Fed continues to ratchet interest rates higher.

On the flip side, a strong dollar inhibits the competitiveness of domestic firms competing overseas against companies operating in countries with weak currencies. If the dollar continues to strengthen, we believe that foreign companies with large export businesses to the US are likely to see improved demand. Coupled with low valuations and high levels of skepticism, we believe that certain emerging market equities look attractive.

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Based upon recent behavior, it is likely that the Trump administration will provide a number of surprises to investors as we proceed through the year. As a result, we believe the best advice is to expect a positive outcome for financial assets in 2017, but buckle your seatbelt in anticipation of a very bumpy ride.

Bruce D. Simon, CFA, CPWA®, Managing Director and Director of Portfolio Research

Bruce rejoined Ballentine Partners in June 2016 as Managing Director and Director of Portfolio Research after more than 5 years as Chief Investment Officer of City National Rochdale, LLC, in Los Angeles. City National Rochdale, a wholly owned subsidiary of City National Bank, serves family clients across the United States with a staff of nearly 100 investment professionals. Before moving to Los Angeles, Bruce served as Chief Investment Officer of Ballentine in our Waltham office for three years. Prior to that, Bruce spent four years with Morgan Stanley Private Wealth Management in New York and eight years with Glenmede Trust in Philadelphia as Chief Investment Officer and Portfolio Manager. Bruce received an MBA with a concentration in Applied Economics from George Washington University and a BS degree in Business Administration from Penn State University. In addition to working directly with a number of family clients, Bruce serves on the Investment Management Committee, which is responsible for the oversight of all of the investment activities for the firm. Bruce holds the Chartered Financial Analyst (CFA) and the Certified Private Wealth Advisor (CPWA®) designations. He lives with his wife in Palm Beach Gardens, Florida.