January 10, 2017

Dear Clients and Friends:

Happy New Year!

What a year 2016 turned out to be for us all! There is not a forecaster on the globe who could have predicted that 2016 would have played out to be a crossroads year economically, socially and politically!

Calendar year 2016 was a wild ride for investors. The year was heavily peppered with frightening bouts of volatility and while we ended on a strong note with respect to stock market returns, the ride was by no means smooth. You may recall the S&P 500 kicked off the year by falling 8% over its first 10 trading days, the worst first 10 trading days in history. After its first 28 trading days, the index was down a little over 10%, again marking January as the worst start in the history of the stock market.

Fear dominated the headlines during the first two months of 2016. Most noteworthy, was the falling growth rate of China's economy which is showing increased evidence of becoming a mature economy. In addition, there was the extreme volatility in oil prices which let to further strife in the high yield bond market. Furthermore, the world was just coming off the Fed's first rate hike since June 2006. These factors stoked fears that the US economy was topping out and approaching a recession.

However, there was little evidence to suggest that we were on the brink of the next market-crashing financial crisis. Sure, it could have been the beginning of a bear market. But after the initial selling came to an end in mid-February, many seasoned experts told clients that this was not a time to panic. Locust Capital's continued guidance was to remain disciplined and focused on diversification with a long-term view. This prudent and disciplined strategy has again paid off for our clients.

By April, fears over China were fading and the volatility in oil prices were subsiding. The headlines switched gears and began focusing on politics such as Britain's upcoming vote to exit (BREXIT) the European Union (EU) and the US presidential election. Both topics were met with bearish anti-trade rhetoric. Volatility once again seeped back into the markets as the Brexit vote neared. While the Brexit polls signaled status quo, the polls were nevertheless close.

By early June, the S&P, trading at (2100+/-), recovered all it losses from earlier in the year. On June 24th, populism prevailed as Great Britain voted to leave the EU. It was an almost unthinkable event that sent global financial markets around the world nosediving in its wake. Perhaps the only thing that brought investors comfort was that the market appeared to be acting rationally (i.e. one direction). This phenomenon was short lived. After a few days, the markets recovered and recouped all their losses.

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Like the sentiment leading up to the Brexit vote, the US Election brought with it a new round of volatility and uncertainty. The US election results were unexpected and like Brexit, were followed by a violent sell-off in overnight trading. This was also short lived and was followed by a market rally during the day. This rally continued thru year end 2016!

The fourth quarter was dominated by market reactions to the Donald Trump victory and his promises to reduce regulation and taxes while committing to infrastructure and returning jobs to the US. This has helped to sharply increase inflation expectations, leading to a surprising 4th quarter rise in bond yields.

Asset Class	Index	4th Qtr	2016
U.S Large Cap	DOW JONES INDUS. AVG	8.66%	16.50%
U.S Large Cap	S&P 500 INDEX	3.82%	11.95%
U.S. Mid Cap	S&P 400 MIDCAP INDEX	7.41%	20.73%
U.S. Small Cap	S&P 600 SMALLCAP INDEX	11.06%	26.46%
International	MSCI EAFE	-0.62%	1.59%
Emerging Markets	DJTSM EmgMktT	-3.71%	11.43%
U.S. Bonds	iShares Core U.S. Aggregate	-3.12%	2.41%
U.S. High Yield	iShares iBoxx High Yield	0.86%	13.40%
Real Estate	WilshireUS REIT	-3.29%	3.17%
Dollar	Bloomberg Dollar Spot Index	7.15%	2.82%
Commodities	IPATH COMMODITY INDEX	3.24%	12.86%

Globally we saw relatively healthy gains through the end of 2016. Small Cap U.S. Equities far outperformed all other asset classes, up 26% for the year. U.S. Large Caps lagged, but were still up over 12%. Commodities ended up 13% as production cuts from OPEC and prospects of increased infrastructure spending helped propel oil and industrial metals upward. This improvement in commodity prices, combined with a better economic growth outlook, resulted in Emerging Market Equities returning 12%.

High Yield rebounded after a negative showing in 2015, returning over 13% as recession fears subsided. Core Fixed Income and interest rate sensitive sectors of the equity market, such as REITs, did not fare as well in 2016 as interest rates moved upward because of higher expected inflation and growth. The Barclays Aggregate Bond Index was up only 2% for the year while REITs gained a mere 3%.

As we look towards 2017, there is great hope for a shift from monetary to fiscal stimulus. Much of this fiscal stimulus could come from tax cuts and infrastructure spending. These policy measures have been the catalyst to the recent stock market surge with a vision that higher economic activity will be met with higher valuations. Of course, how much of a boost in growth that can be delivered by incoming Trump administration remains to be seen.

It will be interesting to see if the incoming administration can successfully implement their proposed agenda in a timely manner. While the markets have rallied around the anticipation of the administration's ability to accomplish their agenda, 2017 will certainly be an interesting year.

We look forward to speaking with you and working together in 2017!

Sincerely,

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