The Cobblestone Advisor
Investment Brief

COBBLESTONE CAPITAL ADVISORS

January 20, 2017

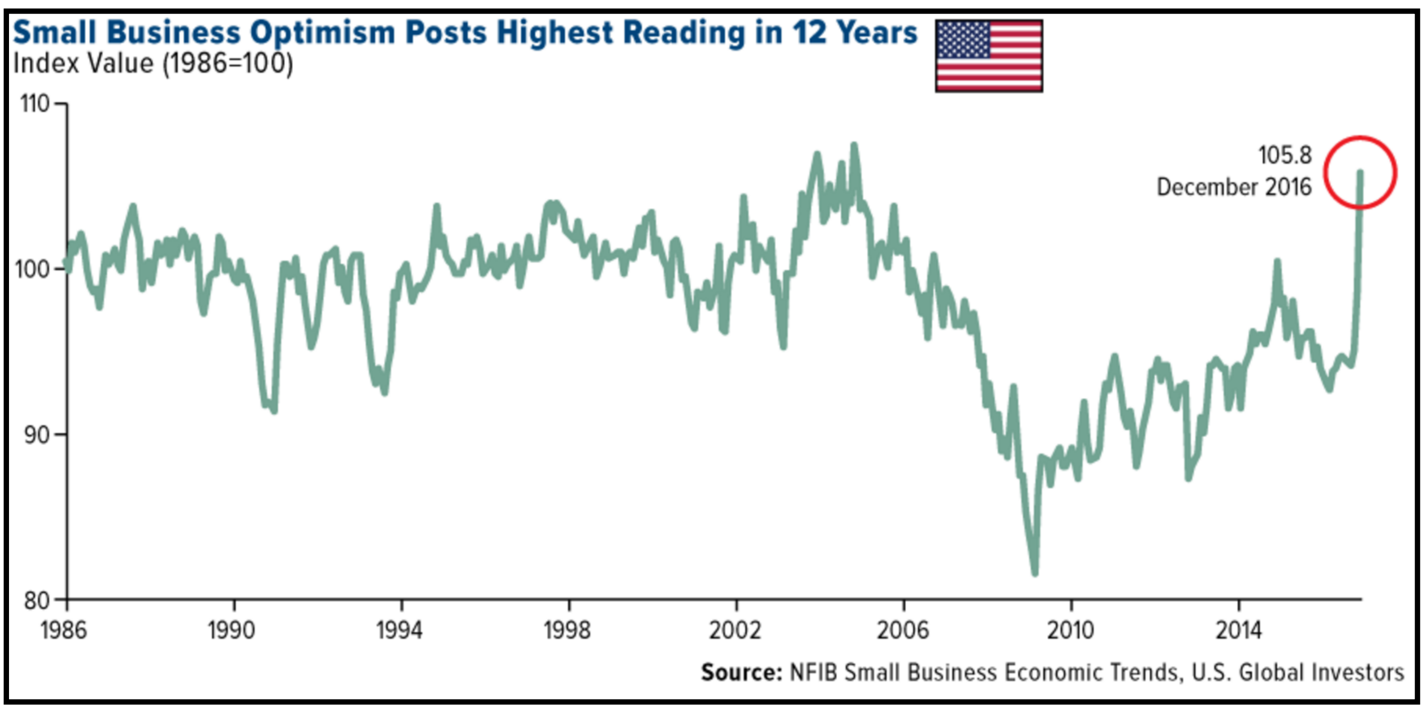
Election Surprise Leads to Spike in Confidence and Markets

On November 8th, 2016 the United States went to the polls and shocked the political establishment, as well as much of the rest of the world, by electing businessman Donald J. Trump to be the 45th President of the country. With the election behind us, all eyes now turn to the potential actions of what promises to be the most unpredictable administration in recent memory. While the political reaction to the election of Mr. Trump has been every bit as polarized as the campaign that preceded it, the U.S. stock market reaction has been almost uniformly positive.

The removal of the election uncertainty, the promise of potential pro-growth policies from the incoming administration, and the surprisingly strong economic data through the end of the year led to an unleashing of "animal spirits" that propelled the U.S. equity markets significantly higher in the months after the election. The S&P 500 increased +5.4% from the day after the election to finish the year up +11.9%. Small-cap U.S. stocks finished even stronger, up +14.2% post-election and +21.2% for 2016. There were also significant gains in commodities and the U.S dollar.

Enthusiasm is also evident in various measures of both consumer and business confidence. The chart at the bottom of this page shows the NFIB Index of Small Business Optimism, which posted record increases in both November and December. These increases were driven by a significantly higher percentage of respondents who expect business conditions to improve and anticipate expanding as a result.

To be sure, there are negatives being priced into the market as well. After one of the strongest starts to a year in history, the bond market gave up most of its gains in the second half of 2016. After the election, the 10-year U.S. Treasury yield spiked from 1.9% to close the year at 2.5%. This suggests that market participants are concerned about a resurgence of inflation, which is already starting to show up in wages and commodity prices, and that they believe the Federal Reserve is finally prepared to begin the process of normalizing interest rates. Additionally, the returns of international stocks lagged domestic stocks. In



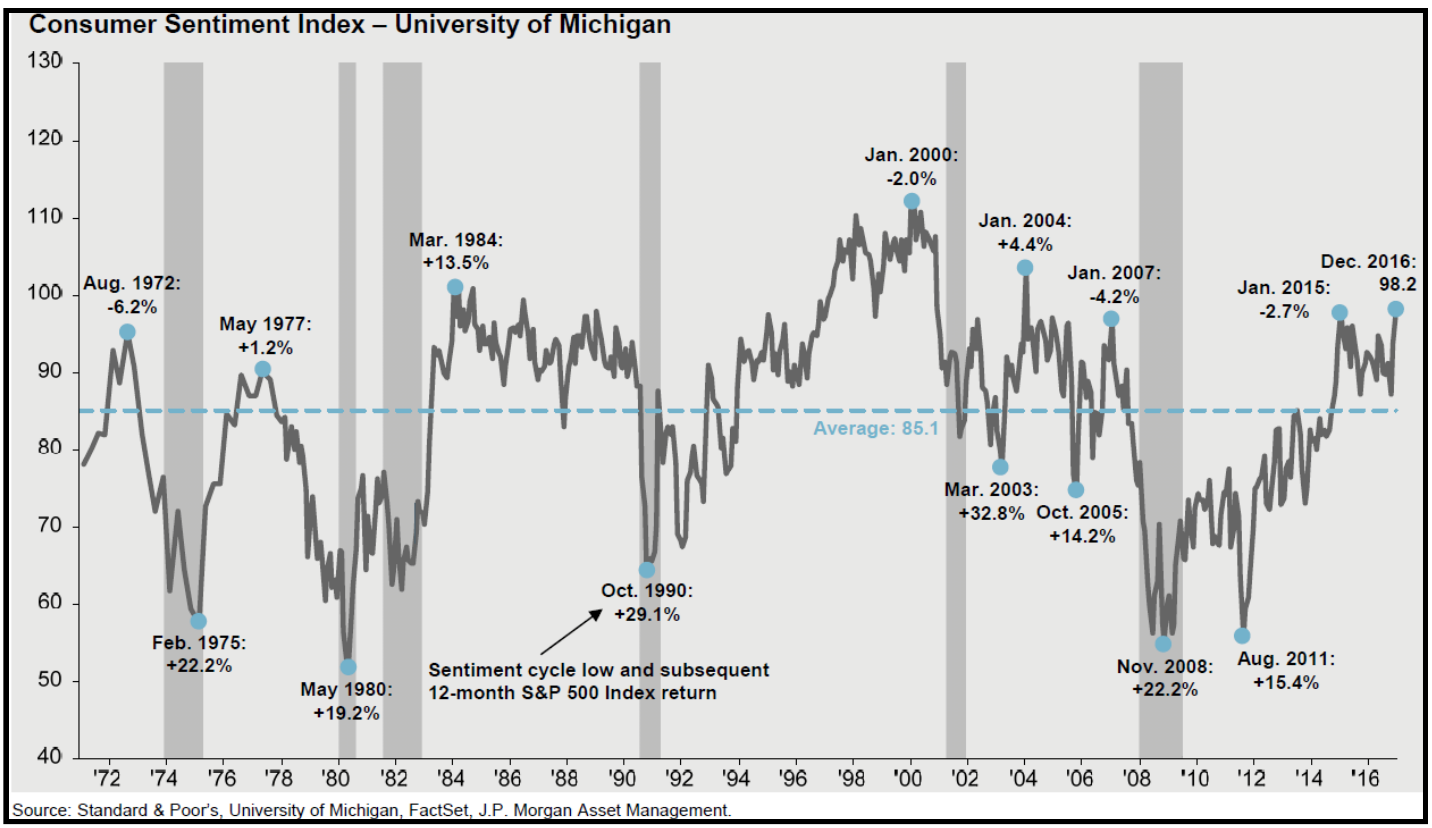
particular, emerging market stocks were down -3.3% post-election after being market leaders early in the year. The MSCI EM index still finished 2016 up +11.1%, but the sell off at the end of year highlights concerns that the protectionist rhetoric of the Trump campaign could become reality in 2017.

Ok, So Now What?

Despite the recent gains and improving economic outlook, there are ample reasons to be concerned about the sustainability of the "Trump Rally" as we move into 2017. The first, somewhat counterintuitively, is what history shows to be the market implications of a rise in consumer confidence. As the chart on this page indicates, 12-month forward returns on the S&P 500 tend to be muted following the type of spikes in confidence that we've seen in recent months. Further, with the S&P 500 trading at 20 times trailing earnings, it is difficult to make the argument that stocks are trading at compelling valuations right now.

Balanced against these concerns is the possibility that we are entering a period of fundamental change in potential global economic growth. The research firm TrendMacro™ has calculated that, starting with Spain's election of Mariano Rajoy in December 2011 and continuing through our election in November, over 40% of the world's population (as measured by cumulative GDP) has elected pro-growth governments in the last five years. This is a potentially transformative turn of events that could prolong the current economic and market cycle for years to come. We are closely watching the economic data for signs that this phenomenon is beginning to manifest itself in a measurable way.

With that as the backdrop, our outlook is one of cautious optimism for the year ahead. While we expect surprises and volatility, we believe it is more likely that this volatility will be a source of opportunity than a harbinger of the next recession.



There is no assurance that expectations expressed in this article will prove to be correct. Past performance is not indicative of future results. Investment in securities, including mutual funds and ETFs, may result in loss of income and/or principal. Nothing in this article is intended to be or should be construed as individualized investment advice. Investors should consult their Cobblestone advisors for tailored advice. Any references to third-party data or opinions are listed for informational purposes only and have not been verified for accuracy by the Advisor.