DeMarche
ASSOCIATES, INC.

Putting Research To Work

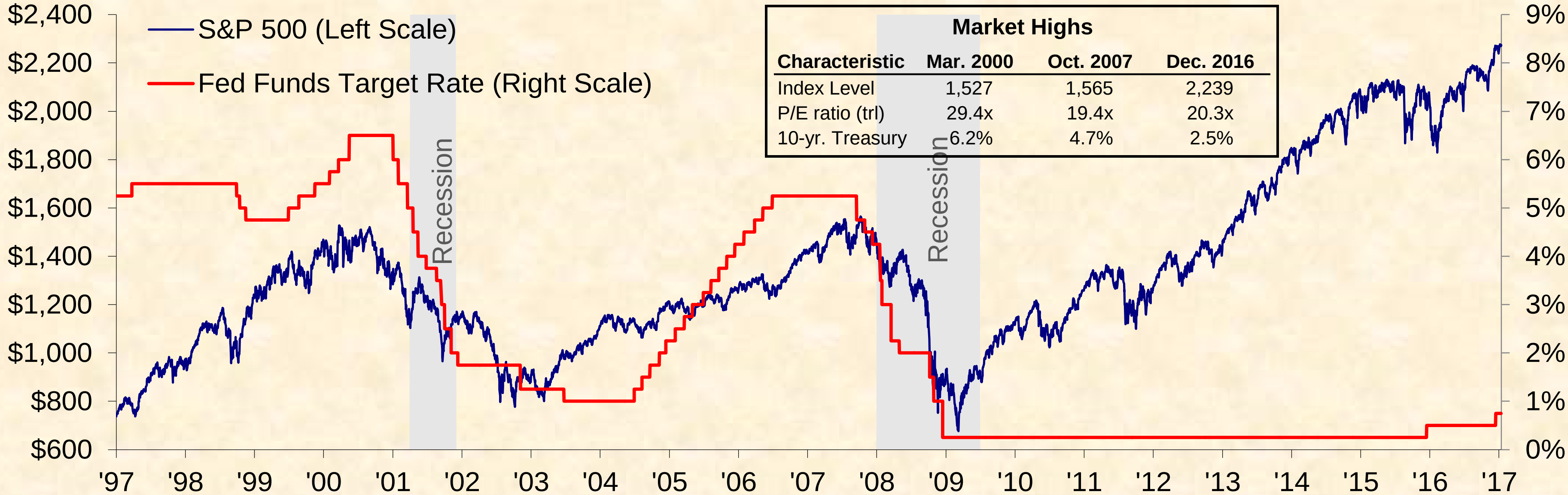
Capital Market Review

December 31, 2016

DeMarche Client Conference

Save the date for the 34th annual DeMarche Client Conference, **September 6-8, 2017** at **The Sheraton Kansas City Hotel at Crown Center** in Kansas City, Missouri. Further information will be mailed to clients in February. Questions may be directed to your DeMarche consultant.

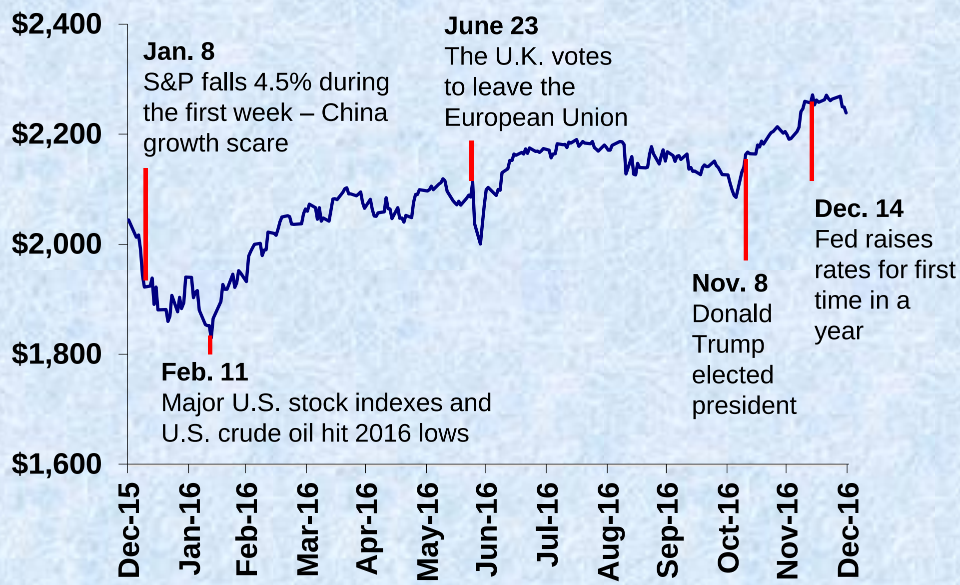
Predictably Unpredictable



Market Highs

Characteristic	Mar. 2000	Oct. 2007	Dec. 2016
Index Level	1,527	1,565	2,239
P/E ratio (trl)	29.4x	19.4x	20.3x
10-yr. Treasury	6.2%	4.7%	2.5%

Events That Shaped The S&P 500 In 2016



Even amid all the tumult of 2016, it was a banner year in many markets. The twists and turns along the way provide unexpected opportunities for investors to rebalance portfolios. The year started out on a down note as markets fell and investors braced for a global slowdown. Oil prices bottomed in February, but then rallied from under $30 to over $50, as the slowdown did not materialize. The energy rally affected currencies, high yield, and emerging markets along the way. In June came the "Brexit" vote, with the British deciding whether they should stay or go. After the surprise outcome to leave the European Union, stocks fell for two days before eventually rebounding to record highs. Last, but not least, the unexpected outcome of the U.S. election changed investor perceptions of global growth and inflation. Yields spiked and markets rallied. The Fed then capped the year, with the only expected move all year of a 25 basis point increase. The markets yawned in response.

Broad Market Overview

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INDEX	4th QTR.	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI World	1.9	7.5	3.8	10.4	3.8
DeMarche World*	1.7	7.8	3.1	9.8	3.8
DeMarche 3000	3.1	12.4	5.8	11.7	5.6
Russell 3000	4.2	12.7	8.4	14.7	7.1
S&P 500	3.8	12.0	8.9	14.7	6.9
DeMarche International	-0.1	2.2	0.4	7.4	1.9
MSCI EAFE USD	-0.7	1.0	-1.6	6.5	0.7
DeMarche Bond	-3.2	2.1	2.9	1.9	4.1
BlmBarc Aggregate	-3.0	2.6	3.0	2.2	4.3
Citigroup Non-U.S. Gov't Bond	-10.8	1.8	-2.2	-1.9	2.5
BlmBarc Global Aggregate	-7.1	2.1	-0.2	0.2	3.3
NCREIF (Private RE)	1.7	8.0	11.0	10.9	6.9
Bloomberg Commodity	2.7	11.8	-11.3	-9.0	-5.6

Notes: All 3, 5 and 10-year returns are annualized. *Does not include Canada or Brazil.

Indicator Year Ending 12/31	2016	2015	2014	2013	Long Term Average
GDP Annual Growth Rate	1.9	1.9	2.5	3.1	3.1
Unemployment	4.7	5.0	5.6	6.7	5.9
Inflation (CPI)	2.1	0.7	0.8	1.5	3.7
10-Year Interest Rates	2.5	2.3	2.2	2.9	5.9

Asset Class Performance in Times of Rising Interest Rates

Will this time be different?

All Returns are Cumulative (Not Annualized)

Period (End of Month)	10-Year Treasury Rate	S&P 500	MSCI EAFE	MSCI Emerging Markets	Merrill Lynch US High Yield	Bloomberg Barclays Aggregate	Barclays Commodities
10/2001 – 3/2002	4.3 – 5.4	8.9	4.8	32.7	4.5	-1.9	11.0
5/2003 – 8/2003	3.4 – 4.5	5.1	7.4	19.8	2.6	-2.9	2.0
2/2004 – 5/2004	4.0 – 4.7	-1.7	-1.4	-8.9	-1.6	-2.3	3.0
8/2005 – 6/2006	4.0 – 5.2	5.7	19.8	25.5	2.7	-1.2	5.1
12/2008 – 5/2009	2.3 – 3.5	3.0	8.6	37.9	25.3	1.3	6.6
9/2010 – 1/2011	2.5 – 3.4	13.4	9.1	4.4	5.1	-1.2	17.0
4/2013 – 8/2013	1.7 – 2.8	3.0	-2.2	-9.4	-2.0	-3.7	-2.4
6/2016 – 12/2016	1.5 – 2.5	7.8	5.7	4.5	7.5	-2.5	-1.3
	Average	5.6	6.5	13.3	5.5	-1.8	5.1

Source: DeMarche Associates, Inc.

- The U.S. dollar strengthened against other developed nation currencies in the 4th quarter. As a result, returns of international stocks and bonds were negative in dollar terms. The dollar's strength was in response to the Fed increasing interest rates and the prospect of renewed economic growth.
- The increase in interest rates in the 4th quarter provided a headwind for domestic bond returns. The Aggregate Index fell 3.0% for the quarter. Longer-term averages are in low single digits. Domestic bonds now carry a lower coupon rate, so interest rate moves will influence returns to a greater degree than in the past.
- Commodity prices continued to firm up over the past 12 months in response to better fundamental economic growth. Oil prices increased 45% for the year and gold improved 8.5%.
- Stocks rallied after the election in November, reaching all-time highs. The one-year performance of over 12% was the sixth double-digit performance of domestic stocks since 2008, far outpacing the 2015 performance of just over 1%.
- Interestingly, rising interest rates are not the death knell to global stock markets. According to the chart at the left, global stocks typically perform well when interest rates start to rise. Traditionally, rising rates signal strong economic growth. Expect U.S. equities and high yield bonds do well as growth is positive to a company's balance sheet. Of course, higher rates will make investment grade bonds suffer.

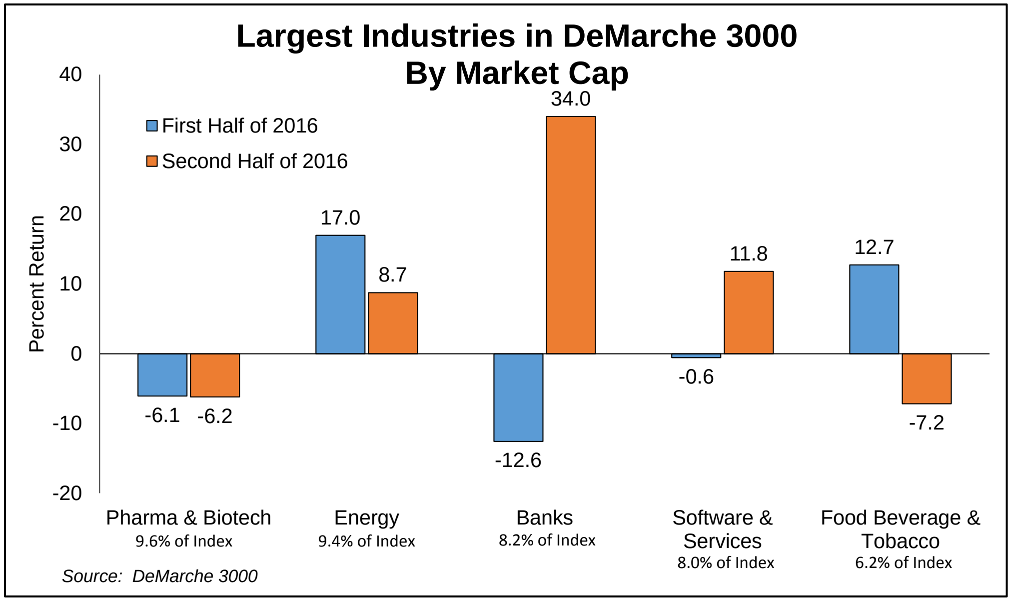
DeFact

The S&P 500 is on a roll. The index has returned eight straight positive years from 2009 through 2016. During the run, six of the eight years returns are above 12%, while laggards 2011 and 2015 returned 2.1% and 1.4%, respectively. Only the nine-year positive run of the index from 1991 to 1999 is longer.

~ Pension Partners, DeMarche Associates

DOMESTIC EQUITIES

INDEX	4th QTR.	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Growth	1.9	8.6	7.4	12.7	6.9
DeMarche Value	4.7	17.5	3.5	10.6	3.9
DeMarche Aggressive	4.3	13.3	0.2	12.3	3.6
DeMarche Defensive	3.0	12.1	6.3	11.5	5.6
DeMarche Large Cap	2.4	10.4	5.6	11.2	4.9
Large Cap Growth	0.9	7.1	7.7	12.6	6.5
Large Cap Value	4.0	14.8	3.0	9.6	2.9
DeMarche Small Cap	10.6	28.2	5.5	14.8	6.6
Small Cap Growth	9.7	19.8	4.8	12.7	5.7
Small Cap Value	11.3	34.7	5.9	16.2	7.2
S&P 500	3.8	12.0	8.9	14.7	6.9
S&P Mid-Cap 400	7.4	20.7	9.0	15.3	9.2
S&P Small-Cap 600	11.1	26.6	9.5	16.6	9.0
Russell 1000	3.8	12.1	8.6	14.7	7.1
Russell 1000 Growth	1.0	7.1	8.6	14.5	8.3
Russell 1000 Value	6.7	17.3	8.6	14.8	5.7
Russell 2000	8.8	21.3	6.7	14.5	7.1
Russell 2000 Growth	3.6	11.3	5.1	13.7	7.8
Russell 2000 Value	14.1	31.7	8.3	15.1	6.3



- Small cap stocks far outpaced large cap stocks for the quarter and for the year, but still trail for the three-year period. A strong dollar hurts the overseas earnings power of large cap companies. Most large cap stocks derive a portion of earnings from international sales.
- Value stocks lead growth stocks by a wide margin in the quarter and one year. Energy and financial stocks, which have a large weighting in value indexes, caused the wide divergence in annual performance. Financials and energy small cap stocks returned over 31% and 35% for the year, respectively. Large cap energy stocks and financial stocks returned over 25% and over 19% for the year. Value stocks rallied strongly in the 4th quarter due to hopes of an improving economy.
- Growth stocks lagged value stocks in both the large and small cap spectrum. Health care, a large portion of the growth stock universe, struggled throughout the year. In large cap stocks, healthcare returned negative 2.8% for the year and in small cap stocks, returned 3.3% for the year.
- The chart at the left shows the large swing in stock sector leadership that occurred from the first half of the year versus the second half of the year. Financial stocks, which make up a large allocation in value indexes, were a grand slam. Healthcare, which is a large component in growth indexes, struggled all year.

DeFact

Bank of America stands out as the most interest-rate sensitive of the major banks due to its low-cost deposits and large holdings of mortgage-backed securities. Bank of America figures that a 1% rise in interest rates across the maturity spectrum will add $2.9 billion in pre-tax income in 2017. The stock is up 30% since the election and 41% since the end of the third quarter just as interest rates jumped.

~ Wall Street Journal

INTERNATIONAL EQUITIES

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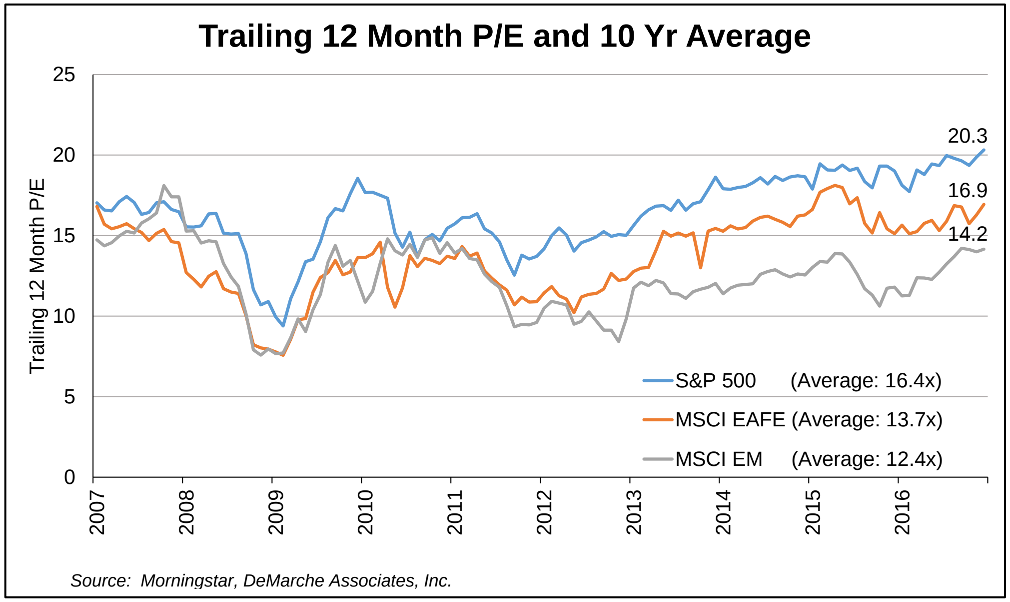
INDEX	4th QTR.	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Int'l	-0.1	2.2	0.4	7.4	1.9
Growth	-4.2	-3.4	-0.6	6.2	2.0
Value	4.2	7.9	-0.3	7.5	1.4
DeMarche Int'l Small Cap	1.6	6.0	2.9	10.3	3.0
DeMarche EM	-0.9	2.5	0.4	3.4	2.2
MSCI EAFE Local	7.1	5.3	5.5	11.8	2.2
MSCI EAFE USD	-0.7	1.0	-1.6	6.5	0.7
Growth	-5.5	-3.0	-1.2	6.7	1.6
Value	4.2	5.0	-2.1	6.3	-0.2
MSCI Japan	-0.2	2.4	2.5	8.2	0.5
MSCI AC Asia-ex Japan	-6.3	5.4	0.1	4.8	3.7
MSCI Germany	1.5	2.8	-3.3	9.2	2.4
MSCI France	2.9	4.9	-1.9	7.7	-0.2
MSCI U.K.	-0.9	-0.1	-4.4	4.0	0.3
MSCI EAFE Small Cap	-2.9	2.2	2.1	10.6	2.9
MSCI EM	-4.2	11.2	-2.6	1.3	1.8
MSCI All Country-ex U.S.	-1.3	4.5	-1.8	5.0	1.0



- The strong dollar noticeably affected returns of stock measured in local currency versus in U.S. dollar terms. The MSCI EAFE local currency index has outperformed U.S. dollar returns in the trailing periods shown. While the weak local currency has helped the earnings growth of foreign companies, the resulting performance was not enough to offset U.S. dollar strength.
- The direction of commodity prices typically influence emerging market stocks returns, as many of them are commodity exporters. The rebound in energy helped one-year returns for emerging market stocks, especially in Russia and in Brazil. However, the strong dollar rally in the 4th quarter negatively influenced returns. For example, Mexican stocks posted below a negative 9% return in U.S. dollar terms.
- Asian stocks struggled in the 4th quarter after posting strong results in the 3rd quarter. While some Asian stocks did well, such as South Korea, stocks of China and India fell over 8% for the quarter due to economic growth concerns and weak currencies.
- The continued push upward of the S&P 500 since 2009 has brought its P/E ratio four points above its ten-year average. While the P/E ratios of other indexes look overvalued compared to 10-year averages, international stocks appear comparatively undervalued and offer an opportunity to rebalance equity allocations.

DeFact

Brazil and Russia led emerging market stock markets in 2016, up over 64% and 54%, respectively. The firming of energy prices significantly bolstered their economies. Additionally, since the culmination of the U.S. election in November, the Russian market has been up over 17%. Broadly, EM markets were down in the 4th quarter, mainly due to U.S. dollar strength.

~ BlackRock

FIXED INCOME

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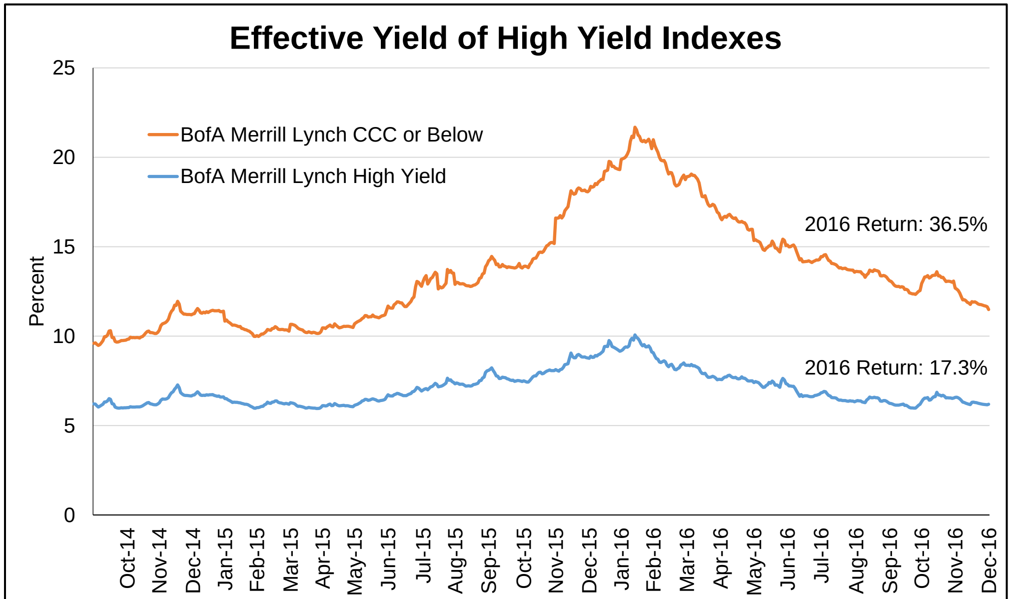
INDEX	4th QTR.	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Bond Index	-3.2	2.1	2.9	1.9	4.1
Quality					
AAA/Aaa	-3.7	1.3	2.5	1.2	3.7
BBB/Baa	-0.4	6.3	5.2	5.0	6.5
Duration					
1-5 Years	-1.0	1.3	1.3	1.2	3.1
5-10 Years	-3.7	2.6	3.5	2.3	5.1
10-20 Years	-8.1	4.1	7.3	3.6	5.9
Sector					
U.S. Treasuries	-3.8	1.3	2.5	1.2	3.8
U.S. Agencies	-1.5	1.0	1.9	1.4	3.2
Corporates	-0.9	5.5	4.7	4.7	6.1
BlmBarc U.S. TIPS	-2.4	4.7	2.3	0.9	4.4
BlmBarc Aggregate	-3.0	2.6	3.0	2.2	4.3
BlmBarc Gov Credit Long	-7.8	6.7	7.2	4.1	6.9
Merrill Lynch High Yield	1.9	17.3	4.7	7.3	7.3
CSFB Leveraged Loan	2.3	9.9	3.8	5.3	4.3
JPM Emerging Mkt Debt Global	-4.2	10.2	5.6	5.4	6.8



Source: St. Louis Federal Reserve

- Interest rates increased slightly in the quarter and over the year. The returns on longer duration bonds were the most negative due to the rise in rates. Returns for bonds are low across all time periods shown.
- Investment grade corporate bonds continue to perform the best within all bond sectors in the quarter, one-year and three-year time periods. Corporate bonds provide a yield pickup over government bonds and are not impacted as much by a strong rebound in the energy sector, as are high yield bonds. Even with the yield pickup, corporate bond returns were in the low single digits for the past three years and five years.
- Emerging market debt produced strong returns through much of 2016, outperforming most fixed income sectors as negative yields on developed market debt pushed investors into higher-yielding sectors. The rally in the U.S. dollar in the 4th quarter proved a headwind as a stronger dollar impairs the ability of emerging market countries to repay debt.
- High yield bonds posted positive returns during the quarter and year. Concerns about energy companies earlier in the year influenced returns. However, recent performance has more to do with better economic growth prospects. Interestingly energy companies now make up only 10% of the high yield index, down from a high of 15% in 2014.

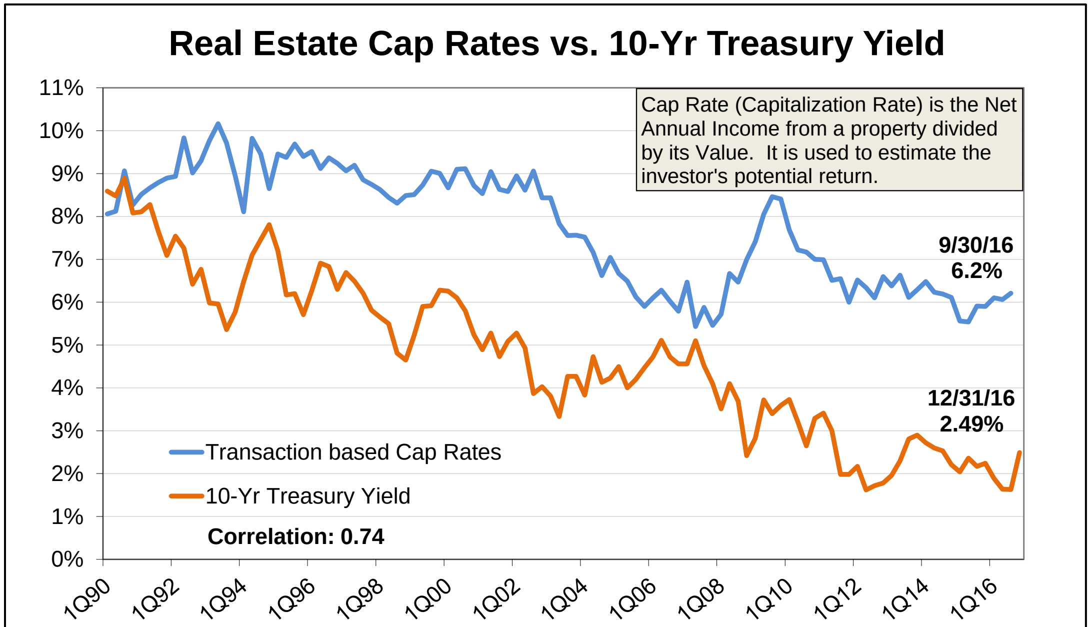
DeFact

The total amount of global debt securities with negative yields fell a little over $3 trillion in the 4th quarter. From the late September high of $13.3 trillion, the amount now stands at a little over $10 trillion. Japanese and German 10-year government bonds rose to slightly positive yields at the end of the year. Expectations are that negative yields will persist through 2017, despite some moderation.

~ Wall Street Journal

LESS LIQUID STRATEGIES

INDEX	4th QTR.	1-YEAR	3-YEAR	5-YEAR	10-YEAR
NCREIF Property (Private RE)	1.7	8.0	11.0	10.9	6.9
Apartment	1.7	7.3	9.9	10.2	6.6
Industrial	3.0	12.3	13.5	12.7	7.3
Office	1.4	6.2	10.0	9.9	6.3
Retail	1.7	9.0	12.5	12.4	8.3
NAREIT (Public RE)	-2.9	9.3	12.4	12.0	4.7
NCREIF Timberland	1.2	2.6	6.0	7.1	5.8
HFR FOF Composite	1.1	0.7	1.2	3.5	1.3
Conservative	2.0	2.3	1.9	3.5	1.3
Diversified	1.6	0.9	1.4	3.5	1.4
Strategic	0.2	-0.1	0.8	3.7	1.2
Bloomberg Commodities	2.7	11.8	-11.3	-9.0	-5.6



Source: NCREIF, Federal Reserve, Prudential

- Secondary offerings of private equity partnerships have attracted a good amount of capital as investors look to mitigate the private equity J-Curve effect. It appears likely that secondary private equity funds will total nearly $40 billion in 2016.
- Hedge funds posted another quarter of positive performance spurred on by market volatility since the election. Returns for one and three years are still very low. Across strategies, the environment favored niche strategies over broader, more diversified options. For example, distressed debt funds, which concentrated in energy-related bets benefitted from the rebound in commodity prices.
- Private Real Estate continues to post strong returns from 2009 recession. One year returns are slightly lower than 3 and 5 year returns but are more in line with longer term 10 year returns. Current returns consist more from income than from capital appreciation than the above average returns coming out of the recession.
- With the uptick in interest rates in the 4th quarter, real estate cap rates can be expected to trend upward. Higher trending interest rates tend to slow down real estate price appreciation but rental income can reset upward in inflationary times.

DeFact

Over the past three quarters, investors have withdrawn almost $25 billion from hedge funds. Although it is less than 1% of the roughly $3 trillion the funds manage, this has been the industry's longest stretch of redemptions since the the financial crisis.

~ Bloomberg

2017 DeMarche Workshop Series

Programs in Finance and Investment

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Defined Contribution – Shifting Sands – (Concluded)

January 24, 2016
Houston, TX | The Westin Galleria
7:30 a.m. – Noon

Discretionary Consulting Today: Delegating Institutional Investment Management

February 9, 2017
Washington, D.C. | The Westin City Center
7:30 a.m. – Noon

Managing Pension Risk Today

April 26, 2017
Dallas, TX | The Hotel Crescent Court
7:30 a.m. – Noon

The Evolution of Alternative Strategies

May 24, 2017
Kansas City, MO | The InterContinental
7:30 a.m. – Noon