Bernard Wealth Management

28411 Northwestern Hwy. Suite 200
Southfield, MI 48034
(248) 556-2900
www.bernard-wealth.com

Fourth Quarter 2016

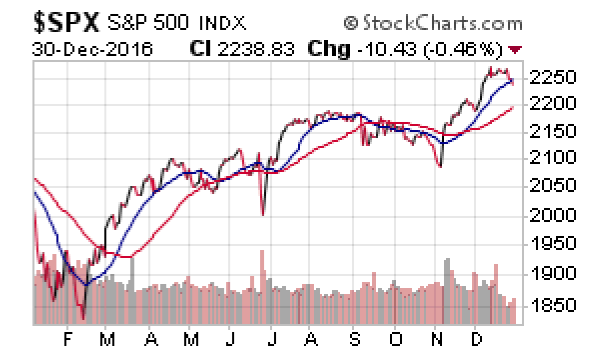

Fig. 1 – S&P 500

Fig. 2 – US Dollar Index

Stocks closed 2017 with a fourth quarter rally, following pre-election uncertainty. The large cap S&P 500 index (**Figure 1**) posted a total return of +3.8% in the quarter and finished the year up 12%. Small cap stocks continued their outperformance. The Russell 2000 rose 8.8%, ending 2016 +21.3%. Foreign markets bounced back after a weak second quarter. Overseas market performance was considerably weaker. The developed world outside the U.S., including Europe and Japan fell -0.7% in the quarter, finishing +1.0% for the year. Emerging markets also lost ground, falling -4.6% in the fourth quarter, but finishing 2016 +8.6%. Foreign stock performance was hit by the strengthening US dollar, which jumped following the presidential election (**Figure 2**).

In the third quarter, S&P 500 companies reported earnings growth, after five straight quarters of contraction. According to research firm Factset, earnings grew 3.1% vs. 2015, significantly better than the -2% that was expected before earnings were reported. The energy sector (-62.9%) continued to lag significantly. Earnings were generally better than expected, with 72% of companies beating analyst estimates. Modest earnings growth of approximately +3% is expected to continue in the fourth quarter and in 2017. Much of this growth may now be reflected in current stock prices, and investors may need to see acceleration in earnings to move markets higher.

The U.S. economy continued to grow in the second half of the year. Gross domestic product (GDP) rose +2.9% in the third quarter, and is expected to grow roughly 2% in the fourth quarter. Some spending activity did appear to slow in September and October, held down by election fears. The post-election rally reflected the receding of these fears, and economic readings since, in both the manufacturing and service sectors, have indicated solid growth, especially in new orders. New job creation has been steady, and layoffs have remained below historical averages. Housing data was mixed; home sales were weaker than anticipated as interest rates rose. However, construction spending was stronger than expected, and may provide a longer lasting boost to the economy. Market watchers will be looking for additional construction spending from new infrastructure projects, as promised by the incoming administration.

U.S. Treasury yields continued to rise, as markets moved from the fears of June's Brexit vote to the anticipation of stronger growth after the U.S. presidential election (**Figure 3**). The Federal Reserve did finally raise short-term lending

Index returns taken from Morningstar.com and MSCI.com

rates 0.25% in December, only the second increase since the Great Recession. Inflation in the U.S. is still below the Fed's stated target of 2%. However, strengthening economic indicators, including rising oil prices, may lead the Fed to increase rates more aggressively in 2017. This will likely hurt bond returns. Investments that offer a yield advantage over government bonds, including corporate and high yield debt, may provide the best fixed income returns.

Fig. 3 – U.S. 10 Year Treasury Yield

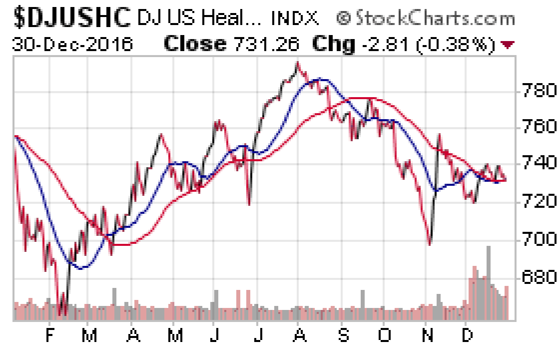

Fig. 4 – Dow Jones U.S. Health Care Index

The post-election rally was initially fueled by the lifting of uncertainty, but benefited strongly from promises made on the campaign trail by President-Elect Trump. These include tax reform and reduced corporate tax rates, less regulation, and increased infrastructure spending. If enacted effectively, such initiatives have the potential to boost the economy, and some sectors, including industrials and financials, will continue to benefit. Companies leveraged to consumer discretionary spending, including the housing and automotive industries, may also prosper, bolstered by ongoing strong employment trends and solid personal balance sheets.

The healthcare sector was a notable laggard in 2016, the only sector to lose ground (**Figure 4**). The sector has been hurt by the potential repeal of the Affordable Care Act, as well as the threat of controls on pharmaceutical prices. In the past this group has bounced back strongly from headline scares. Well-managed, profitable healthcare companies may provide solid future returns as the new administration's plans become clearer. International indices also fell in the fourth quarter. Potential tariffs, as well as a strong dollar policy, may continue to weigh on foreign stocks.

The post-election rally was a surprise to many; stock futures had predicted a sell-off if Trump was successful. We have previously stressed the difficulty of trying to time markets. Patient investors will generally be rewarded over time as headlines fade, businesses innovate, consumers spend, and the economy grows.

Much of the financial advisor industry has been worried this year by the Department of Labor's new Fiduciary Rule. Under the new rule, advisors will have to act as a fiduciary for retirement accounts, meaning that they will have to put their clients' interests ahead of their own. Brokers have traditionally been held to a lower suitability standard when selling products to their clients. As a Registered Investment Advisor (RIA), Bernard Wealth Management Corp. has always been a fiduciary – we have always put our clients' interests first. We encourage you to contact us anytime to learn more about the new rule, and why we believe you are well served by a fiduciary advisor for all your investments.

We wish you a Happy, Healthy and Prosperous New Year, and we look forward to talking with you soon.

Sincerely,

Kenneth M. Bernard, CFA