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Investors also pushed interest rates upwards in anticipation of higher growth and inflation. The 10-year U.S. Treasury yielded 2.4% at year-end, notably higher than its mid-year low of 1.4%. The rise in interest rates provided the Federal Reserve (Fed) a window to reassert its normalization strategy and it took advantage, raising its key policy rate a quarter percent and indicating its intentions to hike rates three more times in 2017. All of this led to post-election dollar strength—up 5% vs. the euro and 11% vs. the yen. The strong dollar moderated robust post-election rallies in other developed markets. Japanese equities gained 12% in local currency but only 1% in dollar terms; Europe’s 8% gain was reduced to 3% after translation. The election was less kind to emerging market equities, as fears of trade wars given Trump’s campaign rhetoric resulted in a -4% post-election return.

### Post Election Data

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### FOURTH QUARTER AND YEAR-TO-DATE TOTAL RETURNS

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<td>-4.1</td>
<td>5.3</td>
<td>-5.8</td>
<td>-4.1</td>
</tr>
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Source: Northern Trust Investment Strategy, Bloomberg. Indexes are gross of fees and disclosed on last page.
Key Developments

Investors Have Grand Expectations

The Republican sweep set off a late-year rally in U.S. equities. Investors hate uncertainty but they also embrace change. And, post-election, investors focused on potential changes to the tax code and regulatory policies. There is some precedent for the recent market reaction (see chart). Japan’s Prime Minister Shinzo Abe’s 2012 “three arrow” platform (monetary policy easing, fiscal stimulus and structural reform) pushed Japanese equities up nearly 50% in the year after his election. India’s Prime Minister Narendra Modi focused his 2014 campaign on stamping out corruption and rolling back regulations; Indian stock markets gained more than 20% over the following year.

Small Companies Think Big

Anecdotes of new-found economic optimism are starting to surface: whether it be Company A planning new capital expenditures, encouraged by the promise of a lower tax burden; or Company B shelving a decision to sell the business, expecting regulation rollback to increase its value. These anecdotes are captured in confidence surveys—both business and consumer—which have moved higher. Particularly encouraged are small business owners (see chart), who stand to benefit most from Republican initiatives on tax reform and regulatory rollback. Related, small cap stocks returned 14% post-election, outpacing large cap stocks by nearly 9% over this timeframe.

Financial Market Review

Interest Rates

The yield curve shifted higher and twisted steeper during the fourth quarter; the 2-year Treasury moved ~0.5% higher (to 1.2%) while the 10-year move upwards was closer to 1.0% (to 2.4%). Driving the yield curve action was the combination of a better economic outlook and expectations for more Fed action in 2017. Rising inflation expectations, settling at 2.0%, accounted for less than half of the rise in the 10-year yield. This implies interest rates went up for the “right” reasons—a better growth outlook, as opposed to concerns over excessive inflation. Municipal yields moved mostly in concert with Treasury yields over the full quarter, but experienced greater volatility around the election.
Populist Politics Continue

After the U.S. election, the populist politics world tour moved back to Europe. The last stop of 2016 was in Italy, where Italian Prime Minister Matteo Renzi resigned after his attempt at constitutional reform failed, putting Italy back in the hands of a caretaker government. Italian (and global) markets experienced little disruption; as the verdict was expected (Italian yields had already moved up ahead of the vote, see chart) and Italy has a great deal of experience with government transition (with five Prime Ministers since 2008). In 2017, there will be potential populist politics tour stops in the Netherlands (March 15, general elections) and France (May 7, presidential election runoff vote).

Fed Gets the Green Light

The Fed’s quarter-point rate hike (to a range of 0.50-0.75%) was the first increase in the Fed’s key policy rate in a year. But investors believe the next rate hike will come more quickly and are now expecting the Fed funds rate to be a full 1% higher by mid-2019 than they did previously (see chart). Equity markets have taken this higher interest rate trajectory in stride for two primary reasons: 1) the Fed is getting to raise rates (due to better growth expectations); not having to raise rates (due to runaway inflation); and 2) the assumed trajectory is still very shallow (implying one rate hike every six months). Inflationary pressures could challenge the market’s fairly constructive rate outlook.

Credit Markets

Slight investment grade credit spread tightening was unable to offset the unexpected move higher in interest rates, resulting in a -3.0% fourth quarter return for investment grade debt. However, earlier-year strength was able to offset fourth quarter weakness, leaving investment grade bonds with a 2.6% return in 2016. High yield debt fared much better with a 1.8% fourth quarter gain and a 17.1% return for the full year. The inverse relationship between high yield credit spreads and interest rates left the overall yield on high yield bonds mostly unchanged in the quarter. This left prices mostly steady, exemplifying the way in which high yield responds less to interest rates and more to equity markets.
Equities

Global equity markets rose 1.3% in the fourth quarter, driven by the election-based rally in U.S. equities. Down 3.8% for the quarter four days prior to the election, U.S. stocks gained 7.6% through year-end. This upward march was first driven by increased confidence in a Clinton victory; then, paradoxically, by the perceived benefits of the Republican sweep. Developed market stocks outside the U.S. also gained in local terms but saw those gains wiped out by the strong dollar. Meanwhile, emerging market equity returns were negative in both local currency and dollar terms. Full year returns for U.S., developed ex-U.S. and emerging market equities were 11.6%, 3.3% and 11.6%, respectively.

Real Assets

Our suite of real assets—global real estate, global listed infrastructure, and natural resources—had all pushed upward together through the first nine months of 2016. But the fourth quarter presented a fork in the road. Natural resources continued its gains as the Republican pro-growth agenda and the announcement of OPEC/Russia production cuts pushed commodity prices higher. A 5.3% return in the fourth quarter resulted in a 31.6% full year return. Real estate and infrastructure, however, reversed course as higher interest rates took their toll on these interest rate sensitive asset classes. Quarterly returns of -5.8% and -4.1% resulted in full year returns of 4.6% and 12.4%, respectively.
From the Managing Director

As we look ahead to the promise of a new year, we reflect and look back on a year filled with historic highs and lows. Together, we have certainly celebrated some exciting changes and achievements during 2016.

A New Name, A New Look
Our new name—Enterprise Wealth Management—reflects our understanding that wealth management is more than investing; it is planning, growing and protecting your whole financial health, now and in the future. In 2016, we were pleased to launch a fresh new website, energized with valuable content and resources. It is backed by a technology team continually working behind the scenes to provide you with the most efficient, secure, and productive customer experience.

If you haven’t had the opportunity to see the new site, be sure to visit www.EnterpriseWealth.com.

Enhanced Value for You
In a constantly changing national and global environment, we must be flexible and nimble, anticipating your needs through constant outreach and proactive conversations. To that end, we enhanced our Enterprise Wealth Management team, adding a new client associate to support our relationship managers and their focus on outreach to clients.

The Election and You
We stepped up our game at our annual Investment Forum, our client-centered speaker series addressing significant topics relevant to you. On the heels of one of the most polarizing elections in U.S. history, renowned political analyst Mark Shields—half of the political analysis team on the award-winning PBS “NewsHour” and a moderator of CNN’s weekly political discussion show, “Capital Gang” — cut through the politics to dissect how the election could impact Americans and our economy in the years to come.

Our Enterprise Wealth Management team has closely monitored the pre and post-election markets and what they mean for our individual clients. Because we lead, not follow, we continue to adhere to a disciplined and strategic approach to protecting our clients through a sound diversification investment philosophy, to help you reach your long-range financial goals and minimize your risk.

Delivering What We Promise
Thank you for putting your trust in Enterprise Wealth Management. We know what you expect of us and we work hard every day to deliver. We wish you all the best for 2017 and look forward to our conversations throughout the year.

Sincerely yours,

Rosalin Acosta
Senior Vice President, Managing Director

At Enterprise Wealth Management, our mission is to help clients achieve their financial goals by providing professional money management, extensive resources, and independent, objective advice that you can trust. Enterprise Wealth Management was established in 1992 and manages $650 million in client assets. Our clients are successful executives, professionals, entrepreneurs, non-profit organizations, private foundations, and retirees who desire a financial partnership that can provide access to investment opportunities and alternative strategies.

EnterpriseWealth.com

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