# Investment Briefing

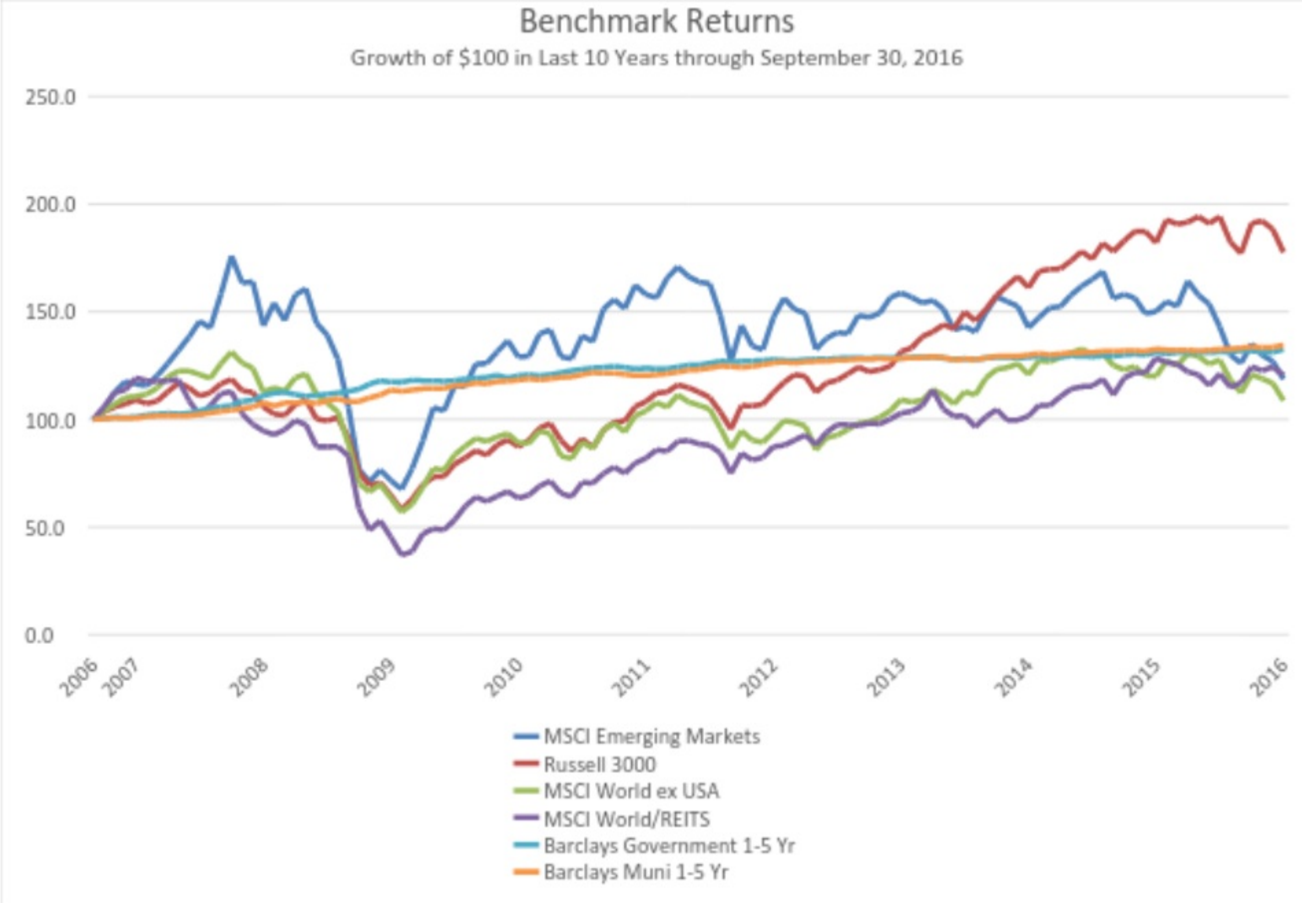
Third Quarter 2016

# Introduction

International stocks were the place to be last quarter, with both developed and emerging stocks doing well.

Generally, markets quickly recovered from the Brexit vote at the end of June and kept going. Bonds and the stocks of real estate companies were just slightly negative as interest rates increased. Looking longer-term, U.S. stocks still hold the prize for the best returns, while international developed markets are the laggards.

| Asset Class[1] | 3rd Quarter | Year to Date | 5 Years (annualized) | 10 Years (annualized) |
|---|---|---|---|---|
| U.S. Stocks (Russell 3000) | 4.40% | 8.18% | 16.36% | 7.37% |
| International Developed (MSCI World ex U.S.) | 6.29% | 3.12% | 6.89% | 1.88% |
| Emerging Markets (MSCI EM) | 9.03% | 16.02% | -3.03% | 3.95% |
| Real Estate Investment Trusts (MSCI World REITs) | -1.01% | 10.55% | 12.89% | 3.23% |
| Taxable Bonds (Barclays 1-5 Yr Gov) | -0.17% | 2.18% | 1.11% | 2.97% |
| Municipal Bonds (Barclays Muni 1-5 Yr) | -0.16% | 1.38% | 1.67% | 3.07% |

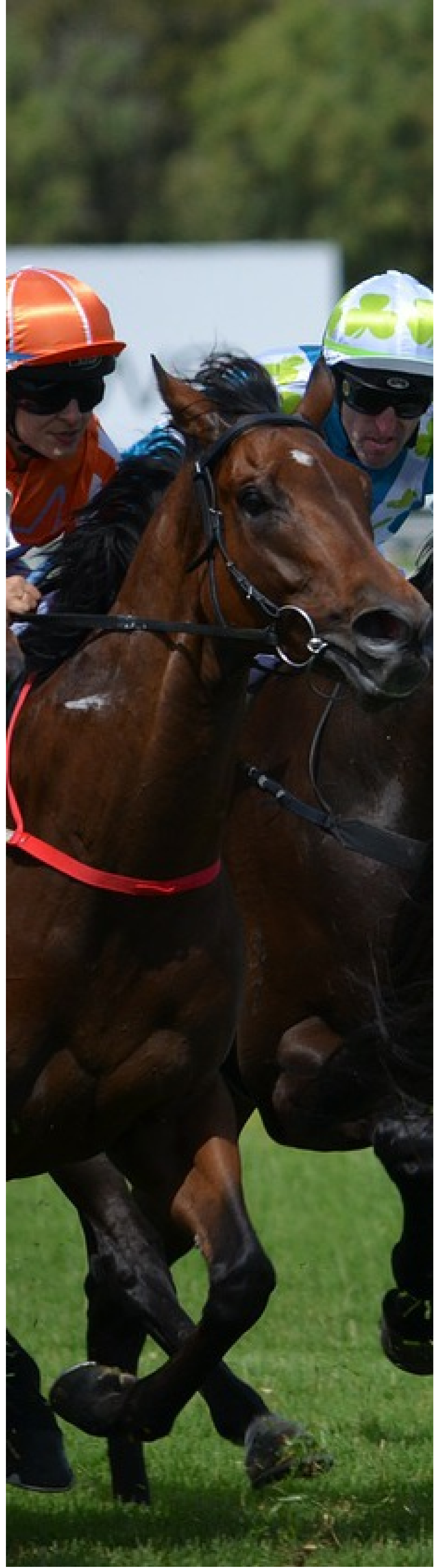



References

1. Return data and charts are from Morningstar Direct.

# U.S. Stocks: A Strong Third Place

When we look at the three broad geographical markets: U.S., International Developed and Emerging, the U.S. had a very nice quarter turning in a 4.4% return.



However, our market only got the third-place consolation prize for performance because international markets far outpaced ours. More about international markets below.

When we look at the news in the U.S. over the last three months, it was mostly dominated by the elections along with a few stirrings from the Federal Reserve. The stock market's climb points to the fact that it's less focused on current events and more interested in future earnings, etc.

The U.S. market was led by the stocks of small companies, which returned approximately 9%. That put small caps' performance strongly in the lead for both year-to-date (at over 15%) and over the last 12 months (at over 18%). Small caps had been lagging large caps, so it was nice to see them regain solid upward momentum.

As regular readers know, attempting to time markets is a fool's game because markets are too efficient and unpredictable to reward timers consistently. There are, however, movements that typically signal relative positives or negatives (we have to be careful with signals as well, because they can quickly reverse). The rise of small cap stocks is considered by many to be a positive signal.

Small caps generally lead after the market has been either down or flat for an extended time, which ours has been. The reasoning is that small companies are able to steer their businesses more quickly when economies improve. They also tend to do well when interest rates are rising, because small companies are typically less dependent on borrowing than large companies. In other words, the recent extended rise in the prices of small company stocks may be a good signal for the wider market going forward, despite the seemingly perpetual worries about trade, politics, monetary policy, etc.

# International Stocks: The Place to Be in Q3

International markets continued their upward momentum from their rebound after the Brexit vote. They quickly recovered, and kept on going to become the star performers in Q3.

As our table on the previous page shows, Emerging Markets returned over 9% and International Developed stocks returned over 6% for the quarter. We've been saying for some time that international markets were comparative bargains, and they finally showed us that they're still alive.

European stocks did especially well, with Austria, Germany and Spain tuning in growth of about 10% or more for the quarter. As well as being bargains, some of this growth could have been due to investors expecting the European Union (EU) to be a little more lenient and in touch with its constituents after the Brexit vote. Supporting this thought was the fact that both Spain and Portugal received additional time from the EU to work out their budget deficits.

Emerging markets, even after this quarter's uptick, are still relative bargains. As we mentioned last quarter, many emerging countries have been working hard to improve their situations, and their stock markets rewarded those efforts handsomely in Q3. A few news items that support this:

- Brazil’s senate decided to remove President Dilma Rousseff from office.
- India passed its most sweeping tax reforms since becoming independent in 1947.
- South Korea passed new anti-corruption legislation prohibiting lavish entertainment for public officials.

Of course, they’re called “emerging” markets for a reason, as evidenced by the fact that Turkey’s President Erdogan issued a decree allowing his government to issue direct military orders after the recent coup attempt there. Political instability takes on real meaning in emerging countries.

# Bonds: Interest Rates Up, Bond Prices Down (Slightly)

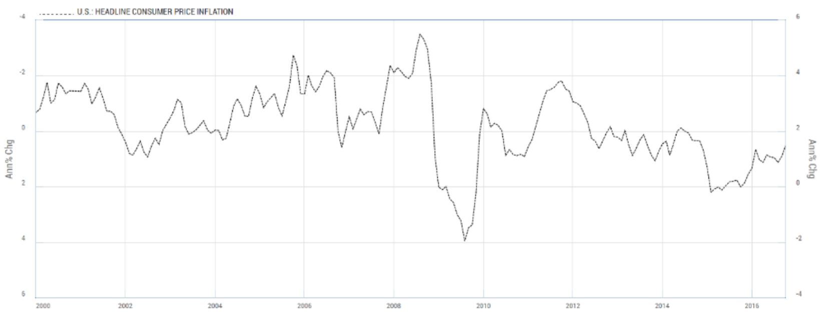
Across most bond sectors, interest rates were slightly up, but still remained near historic lows. As our opening table shows, bond markets were mostly flat for the quarter.

As they have for years now, the Federal Reserve brought up the topic of raising interest rates. The Fed Chair, Janet Yellen, stated that interest rate hikes are on the way if the solid job activity in Q3 continues. Markets now seem to have priced in an increase in December (well after the elections).

What we did see this quarter was an increase in consumer prices (inflation) in the U.S.; with a 1.1% growth rate in August versus one year ago. Higher inflation would most likely mean a hit to bond prices along with a negative impact on certain types of stocks. Bonds are typically issued to pay fixed rates of interest each year and, if prices begin to rise, the interest that bonds pay will be worth less in the future. Dividend paying stocks are affected similarly (except dividends can be increased by management).

As the chart below shows, inflation has been doggedly low since the financial crisis. September's uptick did indicate a fairly large uptick, although the rate remains low. We should keep in mind, however, that even a low rate has a compounding effect that can damage our financial plans over long time periods.

### U.S. Inflation Since 2000




Source: BCA Research

Your team at Vista keeps a close eye on domestic and international inflation rates, and our bond portfolios include some holdings that will react positively to increases in inflation. We also model your financial plans using a variety of long-term inflation rates to ensure that your plan works in different inflation environments.

# Thanks

We hope this briefing brings a little more light to the numbers you see in your reports. As always, we look forward to any questions you may have. Thank you for your trust in Vista.

## Your Vista Wealth Management Team

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