

2016 Third Quarter Review

October 2016

Autumn is upon us. Whether you delight in colorful fall foliage, adorable goblins demanding sweets, or gathering your loved ones for the annual feast, this season offers something for everyone. The markets had something for everyone in the third quarter, too, as almost all segments produced positive returns. Like star quarterbacks, a few indexes turned in stellar performances.

2017: Right Around the Corner

This fall all eyes are on the election coming in November. The current round of campaigning is by turns amusing, dizzying, frightening, and wearisome—unlike any we have seen before. Predictions and analyses of the relationship between market performance and presidential elections cover the board; choose your favorite hypothesis and someone's research supports it.

So while it may be too soon to predict who will play in the Rose Bowl or occupy the Oval Office, we are confident that winter follows fall. Before we know it, we will be celebrating our winter holidays and welcoming 2017. Now is a great time for you to be looking ahead to your board and committee needs for 2017, and we can assist you with many tasks:

- If you are welcoming new members in January, we can help you prepare materials to bring them up-to-date on board and committee activities.
- If your initiatives for the coming year include significant expenditures, we will prepare an analysis and provide our recommendations for funding your new projects.
- We also advise you to review your investment policy statement, along with policies and procedures, bylaws, and other relevant documents to make sure they are up-to-date.

We offer help to our institutional clients in all these areas through our Fiduciary Edge™ program, which is available to you at no additional charge. If your colleagues in other organizations might benefit from our help, we are always happy to discuss their needs with them.

Invite your colleague to contact Matt Balaker at 800.545.4442, extension 231, or mbalaker@towneley.com. Or you may contact Matt with your colleague's name and phone number.

Speaking of the coming year and our Fiduciary Edge™ program, we plan to add more services in 2017. Stay tuned.

On Institutional Immortality

Investment advisors who serve institutional clients need special expertise, like significant knowledge of fiduciary obligations and the special requirements for donation-funded nonprofits. One of the most important characteristics of institutional clients, though, is that most organizations hope to live “forever,” or indefinitely. Here at Towneley, we have managed investments for institutional clients since we opened our doors in 1971. In those decades, we have burnished our credentials as advisors to institutions. Thank you for entrusting us with your institution's immortality.

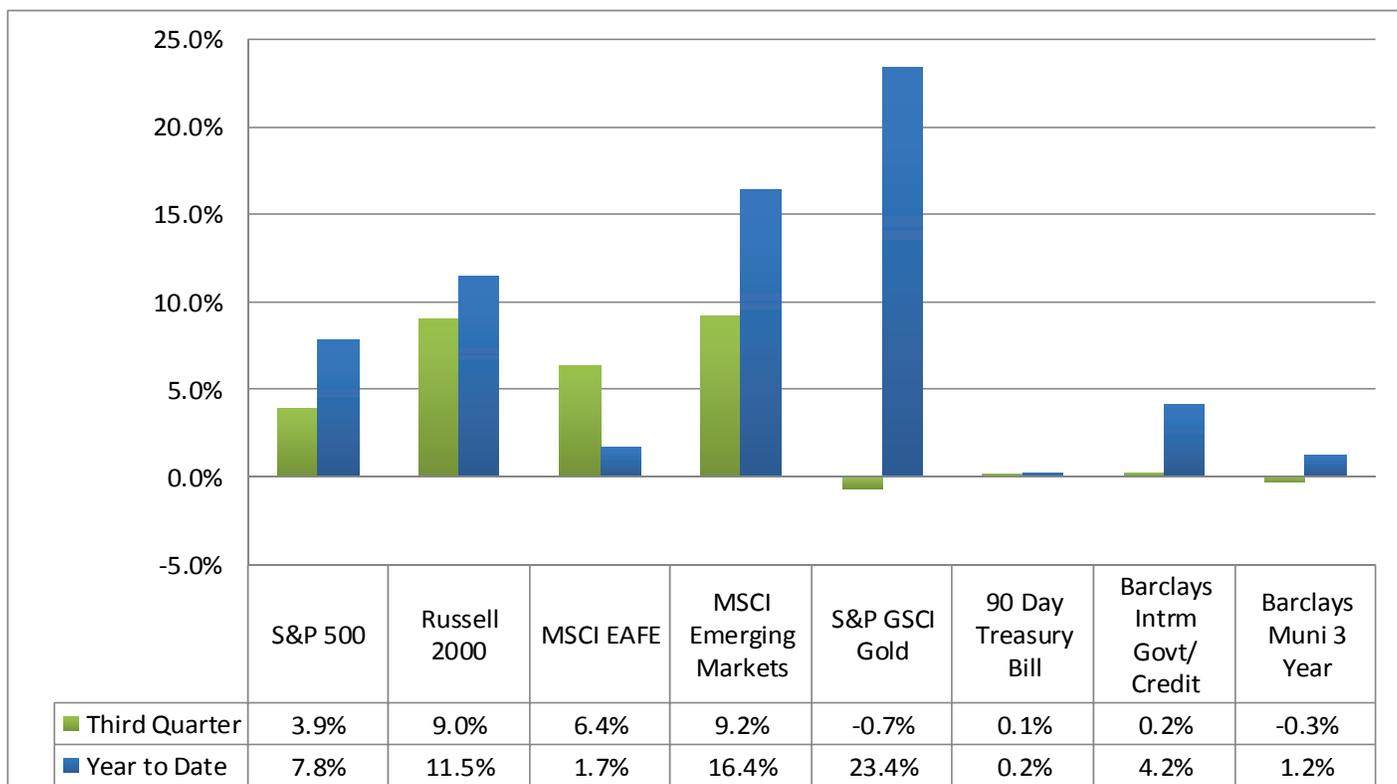
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Your Portfolio

The third quarter brought less volatility than we saw in the previous quarter and most segments posted positive returns. Our second-quarter changes in fixed income allocations helped to boost client portfolio fixed income returns above the indexes in the third quarter. Our international equity allocation includes a slightly higher position in emerging markets than do the indexes, another plus for client portfolios in the third quarter, as returns in that segment came in ahead of the benchmarks. If election results do not spook the markets, we could be in a good position to end the year quite nicely, but that "if" is a big one. In any event, your portfolio is positioned to weather whatever lies ahead as 2016 draws to a close.

Market Returns: Third Quarter and Year To Date



Thoughts From Towneley

GDP growth is slow to moderate, and declining corporate profits are moving the price-to-earnings ratio to higher levels. These valuations may reflect unrealistically high expectations. The market has been up since February, but big returns are not expected over the next five years. We do not see market forces developing that will generate big equity returns and fixed income returns will be low, due to low yields. Most of the Fed's economy-stimulating weaponry has already fired. We are prepared, and more importantly, your portfolios are prepared, for a period of relatively modest returns. The bulls may be getting tired after eight years on the run.

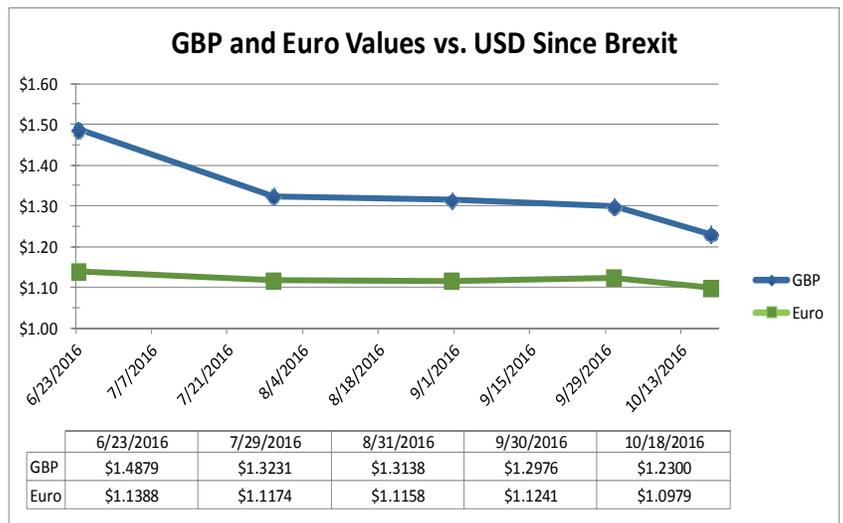
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Economic Roundup

The USA Growth has been slow to moderate but is expected to pick up in the fourth quarter, and higher valuations show us the market has been betting on healthier GDP and profit figures as the year draws to a close. Labor force participation rates are increasing after a period of decrease and wages are growing. In short, the economy is chugging along. The Fed is more likely to raise interest rates in December, once the election is over. Growth and small-cap stocks were the leaders in the third quarter, though value leads for the year to date.

The UK and EU The Brexit decision is hitting the UK harder than it is the EU. While the pound (GBP) has lost over 17% against the dollar since the vote last June 23, the euro has declined 3.6% over that same period. As a result, many pound-denominated investment returns will be lower when converted into US dollars. Exports to the UK will cost more and imports from the UK will be cheaper, but the volume isn't enough to move the inflation needle yet. More important will be the impact on US trade negotiations with the UK and the EU.



The European Central Bank is buying more corporate bonds, reducing the supply to other investors. This action is driving some bond buyers to US securities, so foreign demand for US bonds has increased over the last year.

Currently, more money is moving into riskier assets like high-yield bonds (up 5.6% in the third quarter). This shift could indicate increasing confidence in the economy, but safer choices have been snapped up due to QE and the ECB's efforts to stimulate the economy.

Asia The Bank of Japan (BOJ) announced monetary policies meant to battle deflation. The interest rate is currently set at -0.1 percent. The BOJ has vowed to maintain interest rates between -0.1 and 0.0 and is buying and selling bonds to maintain that rate while expanding the money supply. China managed to continue steady growth during the third quarter. Most Latin American economies remain in recession, but economists are hopeful that modest growth may return in 2017.

Emerging Markets Emerging markets were big winners last quarter. Oil prices have made significant gains since February's trough. Although they dipped a bit in the third quarter, the overall gains are helping to boost 2016 year-to-date returns for resource-rich countries. Low interest rates help, too. Stock prices are rising as a result.