GLOBAL EXCHANGE TRADED FUND STRATEGIES

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Fourth Quarter 2016 Performance Review

Global Balanced Strategy

Our global balanced strategy, which allocates among bonds, stocks, and commodities around the world, declined 3.2% last quarter, lowering the 2016 return to 5%.

Global financial markets finished the year 2016 with positive results. Market sentiment made a drastic turn that buoyed financial assets after Trump's surprise victory. The Dow Jones Industrial Index was at the gate of the 20,000 mark, US 10-year bond yields jumped 100 basis points to over 2.5%, and the US dollar rallied strongly against major currencies around the world.

US equities, as represented by the S&P 500 Index, added another 3.8% to the fourth quarter's return, boosting the annual gain to 12.0%. The MSCI World Index rose 1% for the quarter, raising the annual return to 7.9%. Outside the US, most overseas equity markets retreated in the fourth quarter: developed markets dipped around 1%, and emerging market equities gave up 4.1%. Weaker quarterly results lowered 2016 gains to 1.0% for international equities and 11.6% for emerging market equities.

For bond markets, a higher US growth prospect was a mixed blessing. Soaring US bond yields signal a possible ending of that 30-year bond bull market, which began in 1982. The yield surge shocked global bond investors and government bond markets around the world tumbled. US Treasuries declined 4% and international sovereign bonds plunged 9% in the last three months of 2016. This negative performance resulted in global bonds recording a 4.4% quarterly loss, which lowered the annual gain to 2%. High-flying emerging market bonds also didn't escape the fall; emerging market USD bonds dropped 3% for the quarter, and emerging market local bonds plummeted 9% for the same period.

The dollar rally caused deeper losses in foreign debt securities. The Dollar Index, measuring the dollar's trade-weighted value, rallied to a 14-year high, gaining 7% in three months. Major currencies suffered steep declines against the US dollar; the Japanese yen plummeted 15%, and the British pound fell 5%. The pound, after the Brexit referendum, appears to be falling off a cliff, with the latest plunge sending the GBP/USD rate to the lowest level in 40 years.

The surprise of the dollar move also triggered a massive sell-off in precious metal markets. Gold, a form of hard currency, tumbled to $1,150 per ounce at the year's end, lowering the 2016 gain to 7.7%. Despite the metals' recent setback, raw materials experienced a year of turnaround; the Thomson Reuters/Jefferies CRB Index trended up as growth prospects brightened. The Index rose 3% during the fourth quarter, increasing the 2016 return to 9.6%. The best performer was crude oil, which climbed to over $50 per barrel in mid-2016 and maintained a robust price throughout the remainder of the year.

Strengthened commodity prices also lifted inflation expectations around the world. Inflation indicators are trending upward. The US inflation break-even rate is at 2%, the highest level in two years. German CPI increased to 1.7%, the highest in 16 years. The Citi Eurozone Inflation Surprise Index rose to a 5-year high, another indicator of an early ending to Europe's deflation threat. Bond yields, traditionally, price in the inflation rate. The current bond yields may have already priced in increased inflation.

At the quarter's end, our strategy's equity portion returned 1.2% for the quarter, increasing the yearly return to 8.8%, and the bond portion declined 5.7%, bringing the return to 2.2% for the year. The equity and commodities portion accounted for 55% of the strategy's assets, and bonds accounted for the remaining 45%. Specifically, 25% of strategy assets were invested in US equities, 22% in foreign equities, 24% in US bonds, 21% in foreign bonds and 8% in commodities.