A common theme has been present throughout our past several quarterly economic reviews, mainly: much noise, little action. Well, the noise is over. To discuss the past quarter, or the past year, for that matter, without mentioning the 2016 presidential election, might seem either an enormous oversight, or an incredible redundancy, depending on how you look at it. While the year as a whole, was marked by the run-up to the election, its pitched partisan battles, mudslinging and general hoopla, the events since November 8th have been more about digestion, assimilation and speculation. Undoubtedly, we'll be heading in to 2017 in uncharted territory, with change almost a certainty, but little visibility (at least so far) as to the precise direction that change will take.

Amid the frenzy and noise however, we do have some tangible information to work with. First, the domestic employment situation has continued to show remarkable resiliency, with November's unemployment rate dropping to 4.6%, perhaps illustrating employers' optimism in the economy, but also furthering pressure on wage inflation. Second, in anticipation of higher growth and inflation, interest rates on the long end of the curve have risen fairly dramatically, with the 10 year Treasury yielding 2.45%, up from 1.60% at the end of last quarter. The market's view of increased growth/inflationary pressure was further confirmed by the Fed's December decision to increase short-term rates by 25 basis points, their first such move of the year. In addition, the Fed voiced their intention to increase rates several times over the course of 2017; accordingly, the US Dollar is close to a 15 year high.

In translating this economic information to market performance, we've seen some key themes emerge. Throughout the year, and even more noticeably post-election, the run-up in the stock market has been marked by a distinct sector stratification, wherein some in-favor sectors remarkably outperformed others. The healthcare sector has been buffeted by political wrangling, most notably due to the expected repeal of the Affordable Care Act, as well as the discussion around regulation of drug prices. Similarly, tech stocks have underperformed on the thesis that a Trump presidency will have a de-globalization effect, limiting access to qualified talent. On the flipside, financials had a blockbuster quarter, trading up on the prospect of less regulation and higher interest rates. Also helped by the prospect of a de-regulatory environment, as well as proposed increased infrastructure spending, industrials, materials and energy all had strong fourth quarters.

It is not yet clear whether the general assumptions that investors seem to be trading on, principally, increased fiscal spending, less regulation and tax cuts, will translate to meaningful economic growth. Fiscal spending could certainly provide an economic boost, but with the debt/GDP ratio already at historic levels and interest rates rising, paying for said spending could be a sticky wicket, so to speak. Coupled with President-elect Trump's proposed tax cuts, the situation becomes even murkier. Both of these scenarios present a real possibility for increased inflationary pressure, which, in moderation is a positive for growth, but also needs to be handled carefully. Higher inflation and interest rates mean consumer and business credit becomes more expensive and limiting access to capital when growth is already muted can have a stifling economic effect. The inevitability of a stronger US Dollar presents challenges for US-based multinational corporations, and would certainly be a drag on earnings. This, in turn, could have a negative effect on the trade deficit and GDP.

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The heightened uncertainty and increased sector stratification experienced during 2016 had a disproportionate effect on our portfolio's holdings. Companies and sectors that had historically generated outsized returns for us underperformed the broader market this past year, for reasons both speculative and cyclical, but, in our view, not structural.

The healthcare sector broadly and the pharmaceutical sector more specifically (of which our holdings include CVS, Gilead, Amgen and the S&P Pharmaceuticals Index ETF), traded down mostly on news headlines, principally Hillary Clinton's promise to combat rising drug prices, Mylan's controversy surrounding their spike in EpiPen prices and Trump's plan to repeal the ACA. The knock-on effect to the sector as a whole certainly affected stock prices, but had little bearing on our individual holdings' positions in their industry, ability to execute on corporate strategies, or their growth trajectories, all of which are stable and positive. Despite the possible repeal of Obamacare, or the prospect for whatever will take its place, healthcare as an industry remains a central tenant of our investment strategy. We view the expectation of an aging demographic, rapid technological advances in drug development and healthcare delivery, and access to broader markets, as robust structural drivers of the sector in the future.

As evidence of the asymmetrical effect of investors' sector rotation bias over the past year, energy, which has been and remains one of our long-term, core holdings, was the best performing sector in the S&P in 2016. This comes on the heels of 2015, a year that was one of the worst ever for that sector and that brought forecasts of a prolonged oil slump, a glut in global supply and prices mired in the $20/barrel range. However, despite an ever strengthening US Dollar, prices have stabilized around $50/barrel and oil stocks outperformed for the year. We believe this illustrates the need to maintain a long-term view and avoid knee-jerk reactions in regard to short-term trends.

With the market near an all-time high and valuations similarly elevated, we view the need to be selective, patient and careful, as paramount. While we recognize the need to rebalance the portfolio slightly to reflect the changing market, sentiment and stratification, we are also aware of the pitfalls of being swept up by momentum, and therefore remain focused on the long-term. Our current holdings are selected for our conviction in each individual company's ability to execute its growth strategy, maintain prudent fiscal policies and return value to shareholders; these are the considerations for any potential investment and the criteria we use to evaluate them on an ongoing basis. Going forward, we hope that rising interest rates may finally present a chance to buy individual fixed income securities and rotate out of the bond mutual funds that have acted as place-holders for such an extended time. On the equity side, we may take the opportunity to rebalance in places, or add some new names to our current holdings; we prefer to adopt a wait-and-see approach with regards to policy and market visibility, before making any major structural adjustments to the portfolio.

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