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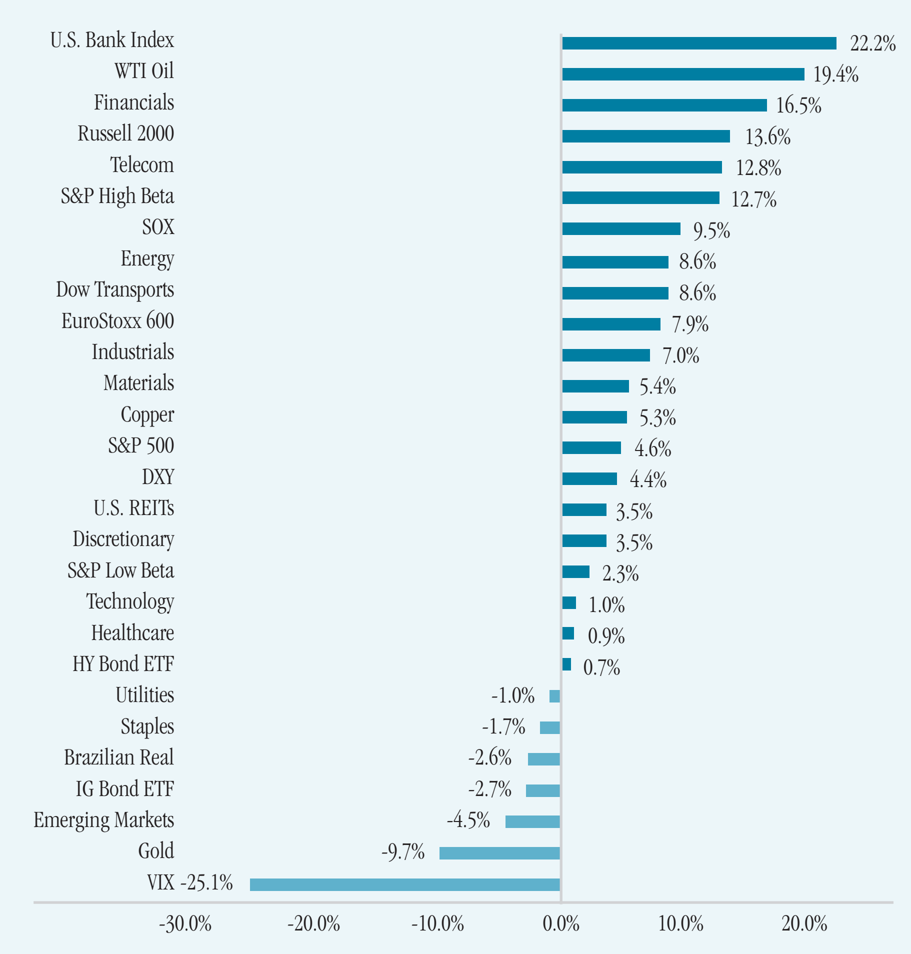
Spinnaker Trust 2016 Market Review & 2017 Outlook:
To quote the Washington Post addressing U.S. equity markets in 2016, "The year began with a panic and is closing with a party." After a very rocky start thanks to Chinese currency devaluation and the resulting spread of deflation, 2016 turned out to be a strong year for U.S. equity markets. The S&P 500 rose a remarkable 24% since its intra-year bottom in mid-February, with the index returning a respectable 12% for 2016. The Energy, Financials and Utilities sectors led the way. For the sixth year running, U.S. equity markets outperformed those of both the Emerging Markets (+11%) and Developed International Markets (1.6%). The U.S. bond market, as represented by the Barclays Aggregate Index, had a sub-par year relative to equities, returning 2.4% as yields rose sharply from October through the end of the year. While core bonds are likely over-sold at this juncture, we believe that the top in the bond market is in, and that the long-term trend for yields is higher.

The bull market which has roared since mid-2009 is now more than seven years old and has seen renewed energy by the election of Donald Trump and the resulting presumption of more business-friendly policies and fiscal stimulus. The revised U.S. GDP data for 2016 highlights that Mr. Trump inherits an economic recovery which may be long in the tooth but has been muted until recently. Historically, when Republicans have had complete control of the government, equity markets have benefitted.

Making Markets Great Again: It is an understatement to say that 2016 was the year of the politically unexpected. First came the surprise vote by Britons to leave the European Union, followed by Donald Trump's historic nomination and win. For global investors, it was the most eventful year since the financial crisis.

U.S. 10 Year Yield

Performance During 2016 Trump Tantrum
11/8/16 to 12/31/2016



Strategists and economists had, of course, predicted that Hillary Clinton would win the U.S. election and that we would see a continuation of Democratic policies. While it was known that her policies would not necessarily be business-friendly, the expectation was that we would be in a predictable political environment and that markets would hold-up. Strategists and economists assigned a very low probability to a Trump victory and declared that, if he should win, markets would tank. Why? Trump is a political unknown, and uncertainty is very bad for financial markets. Well, we could not have been more wrong. To borrow a quote from our research partner Strategas, "Consensus thinking is not always wrong, but when it is, it is often spectacularly so."

Uncertainty around how much Trump will be able to accomplish and when remains, but with one party controlling both houses of Congress as well as the Presidency for the first time since the Democrats took control in 2008, the days of gridlock may have finally ended in Washington. Investors believe that the prospects of pro-growth policy reforms under the Trump administration (deregulation, tax reform, and fiscal spending) should continue to push the market higher. Since the election, we have seen U.S. bank stocks rise by about 22%, oil prices by 19%, small-cap stocks by 13.6%, and the U.S. dollar by 4%. In contrast, we have seen the "safety" sectors like REITs, Utilities, and Consumer Staples fall. We have also seen Emerging Markets fall about 4.5% thanks to worries about a rapidly rising U.S. dollar.

The "melt-up" in equity prices since the election has been dubbed the "Trump Reflation" trade, but the fact is that these market factors were already in motion a month before the election. The economic surprise index had been rising, and consumer confidence had been improving. The election results simply accelerated what we believe was a turn in the market.

Impact of an Even Stronger U.S. Dollar: The Trump narrative of reform and fiscal spending growth should continue to make the U.S. dollar rise, which is generally a bad thing for U.S. earnings. The real broad trade-weighted dollar has appreciated by 21% since mid-2014, largely due to the widening of growth and interest rate differentials between the U.S. and other major economies. If we are indeed embarking on a proper Federal Reserve interest-rate hike cycle (with December 2015 having been a false start), the U.S. dollar will rise even further. The Fed is the only major central bank in rate hiking mode. If there is any geopolitical shock, the U.S. dollar will rise still more. There are derivative effects to a strong U.S. dollar that cannot be ignored. Namely, China is actively trying to depreciate its own currency after having been pegged to the U.S. dollar for decades. If China were to float its currency today and allow market effects to take over, the Yuan would arguably be 15% lower. This would be very bad for global markets and reminiscent of the environment that we saw in January 2016 and August 2015.

The Federal Reserve met in mid-December and chose to raise interest rates for the second time in a decade. We noted an incrementally hawkish (i.e. more likely to keep raising rates) tone from the FOMC. Yellen implied that the economy currently does not require fiscal stimulus given that full employment has been achieved. She seemed to shift her policy emphasis to boosting labor productivity. The Fed is projecting three interest rate hikes for 2017, which actually seems achievable for the first time in recent memory.

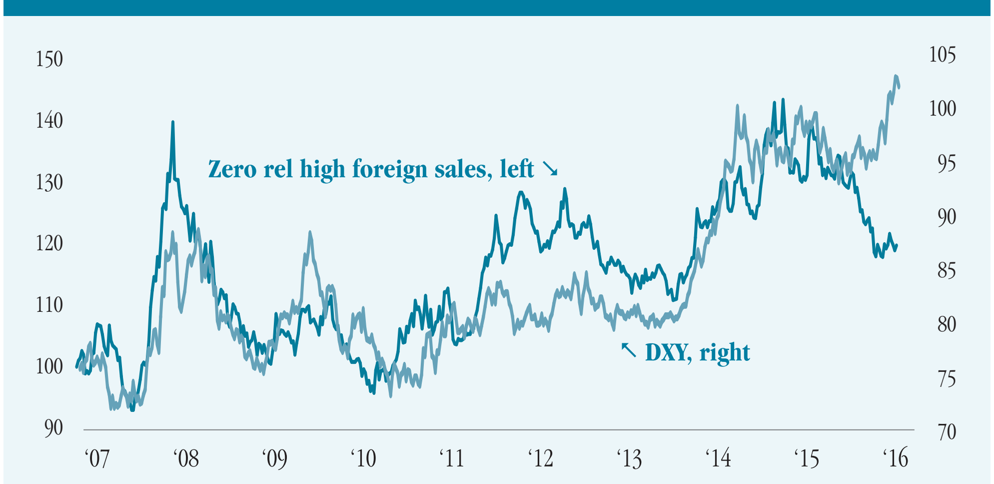
A more "normalized" rate cycle could serve to pressure valuation multiples, corporate profits and further strengthen the U.S. dollar. Historically, a 6% rise in the trade-weighted U.S. dollar has pressured U.S. large company earnings by -3%. Interestingly, the Fed did not seem to share the market's optimism about Trump's reforms, maintaining existing global GDP growth estimates. Only when other central banks embark upon their own interest rate cycles (which, frankly, seems years away) can the Fed hike rates in a sustainable manner due to the impact of an even stronger dollar.

On the positive side of the equation, a stronger U.S. dollar should help to redistribute growth back to the Eurozone and Japan, two economies that need something to go their way! A weakening Euro and Yen are both very positive for these cyclical markets. However, as U.S. dollar-based investors, local market returns can be dampened by the strength of our home currency. For the Emerging Markets, there are both costs and benefits to the recent environment. While a pick-up in global growth is unequivocally good for EM, a strong dollar has historically been quite negative.

Outlook for 2017: In some respects, our outlook for 2017 represents an extension of the same long-cycle that we envisioned for 2016 but with some new, important elements to consider. Concerns about low global growth and deflation are giving way to concern about inflation. Years of focus on global monetary policy are giving way to increased focus on fiscal policy. Concerns about new regulations are acceding to hopes for de-regulation. Lastly, populism is challenging globalism. From investors' point of view, there seems to be little short-term "cost" from populism despite conventional wisdom. The U.K.'s FTSE index rose 9.5% after Brexit while the U.S. market, of course, has also done well.

We expect that a recovery in global profits will carry the equity bull market through 2017, but we believe that analyst estimates of 12.3% earnings growth for the S&P 500 are far too aggressive. In fact, Trump's policies collectively need to add about $5 to 2017 earnings to justify the market at current levels. For context, S&P 500 earnings should be about $119 per share in 2016. Investors have been starved for a growth catalyst for years, and one has appeared. U.S. trade policy will determine the extent of the follow-through into European and Emerging Markets earnings. The big question for investors is whether the improvement in demand will compensate for the strong U.S. dollar and rising wage costs which could hurt elevated profit margins. The most important economic factors to watch are wage inflation and corporate capital expenditure.

S&P 500 Campanies With No Foreign Sales Rel Highest Foreign Sales & Dollar Index (DXY)



The risks of a notable market pull-back are clear and asymmetric: 1.) A sudden, sharp slow-down in China coming from the housing market, a devaluation of the Yuan or general turmoil in the domestic financial system. 2.) Disruption of global trade and investment flows thanks to the growing anti-globalism movement. These would likely emanate from the U.S. 3.) Growing forces of populism and disintegration in the Eurozone where the election schedule is quite full for 2017. 4.) Lastly, global political risks that are as elevated as they have been since World War II according to the esteemed Eurasia Group.

In a rich valuation environment (the S&P 500 is trading at 17xs 2017 earnings versus a long-term average of 15xs); these risks are significant but will likely be offset by accelerating global growth in the near-term. Rising bond yields have historically supported higher valuation multiples up to a certain point, and that point depends on underlying real economic growth. During periods where global GDP growth ranged from 2%-3% (the most likely outcome for this environment), valuation multiples were supported until 10-year U.S. treasury yields hit approximately 4%. The 10-year U.S. treasury yield stands at 2.5% today.

During one of the presidential campaign debates, Mr. Trump said that, "we are in a big, fat, ugly bubble." We are guessing that he would not say the same thing today. The market move since the election has been predicated on a uniformly bullish and positive view of Trump and Republican policies. It should be noted that these policies, no matter how effective or ineffective, are unlikely to have a financial impact on companies until 2018. For the next year or two, the likelihood of a disorderly rise in inflation is low. We believe that this new political era will simply accelerate an improvement in corporate earnings, stock market returns and, eventually, the end of this historically long market cycle.

MARKET DATA

Index		*2016*	*2015*	*2014*	*2013*
S&P 500	*U.S. Large-Capitalization Stocks*	11.95%	1.37%	13.68%	32.37%
S&P 400	*U.S. Mid-Cap Stocks*	20.73%	-2.18%	9.74%	33.46%
S&P 600	*U.S. Small-Cap Stocks*	26.46%	-2.01%	5.74%	41.31%
Russell 1000	*U.S. Large- and Mid-Cap*	12.04%	0.91%	13.24%	33.13%
Russell 1000 Growth	*Growth Stocks broken out*	7.07%	5.67%	13.05%	33.49%
Russell 1000 Value	*Value Stocks broken out*	17.33%	-3.84%	13.45%	32.56%
MSCI EAFE Index	*Established International Markets*	1.59%	-0.28%	-4.32%	23.44%
MSCI Emerging Markets	*Developing International Markets*	11.27%	-14.61%	-1.97%	-2.26%
		12/30/16	12/31/15	12/31/14	12/31/13
90 day T-Bill	*Short-Term Interest Rate*	0.51%	0.17%	0.02%	0.06%
10 Year US Treasury Rate	*Longer-Term Interest Rate*	2.45%	2.28%	2.17%	3.01%
VIX Index	*Risk Measurement*	14.0	18.2	18.1	13.7
Corporate Bond Spread	*Risk Measurement*	120bps	165 bps	131 bps	105 bps
TIPS Spread	*Inflation expectations*	197bps	171 bps	170 bps	257 bps

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