Dear Clients & Friends of Patriot Investment Management

"May you live in interesting times."
- attributed to Austen Chamberlin

2016 certainly was the year for interesting times. Beginning with the worst January performance since records have been kept, the markets rebounded through the spring. Summer brought more drama and market volatility to global markets as the surprise outcome of the Brexit vote sent markets tumbling. A week later, markets had recovered, and the Dow resumed its push into record high territory. Not to be outdone, fall saw the most contentious and vitriolic election season in memory, culminating in the unexpected win of Donald Trump. The upset victory triggered a market rally in anticipation of a pro-business friendly policy agenda from the new administration, with the Dow closing the year out within striking distance of 20,000.

US Economy:

Bond yields rose sharply following the election, as increased optimism for corporate tax reform and domestic infrastructure spending pushed equity valuations higher, and the dollar remains strong, rising to a 15-year high. Overall, US fundamentals are positive, and the likelihood of an economic slowdown in the near-term is remote. As expected, the Fed raised the Federal funds rate 0.25% in December, and we expect them to raise rates twice again in 2017.

Inflation has increased to 2.1% as energy prices have risen and low unemployment continues to put upward pressure on wages. As inflation and interest rates continue to normalize, their path forward will be influenced more by policy changes than systemic factors. If the new administration follows through with their plans for deregulation, tax reform and fiscal spending, these policies would increase growth and inflation, while a move towards protectionism would dampen growth. Regardless, consumers can expect higher prices and increased volatility due to Trump's unpredictability.

Global Markets:

Globally, the political and economic landscape is similar to the US. Most developed markets are moving past the recovery phase into a modest growth cycle, and a rise in populism on a global scale is influencing elections and policy changes. There are positive signs that the worst is over in emerging markets, as earnings growth is beginning to improve.

In Europe, the unexpected result of the Brexit vote for the UK to leave the EU, and the political fall-out that ensued, dominated headlines last year. The British pound dropped to a 31-year low against the US dollar, posting its worst one-day decline on record. The EU has largely recovered, with an increase in manufacturing and industrial activity, and while earnings expectations are lagging behind Japan and many emerging markets, there are indications that earnings are picking up. As long as the European Central Bank (ECB) plans to continue it's quantitative easing program, Europe's GDP prospects should continue in 2017. Volatility and uncertainty in the Eurozone will be driven by political events this year, as the UK will make their formal Brexit notification in March, and France, Germany and the Netherlands are all facing national elections.

In Asia, Japan's experiment with negative rates has had mixed results. On the positive side, the yen has weakened against the dollar, which should help exports and ease deflationary pressures. On the downside, the first half of 2016 saw bank stocks take a big hit, but they had largely recovered by year's end. Overall, GDP is improving, assisted by global growth and the Bank of Japan's (BOJ's) commitment to provide continued stimulus.

China's outlook improved through the second half of 2016, largely due to a combination of accommodative fiscal and monetary policy. Savings reserves have been poured back into the economy to support the structural changes being made as the country moves away from a manufacturing and investment driven economy towards one driven by the consumption of goods and services. This stimulus, along with a bounce in commodities prices has helped to spur growth in global manufacturing and provided a boost to emerging markets. However, the large increase in corporate leverage over the past few years remains a risk factor for China's financial stability.

<u>In Summary:</u>

After a roller coaster ride of a year, the US market has continued its rally into the New Year, boosted by positive fundamentals at home and abroad, and the anticipation of a pro-business policy agenda from the new administration. Going forward, we at Patriot remain guardedly optimistic in our outlook for the year, as global fundamentals improve, but political uncertainties remain, and will drive volatility. The US economy is poised for a steady pace of modest growth, and barring a major geo-political event, the likelihood of a major market downturn is remote.

<u>2016 Year End Returns:</u>

S&P 500 + dividends	11.96%
Dow Jones Industrial	13.42%
Russell 2000	21.31%
Emerging Markets	8.58%
EAFE	1.00%
Barclays Aggregate Bond Index	2.65%

Returns are price-only unless otherwise noted

10 year Bond yield as of 12/31/16	2.45%

Inflation	2.1% thru December 2016
Unemployment	4.7% in December 2016

Thank You!

We value the confidence and trust you have placed with us, and we welcome your questions and comments. Our goal is to be our clients' trusted resource for all things financial.

Do you know someone who could benefit from our expertise? We appreciate your introductions and the opportunity to help your family, friends and colleagues meet their financial goals.