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Third-Quarter 2016 Market Review

Happy 40th Anniversary... to the Index Fund!

October 2016 - In case you missed it, August 31st was the 40th anniversary of the index mutual fund! In 1976, industry pioneer and founder of Vanguard, Jack Bogle, launched the first mutual fund in which the portfolio was based on an index, now known as the Vanguard 500 Index fund. An index is a basket of securities, in this case the 500 stocks that comprise the Standard & Poor's 500-Stock index, which tracks the performance of a benchmark.

The importance of this event cannot be overstated. The introduction of index mutual funds has saved investors enormous (yuuuuge!) sums of money by driving down the cost of investing. A mutual fund that mimics an index is much less expensive to operate than an active fund, which employs analysts and portfolio managers at great cost to try to outperform the index through extensive research.



Index funds continue to have a significant influence on the investment landscape and expand their market share. According to the Investment Company Institute's 2016 Fact Book, at the end of 2015, the share of assets invested in index equity (stock) mutual funds relative to all equity mutual funds' assets was 22.0%, nearly double the share of 11.7% in 2007 (the share was 9.1% in 2000). Eighty-one percent of the \$2.2 trillion of index mutual fund assets were invested in funds that track stock indexes.

Index-based Exchange Traded Funds (ETFs) came on the scene in 1993. Assets in ETFs, the bulk of which are index-based, have more than tripled to \$2.1 trillion at year-end 2015 from \$680 billion in 2007. Together, index mutual funds and ETFs totaling \$4.3 trillion represent approximately 24% of the \$18.1 trillion of assets managed by U.S. investment companies, more than twice the 10% share in 2007.

Third-Quarter Review

Tech stocks drove equity prices higher during the third quarter, with the NASDAQ Composite index jumping 9.7%, while the Standard & Poor's 500-Stock index (total return) rose 3.9% and the Dow Jones Industrial Average added 2.1%. Apple, Alphabet (Google), and Microsoft all surged at least 12%. In August, the NASDAQ completed an eight-week streak to the upside, the first time since 2010. On August 11th, the three market barometers (Dow Jones, S&P, and NASDAQ) all closed at record highs, the first time on the same day since December 31, 1999.

After two weak quarters to start the year, International stocks were the place to be in the third quarter: large caps advanced 6.5%, small caps climbed 8.7%, and emerging markets swelled 9.2%. Through the first three quarters of 2016, emerging markets have rallied 16.4%, more than wiping out last year's 14.6% tumble.



Broad domestic stock sectors put in decent gains with high single-digit and low double-digit returns thus far for 2016. Commodities continued to recover from 2015's 27.0% pummeling, with a gain of 4.2% for the quarter and 21.5% for the first nine months.

With the exception of Municipals, all broad bond sectors moved ahead in the third quarter. The riskiest sectors of the bond market continued to outperform, with U.S. High Yield and International Emerging Markets rising 5.6% and 3.1%, respectively. For the first three quarters of 2016, U.S. High Yield soared 15.1% and International Emerging Markets leapt 12.8%.

Mixed economic signals led the Federal Reserve to hold its interest rate policy steady during the quarter. Despite a stronger labor market, including signs of wage growth, inflation remains subdued. Although the central bank has stimulated the economy with low interest rates and trillions of dollars of "quantitative easing," a robust economic liftoff remains elusive. Nevertheless, the Fed signaled that it expects one rate hike in 2016.

At quarter end, the yield on the 10-year Treasury note was 1.60%, up 11 basis points for the quarter and down 67 basis points year-to-date (the yield as of October 7th was 1.73%).

Below are rates of return for selected market indices for the third quarter and first nine months of 2016, and the three, five, and 10-year compound annual returns as of December 31, 2015.

	<u>3Q:2016</u>	<u>YTD-2016</u>	<u>3-Year</u>	<u>5-Year</u>	<u>10-Year</u>
<u>Equity (Stock) Indices</u>					
Domestic					
Russell 1000 - Large Cap	4.03%	7.92%	15.01%	12.44%	7.40%
Russell Midcap	4.52%	10.26%	14.18%	11.44%	8.00%
Russell 2000 - Small Cap	9.05%	11.46%	11.65%	9.19%	6.80%
Real Estate (FTSE NAREIT Equity REITs)	-1.43%	11.75%	11.23%	11.96%	7.41%
Commodity (Dow Jones Global Equity 100)	4.22%	21.48%	-14.31%	-11.66%	NA
International					
MSCI EAFE Developed Large Cap	6.50%	2.20%	5.46%	4.07%	3.50%
MSCI EAFE Developed Small Cap	8.71%	5.53%	10.79%	6.67%	4.90%
MSCI Emerging Markets	9.15%	16.36%	-6.42%	-4.47%	3.95%
Global - MSCI All Country IMI	5.69%	7.48%	8.41%	6.66%	5.52%
<u>Fixed-Income (Bond) Indices</u>					
Bloomberg Barclays					
Global Aggregate	0.82%	9.85%	-1.01%	1.34%	4.00%
U.S. Aggregate	0.47%	5.80%	1.45%	3.25%	4.52%
U.S. Treasury TIPS	0.97%	7.27%	0.03%	3.99%	4.66%
U.S. Corporate High Yield	5.55%	15.11%	0.45%	4.27%	6.56%
Municipal	-0.31%	4.01%	4.16%	5.96%	5.02%
International Emerging Markets	3.13%	12.82%	2.40%	6.26%	7.30%

Source: ftserussell.com, reit.com, djindexes.com, msci.com, barcap.com



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