APEXIUM® FINANCIAL LP

4TH QUARTER 2017

The consensus of opinion leading into the fourth quarter of 2016 was that it was going to be a particularly interesting one, and in that sense it didn't disappoint. The quarter saw the conclusion of the longest, strangest and most contentious presidential election of modern time. The election dominated the analysis of most market prognosticators, a majority of whom concluded that Hillary Clinton would win the election and that she would represent the safest scenario for U.S. and worldwide financial markets. She, of course, lost the election, and aside from a sharp sell-off in afterhours markets once it became clear that Donald Trump would be elected, global stock markets rallied and have been quite strong ever since. That is not to say that the rally has lifted the valuations of all sectors. For example, while banks and financial stocks rallied sharply, health care stocks, under the cloud of a threat to dismantle the Affordable Health Care Act, have declined in value.

As for the major indices, the S&P 500 index was up 3.82% for the quarter and 11.96% for the full year. The narrower thirty company Dow Jones Industrial Average outperformed the S&P, by advancing 8.66% for the quarter and 16.50% for the year. Small Cap stocks, however, were the best performers for 2016. The Russell 2000 index advanced 8.83% for the quarter, and rose an impressive 21.31% for the year. International stocks continued to significantly lag behind U.S. stocks. Given their weakness, an increased exposure to non-U.S. equities is tempting, but global politics and upcoming European elections will have to be monitored, as more countries lean towards populist and pro-domestic policies.

The story for diversified portfolios was far less rosy, as bonds continued to lose ground after a strong start to the year. The Barclays U.S. aggregate bond index lost 2.98% for the quarter. The bond market has been notably weak since the election. The .25% increase in the discount rate by the Federal Reserve, on December 15, coupled with the anticipation of aggressive economic stimulus measures by President-elect Trump, drove bond prices lower. The weakness was especially evident in tax-free bonds, due to fears that a reduction in income tax rates could take a bite out of the attractiveness of tax-free interest income. The prospects of multiple quarter point discount rate increases in 2017, along with anticipated increases in infrastructure spending by the new administration, has helped to resurrect the prediction that the bull market for bonds, which began way back in 1981, is finally dead. If what is considered by many a Federal Reserve-induced bond "bubble" bursts, the bull market will likely end badly.

Interestingly, it has been at this same point in the calendar, during each of the last two years, when stronger GDP growth in the prior year's fourth quarters led many to a prediction of higher interest rates. The reemergence of weakness in the economy, however, in the first quarters of both 2015 and 2016, provided sufficient evidence that the recovery from the recession remained lackluster, and higher interest rates did not materialize. This time, the higher rate camp appears to have a better chance to be correct. The unemployment rate is low (4.7%), consumer confidence is high and commodity prices, which were at this time last year disturbingly weak, have firmed. What a difference a year has made.

Equities appear at this point a superior alternative to fixed income investments, especially for bond maturities on the intermediate and long end of the yield curve. If higher interest rates do become more of a certainty, however, bonds will begin to compare more favorably to equities, particularly if stock prices remain at, or close to, all-time highs.

It is the attempt to manage all of the unknowns that lead us to appreciate the importance of maintaining diversified investment portfolios.

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