Jan. 4, 2017 | Gene Walden, Senior Finance Editor

All things considered, the stock market was remarkably stable and steady in 2016. The current bull market has stretched to nearly 94 consecutive months, the second-longest run in U.S. history without a single drop of 20% or more (since March 2009).

But the 9.54% run-up in the S&P 500® over the past 12 months came amidst one of the most historic and tempestuous years in decades.

The big news story of 2016, of course, was the election of a new U.S. president, whose administration could push for wide-ranging changes in the political and economic landscape.

The outcome reflected a global nationalistic trend that had also contributed to Brexit earlier in the year—a referendum approved by United Kingdom voters to pull out of the European Union. This political shift could open up new opportunities, but the incoming administration still faces some of the same economic obstacles of the past administration.

Read “Outlook 2017: A Look Ahead at the Economy & the Markets” to get our take on the upcoming year.

While the U.S. stock market had a relatively stable year, the fixed income and oil markets both faced some challenging conditions:

**Interest rate bounce**

Interest rates in the U.S. market were among the lowest in history as the market rate for 10-year Treasuries dropped to an all-time low of 1.32% in July. However, after the election, rates rose quickly, and the market yield on 10-year Treasuries ended the year at 2.45%.

**Oil bounce**

The price of oil dropped to less than $27 per barrel (West Texas Intermediate) in February, causing a brief sell-off in the equities markets. But oil improved to $53.72 per barrel by the end of December after OPEC hammered out a production cut designed to bring the supply and demand back in line.

Other leading economic stories of 2016 included:
• **Falling unemployment.** The unemployment rate hit a nine-year low of 4.6% in November, according to the U.S. Labor Department.

• **Solid retail sales.** After a summer swoon, retail sales were solid to close out the final months of 2016. Year-over-year, retail and food services sales were up 3.8% through November, according to the U.S. Commerce Department.

• **Long-awaited Fed rate hike.** The Federal Reserve board approved its first and only rate hike of the year at its Dec. 14 meeting, raising interest rates by 0.25% to the range of 0.50%–0.75%. The last rate hike had been in December 2015.

• **Sluggish international market.** The international market had difficulty getting traction amidst a slow economy in 2016, as the MSCI EAFE Index declined 1.88% for the year.

<table>
<thead>
<tr>
<th>In a Nutshell</th>
<th>Exhibit 1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dec. 31, 2015</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>2,043.94</td>
</tr>
<tr>
<td>NASDAQ Composite Index</td>
<td>5,007.41</td>
</tr>
<tr>
<td>MSCI EAFE Index</td>
<td>1,716.28</td>
</tr>
<tr>
<td>U.S. 10-Year Treasury</td>
<td>2.27%</td>
</tr>
<tr>
<td>Oil (West Texas Intermediate)</td>
<td>37.04</td>
</tr>
</tbody>
</table>

**Drilling down**

**U.S. stocks had a good year**

A post-election surge, coined “the Trump rally,” pushed the S&P 500 up 1.8% in December. The S&P 500 finished 2016 at 2,238.83 after starting the year at 2,043.94 for a gain of 9.54% (Exhibit 2).

The real annual return for the S&P, including dividends and distributions, was 11.96%. The NASDAQ also finished strong, up 1.10% for December. It also had a solid year, finishing 2016 at 5,383.12 after ending 2015 at 5,007.41—an increase of 7.50%.


**Unemployment hits nine-year low**

The U.S. unemployment rate dropped to 4.6% in November—the lowest level since August 2007—according to the U.S. Department of Labor, Bureau of Labor Statistics Employment Situation report issued Dec. 2.
Employers added 178,000 new nonfarm jobs in November. On average, employers have added about 180,000 jobs per month this year, down from an average of 229,000 new jobs per month in 2015. We believe the declining pace of job growth is the natural result of the drop in the unemployment rate over the past few years from about 10% to the current rate of less than 5%.

However, wages are still fairly low compared with levels prior to the Great Recession, and the labor force participation rate for those in their prime working years (age 25 to 54) has been hovering around 81.5%, which is about 1.5% below the prerecession level. See “Unemployment Drops to 9-Year Low.”

**Consumer spending was solid**

Retail sales have continued to experience solid gains, according to the Dec. 14 retail sales report from the U.S. Department of Commerce. The advance estimates of U.S. retail and food services sales for November showed an increase of 0.1% from the previous month, and 3.8% year-over-year.

Total sales for the September 2016 through November 2016 period were up 3.7% from the previous year (adjusted for seasonal variation and holiday and trading-day differences, but not for price changes).

While online sales continue to flourish, traditional retail sales, particularly department stores, have struggled.

**Sector returns**

The past month has been fairly solid nearly across the board for the 11 S&P 500 sectors. Leading sectors included Telecommunications Services, up 8.12%; Utilities, up 4.94%; Real Estate, up 4.35%; Financials, up 3.90%; and Consumer Staples, up 3.17%.

For the year, Energy, Telecommunications and Financials led the pack with gains of more than 20%, followed by Industrials, Materials, Utilities and Information Technology—all with double-digit gains. The only loser was Health Care, which took a 4.00% loss in the fourth quarter, and was down 2.69% for the year.

Exhibit 3 details the monthly, quarterly and 2016 annual performance of each of the 11 S&P 500 sectors.

**Bond yields bounce back from historic lows**

The fixed income market experienced a number of surprises in 2016:

- Initial expectations for three or four rate hikes by the Federal Reserve did not materialize, although the Fed did approve one rate hike on Dec. 14, increasing the federal funds target rate by 25 basis points to a new range of 0.50% to 0.75%.

- Higher risk fixed income assets continued their multiyear run of exceptional relative performance, with the lowest quality sector of the market, CCC-rated bonds, up nearly 30% on a total return basis.
• Longer maturity U.S. Treasury bond prices soared more than 20% early in the year, only to give up those price gains near the end of the year.

Throughout the year, interest rates in the U.S. market were among the lowest in history, although market rates rose after the election.

After ending Oct.1 at 1.82%, the market rate on 10-year U.S. Treasuries moved up to 2.39% to end November (Exhibit 4).

The December rate hike by the Fed further strengthened the yield level, with the market rate moving up to 2.45% by year-end.

The rate had dropped to 1.32% in July—the lowest ever. Yet that still compared favorably with government bonds in Japan and many European nations where rates were below 0.00%. The total amount of bonds carrying negative interest rates reached a high of about $10.9 trillion in September before tapering off to $10.4 trillion the next month, according to the Nov. 1 Fitch Ratings report. (Negative interest rates refer to a monetary policy in which bank deposits and government bonds actually return less than the investor deposits.)


**Equity earnings projections edge up**

The consensus 12-month forward earnings for the S&P 500 has continued to move up, closing the year at $132.83 per aggregate share versus $129.69 at the close of the third quarter (Exhibit 5). At the start of 2016, the Standard & Poor’s consensus analyst forward earnings estimate was $124.30.

**Forward price-earnings ratio and earnings yield**

The forward 12-month price-earnings ratio (P/E) for the S&P 500 ended the year at 16.9, a level it has maintained fairly steadily since mid-summer (Exhibit 6). It began the year at 16.1.

The forward 12-months earnings yield for the S&P 500, which is the inverse of the P/E, ended the quarter at 5.93% (Exhibit 6). It began 2016 at 6.31%.

What do these two factors—12-month forward P/E and earnings yield—reveal about the market?

The fact that the P/E has been rising—and the earnings yield declining—since 2011 means that shareholders are getting less in earnings relative to the price of the stock.
While the 16.9 P/E is well below the mid-20s level of the tech bubble in 2000, the P/E has been hovering at the highest level in about seven years—and about 2.5% higher than the historic average. In short, that means that stocks have gotten more expensive (based on earnings) but are still within a fairly normal range.

The 12-month forward earnings yield can be helpful in comparing stock earnings yields with current bond yields. At 5.93%, the equity earnings yield is still significantly higher than the market interest rate for 10-year Treasuries of 2.45%, but that gap has closed by more than 1.00% since bond yields hit their low mark in July.

**Dollar strengthens**

A surge at the end of year pushed the strength of the dollar to the highest level since February versus the world’s other leading currencies. From Nov. 8 (the day of the election) through the end of the year, the dollar moved up 4.52% versus the euro and 11.31% versus the yen (Exhibit 7).

Early in 2016, the dollar began falling versus other leading currencies, but after troughing against the euro in May and the yen in August, the dollar recovered most of that ground in the second half of the year. For all of 2016, the dollar declined slightly versus the yen, off 3.05%, and it moved up 3.23% versus the euro.

While the rising dollar tends to make imports and overseas travel a bargain for American consumers, it puts an added strain on U.S. manufacturers and service providers competing in the global market.

**Oil keeps climbing while gold keeps sliding**

Oil prices continued a rally in December that began Nov. 30 when OPEC agreed to cut production by 1.2 million barrels of oil per day. West Texas Intermediate closed the year at $53.72, which represented an 8.66% jump from the November closing price of $49.44 (Exhibit 8).

After closing 2015 at $37.04, the price of oil dropped to a low of $26.21 on Feb. 11 before rebounding through remainder of the year. For all of 2016, the price of oil moved up 45%. (See “Are Rising Gasoline Prices Good or Bad for the Economy?”)

Gold prices continued to slide in December, prolonging a trend that began in November, shortly before the election. The price of gold was down 12.2% for the fourth quarter (Exhibit 9).
After ending 2015 at $1,020 an ounce, the price of gold reached a two-year high of $1,367.10 per ounce on Aug. 2 before trending down to $1,128.80 on Dec. 21. A final week rally pushed up the year-end closing price to $1,151.70—a gain of 12.9% for the year.

**International market**

The international equity markets took a hit after the U.S. election, but edged back up in December, with a 3.3% gain, as measured by the MSCI EAFE Index (Exhibit 10).

For the year, the MSCI EAFE had a disappointing decline of 1.88%, as the sluggish economy brought on by the Great Recession still lingered.

While uncertainty surrounds future trade policies in the wake of Brexit and the new U.S. administration, European and Asian companies could benefit from the strengthening U.S. dollar.

A stronger dollar makes foreign goods cheaper here and U.S. goods and services more expensive overseas—giving foreign operations a growing competitive advantage. Protectionist trade policies, if implemented, could add further to the advantage of home-based European and Asian companies in their own markets, although it could hinder their competitiveness in the U.S. market.

Gross domestic product (GDP) in the eurozone grew at an annualized rate of 1.4% in both the second and third quarter, according to Blue Chip Economic Indicators, which also reported that the consensus forecast for 2017 is 1.0% versus the projected growth of 2.0% in 2016.

In Japan, GDP in the third quarter grew at an unexpectedly high annualized rate of 1.3%. The consensus estimate for 2017 is 0.9%.

How will the markets and the economy fare in 2017? Read our full report: “Outlook 2017: A Look Ahead at the Economy & the Markets.”

---

**Thrivent Asset Management Contributors to this report:** Russell Swansen, Chief Investment Officer; David Francis, CFA, Head of Equity; Mark Simenstad, CFA, Head of Fixed Income; John Groton, Jr., CFA, Director of Equity Research; Darren Bagwell, Sr. Equity Portfolio Manager; and Jeff Branstad, CFA, Senior Investment Product Strategist; Thrivent Distributors LLC

**Media contact:** Callie Briese, 612-844-7340; callie.briese@thrivent.com

All information and representations herein are as of Jan. 3, 2017, unless otherwise noted.

The views expressed are as of the date given, may change as market or other conditions change, and may differ from views expressed by other Thrivent Asset Management associates. Actual investment decisions made by Thrivent Asset Management will not necessarily reflect the views expressed. This information should not be considered investment advice or a recommendation of any particular security, strategy or product.

Past performance is not a guarantee of future results. Investment decisions should always be made based on an investor’s specific financial needs, objectives, goals, time horizon and risk tolerance.

Indexes are unmanaged and do not reflect the fees and expenses associated with active management. Investments cannot be made directly into an index.
The S&P 500® Index is a market-cap weighted index that represents the average performance of a group of 500 large-capitalization stocks.

The NASDAQ (National Association of Securities Dealers Automated Quotations) is an electronic stock exchange with more than 3,300 company listings.

The MSCI EAFE Index measures developed-economy stocks in Europe, Australasia and the Far East.

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing.

Asset management services are provided by Thrivent Asset Management, LLC, a wholly owned subsidiary of Thrivent Financial, the marketing name for Thrivent Financial for Lutherans.

1674322-010417