Through the first three quarters of 2016, the taxable fixed income markets were relatively stable and range bound. When disruptions (such as the credit crisis of February or BREXIT) occurred, the markets spiked but quickly returned to equilibrium. This equilibrium lasted into the first six weeks of the fourth quarter, ending with the surprise election of Donald Trump as the 45th President of the United States. Post-election, the stock market took off, trading to new all-time highs, while the bond market experienced a dramatic increase in yields along the yield curve. The 2Yr spiked up 40 basis points, the 10Yr up 77 basis points, and 30Yrs up 58 basis points in short order. However, with the exception of the election, nothing much has changed: unemployment is stable, inflation is low, and economic growth, while low, is stable and trending upward.

The "Trump trade" appears to be unprecedented – markets usually do not like uncertainty and a Trump presidency is certainly an unknown. Trump, with his tweets, unconventional management style, and lack of political experience, have many wondering what he can actually accomplish. He enters office without a defined mandate – he lost the popular vote, and the majority in the Senate is only two votes, meaning Democrats can filibuster virtually anything excepting political appointments. Trump calls himself 'the greatest deal maker,' and working with Congress will test all his talents. High on his list of legislative priorities are the repeal of the Affordable Care Act, watering down elements of Dodd-Frank and other regulations, tax reform (including the repatriation of foreign held cash), and increased spending on infrastructure and the military.

Market participants appear to feel that President Elect Trump will be able to accomplish a great deal of his agenda, as the markets have priced in stronger economic growth with a moderate increase in inflation. At the same time, the Federal Reserve voted unanimously to increase the overnight rate in December, and recent statements endorse further gradual removal of accommodation – more rate hikes. Recent increases in oil prices will also need to be factored in, as these price increases tend to be viewed as a tax and a drag on economic growth while simultaneously contributing to inflation. While the markets are forward looking, there may be an element of overshooting expectations, as any policies and legislation that the Trump administration can pass remain unknown and will take at minimum six to nine months to have an appreciable impact on the economy.

Following the turbulence in the high-yield market and oil patch in the first half of the year, the corporate credit market seemed to settle into "cruise control" in the back half of 2016. Encouragingly, the pace of financial engineering and share buybacks slowed somewhat, and earnings improved from negative growth territory throughout most of 2015 and early 2016. This, along with low absolute rates, set the stage for a very robust and record setting year for issuance. Typically, the fourth quarter months, especially November and December, are relatively quiet months for issuance. This year was no different, with only $125.95 billion coming to market over the two month time span for a total of $274.8 billion over the quarter. That being said, the total Investment Grade issuance for 2016, including Supranationals, Agencies, and Sovereigns (SAS), reached a record setting $1.61 trillion, representing an increase of 7% over 2015. Issuance, sans SAS, topped $1.34 trillion (up 3% over 2015). The spike in issuance was driven by a significant amount of M&A activity, low borrowing cost due to low sovereign yields, and very tight credit spreads as investor demand remained strong. The strong bid for corporate bonds kept spreads in a tight trading range for the back half of the year. According to the Bloomberg Barclays US IG Corporate Bond Index, the wide for 2016, on an OAS basis, was +215 back in January. The market recovered quite nicely to end the year at +122, the exact same level at the end of 2015.

Given the relatively stable spread environment, performance in the fourth quarter was primarily driven by curve positioning and security selection. Unlike our benchmark, which is heavily front-loaded, our strategy is currently managed to a bell curve peaking around 3-5 years, with our underweight exposure to 1-2Yrs and overweight exposure to 5-7Yrs detractors. However, our underweight exposure to 7-10Yr maturities was an offsetting contributing factor. By credit quality, while we underperformed in our "AAA" credit allocation, largely as a product of longer positioning, strong outperformance in "AA" and "A" rated credits relative to our benchmark was a positive over the quarter. Broken out by sector, our outperformance in the Consumer Goods sector was a strong contributor, followed by healthy contributions from Taxable Municipals, Capital Goods, Insurance, and Healthcare. Underperformance in Treasuries and Telecommunications were each offsetting detractors. Overall, our strategy was closely in line with its benchmark for the quarter, returning -2.04% to the benchmark's -2.05%.

The neutral relative performance of the fourth quarter brought us to 2.62% on the year, a comfortable 111bps above our benchmark's 1.51%. With the overall contribution from curve positioning largely a wash over the quarter – underweight allocations at the front were a modest contributor, while underweight allocations further out were a modest detractor – our overweight exposure to corporate credit was a strong contributor, with underweight allocations to "AAA" credits and overweight allocations to investment grade corporates, both making significant contributions to our relative return due to the higher yield roll in a period of tight but stable credit spreads. We also generally saw solid outperformance from the names in which we invested; in particular, Consumer Goods, Retail, and (despite 4th quarter weakness) Telecom all contributed to our outperformance in 2016.

As we look forward to 2017, the Appleton team is working to identify which sectors of the corporate credit market will be most impacted by the Trump administration. For the financial sector, we view the leadership change as largely a positive for two reasons. First, Trump's proposed policies have been characterized as inflationary, which would theoretically result in a steeper yield curve and better net interest margins. Secondly, the new administration's pledge to roll back regulation on the sector should reduce fixed costs and encourage higher growth in the sector. For industrials, Trump's fiscal stimulus proposals should generally help provide a tailwind to economic activity, particularly for industrial names that would benefit from potential infrastructure spending. The outlook for technology and healthcare is more ambiguous. A rising economic tide would lift all boats, and technology and healthcare companies likely stand to benefit the most from any proposed repatriation holiday. On the other hand, Trump has made comments about bringing down drug prices, and his protectionist trade policy views may hurt the technology sector's overseas investments. Lastly, we would be remiss not to point out that a lower corporate tax rate would boost the general outlook for corporate credit on the whole, as it would generate significantly more available cash flow to service corporate debt. Of course, any discussion of the likely impact at this point is very hypothetical given the high degree of uncertainty surrounding the Trump administration's proposed policies, and we will be watching closely to see what policies may actually be enacted.

As always, we welcome your comments and questions. Please contact us if there are any changes to your financial situation or investment objectives. Appleton is on Twitter: follow us at @AppletonPtnrs.

APPLETON PARTNERS, INC. ONE POST OFFICE SQ. BOSTON, MA 02109 TEL. 617.338.0700 WWW.APPLETONPARTNERS.COM