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THIRD QUARTER 2016 REPORT FOR BROKERAGE ACCOUNTS

The third quarter of 2016 was a historically uneventful quarter for markets. The S&P 500 went through a 17 trading day period in August without a move of more than 0.75%, the longest such stretch since 1970. The S&P 500 closed out August without a move of greater than 1%, an unusual feat for what has historically been one of the more volatile months of the year. Going back to August of 2015, concerns over China caused three straight declines of greater than 2%, including a brief drop of 1,000 points. Although low volatility is welcomed by many, subdued periods tend to be followed by periods of increased volatility. With the upcoming election and focus on the Federal Reserve and interest rates through the end of the year, we expect to see an increase in volatility.

Markets continued their strong run that started in early March, extending full year returns to healthy levels. The sharp selloff in the first two months of the year make year-to-date returns even more impressive, as the S&P 500 is up almost 19% from its February low. As volatility increases, we would not be surprised to see the market give back some of these gains during the fourth quarter. However, the current bull market has survived numerous scares including the Brexit vote and concerns over a slowdown in China over the last year, and we don't see any near-term risks great enough to dramatically change the course of the market.

Major Stock & Bond Indexes (Total Return)			*Lipper Mutual Fund Indexes (Total Return)*		
	3Q16	YTD		3Q16	YTD
S&P 500 Index	3.9%	7.8%	Large-Cap Core Funds	3.7%	6.1%
Dow Jones Industrial	2.8%	7.2%	Large-Cap Growth Funds	5.7%	3.2%
Russell Midcap Index	4.5%	10.3%	Large-Cap Value Funds	4.2%	7.2%
Russell 2000	9.1%	11.5%	Mid-Cap Core Funds	4.8%	8.6%
MSCI EAFE (USD Gross)	6.5%	2.2%	Small-Cap Core Funds	7.0%	10.2%
MSCI EM (USD Gross)	9.0%	16.0%	International Large-Cap Core	6.1%	3.0%
NAREIT U.S. Real Estate Ind.	-1.2%	12.3%	Emerging Markets	7.5%	14.2%
Barclays US Agg. Bond (3-5yr)	0.3%	3.8%	Core Bond	0.8%	5.9%
Bloomberg Commodity	-3.9%	8.9%	High Yield	4.7%	11.6%

THE ELECTION:

This year's presidential election is still a very tight race, although Hillary Clinton has increased her lead over Donald Trump following the first debate. Since the stock market favors predictability and continuing the status quo, and given that Donald Trump represents neither of these, a victory by Secretary Clinton would be the best outcome for stocks. It does appear that stocks have started trading with the polls as volatility increased while Trump gained ground, bringing the race to about even. With Hillary Clinton pulling away over the past few weeks, volatility has fallen and stocks have started to recover. Wall Street has dismissed Donald Trump's chances of winning the election since becoming the Republican nominee, and a Hillary Clinton presidency looks to be priced into stocks. We therefore do not expect too much movement in prices were she to win the election.

The presidential election is a single event that attracts much investor focus, however congressional elections and resulting economic policy play a bigger role on economic growth. The House of Representatives looks very likely to remain under Republican control, with the Senate a coin toss of either going Republican or Democrat. The system of checks and balances spelled out in the constitution is designed to prevent any one individual from gaining too much power. Given this mix, a Clinton presidency would have to work with a split government. As such, there appears to be broad support for some infrastructure spending which would provide some fiscal stimulus to the economy that has been lacking in this recovery. It is unlikely that major tax increases would clear a Republican Congress, although there appears to be support from both sides on corporate tax reform that would close loopholes and make the U.S. tax rate more competitive to other developed economies.

Should Donald Trump win the election, he will face heavy opposition from Congress for his mostly anti-growth policies. Although a President has the right to negotiate trade policy, existing policy can be more difficult to change as proposals are written into law and many would require an act of Congress to unwind. The last time trade tariffs were increased was the Tariff Act of 1930, known as the Smoot-Hawley Tariff, in an attempt to protect American jobs as the country was entering into what would become the Great Depression. In the ensuing years, American imports and exports were cut by more than half and many economists believe this contributed to the length and depth of the depression. Representatives on both side of the aisle are well aware of this and likely will do all they can to avoid a repeat of history. Donald Trump may be able to get broader tax cuts through a Republican led House and Senate, which would be simulative to the economy, albeit at the cost of a higher budget deficit that would challenge growth over the long-run.

MONETARY POLICY:

The Federal Reserve and central banks globally have aggressively tried to stimulate the economy through accommodative policies. Following the UK vote to leave the European Union, the Bank of England cut short-term interest rates and resumed quantitative easing through the purchase of government bonds, and for the first time, corporate bonds. In Europe, the European Central Bank commenced its corporate bond purchase program that had been announced earlier in the year, and is already the second largest holder of Euro investment grade corporate bonds. The

Bank of Japan announced it would use asset purchases to target a 0% yield on its 10-year bond, adding further stimulus to its negative short-term rate policy. Currently about one-third of global government issued debt has a negative yield and 71% yields less than 1%. By comparison, U.S. interest rates are attractive with a 1.6% yield on the 10-year treasury bond and a Federal Funds target rate of 0.25%-0.50%. Although economic data in the U.S. has started to rebound with fairly strong employment data, the Federal Reserve chose not to increase rates at its October meeting. The Fed meets again the week before the election and again in December to discuss rate policy. Currently, the market is assigning a 60% probability to a December rate increase, however this will likely depend on economic data and thus far, the Fed has been very hesitant to increase rates.

U.S. MARKETS:

The biggest question surrounding U.S. markets is whether corporate profits start to rebound. Although markets have remained relatively flat, valuations have become richer given falling profits over the past five quarters. With low oil prices and an appreciating dollar no longer the headwinds they have been over the past 18 months, analysts are forecasting 10% earnings growth in the fourth quarter and 16% growth for 2017. Although this seems very optimistic, there are indications that the tide is starting to turn as earnings should at least turn slightly positive for the third quarter.

Investors have also been closely watching the Federal Reserve after a string of strong jobs reports led to the belief that officials may elect to tighten interest rates. The Fed chose not to raise rates at its September meeting, the last realistic opportunity ahead of the election. Although the Fed meets in November, it has not historically announced policy decisions that close to a presidential election. Despite the decision to hold rates unchanged, markets have already done the work for them as financial conditions have already tightened. Most of this tightening is the result of rising costs for short-term borrowers, as the three month LIBOR rate recently reached its highest levels since 2009. As a result, we believe it is unlikely the Fed will touch interest rates through the end of the year. Looking into 2017, however, early signs of rising inflation may force their hand regardless of overall economic strength.

OUTLOOK:

As long as economic growth remains slow and under control, the current recovery should continue for the foreseeable future. One of the biggest risks to the recovery could come from the economy's structural inability to handle higher demand driven growth. As businesses have invested very little in capital, worker productivity growth has remained subdued. Combined with very limited growth in the workforce due to an aging population and declining immigration, the economy could rapidly overheat if we were to see a return to higher GDP growth.

Stock market volatility should increase during the fourth quarter as investors monitor the elections and the December Fed meeting. Although stocks are a little expensive relative to historical trading ranges, they do not appear wildly overvalued. An earnings recovery is likely as we enter 2017, which should help support current prices. At current levels, stock market returns will likely be lower than the past several years, but have historically been able to produce

positive results over the long-term. The bull market that began in 2009 still appears intact, and we do not advise trying to time pullbacks, but rather stick with long-term asset allocations to cushion the volatility. With interest rates at very low levels, bonds also appear fully valued. However, given that the U.S. still has some of the highest interest rates in the world, foreign investors should support bond prices in search of better yields. Individual bond ladders are a defense against rising interest rates when they do eventually happen, as returns are locked in at the time of purchase and not subject to swings in market price.

COMMUNICATIONS FROM HC FINANCIAL ADVISORS, INC.

We want to meet with you at least once a year to review and update any changes in your goals and objectives. We want you to understand the decisions we are making on your behalf and be comfortable with your asset allocation. Please call us with any questions or concerns.

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