GIA PARTNERS

4th Quarter 2016

Highlights

- The U.S. election surprised markets. Equities rallied and interest rates rose on expectations of high-growth policies. Despite higher rates, credit markets had a superb year;
- Economists and strategists altered their outlooks after the election. Expectations for tax cuts, deregulation and infrastructure investment lifted growth forecasts;
- Revised growth and inflation forecasts will likely push interest rates higher. While we think changes should be gradual, the Fed may be forced raise rates faster than currently believed.

Markets

		Returns (%)	
GIA*	Average Quality	4Q16	12 Months
Core Plus Composite	(A)	-1.88	6.43
Global Credit Plus Composite	(BBB+)	-2.03	7.63
Global High Yield Composite	(B+)	2.57	20.29
Emerging Market Debt Composite†	(BB+)	-0.49	12.72

**Returns are net of fees*

Benchmark Bonds			
Bloomberg Barclay's U.S. Agg. Index	(AA+)	-2.98	2.65
Treasury	(AAA)	-3.84	1.04
Credit	(A)	-2.97	5.63
Mortgage	(AAA)	-1.98	1.67
Government/Credit	(AA)	-3.39	3.05
BoA Merrill U.S. Corps & Yankees	(A)	-2.93	5.43
BoA Merrill Corporate Master	(A-)	-2.88	5.96
BoA Merrill High Yield	(B+)	1.85	17.34
BoA Merrill EM Corporate Plus	(BBB)	-1.63	9.79
JPM Emerging Markets EMBI+	(BB+)	-5.32	9.62
JPM CEMBI Broad	(BBB-)	-1.17	10.76
JPM GBI-EM Global Diversified	(BBB)	-6.09	9.94
BoA Merrill Global Gov't ex-US	(AA-)	-2.46	4.01

Benchmark Equities			
S&P 500	NA	3.25	9.54
Nasdaq Composite	NA	1.34	7.50
Russell 2000	NA	8.43	19.48
MSCI EAFE	NA	-1.04	-1.88
Europe	NA	-0.73	-3.39
Japan	NA	-0.28	0.46
MSCI Emerging Markets Equity	NA	-4.56	8.58

Markets

Year 2016 may be remembered for "the unexpected." From financial markets opening in crisis during the first two weeks of the year, to Britain voting to exit the European Union in June, to Donald Trump winning the presidential election, many events did not turn out as most expected. The same may be said for financial markets which defied forecasts every time. Expectations for crisis after Brexit were supplanted by euphoria over more central bank stimulus and forecasts of gloom and doom after a Trump victory gave way to giddy optimism over possible changes in economic policy. For the quarter the S&P 500 moved higher by 3.25%, which included a 5.03% jump in the month and a half after the election. Similarly, European stocks rallied in Euro terms, up 5.68% for the quarter, although a stronger U.S. dollar made those returns -0.73% in USD terms. Bonds did not fare as well with expectations for better fiscal policy raising concerns over inflation. U.S. treasuries declined -3.84% for the quarter, investment grade corporate bonds were down -2.88% and the Barclays U.S. Aggregate index declined -2.98%. The big outperformer in bonds was high yield with 1.85% returns bucking the negative numbers for most fixed income.

High yield bonds had an impressive 2016 after a dismal start and a lousy 2015. Led by recoveries in energy and commodities, and eroding default rates, the Bank of America Merrill Lynch High Yield Cash Pay Index (J0A0) ended up 1.85% for the quarter and 17.34% for the year. Spreads narrowed from 505 b.p. to 429 b.p. in the quarter, while the yield to worst decreased from 6.17% to 6.07%. Despite excellent performance, apprehension over the high yield market was reflected in volatile fund flows during the year, with negative $2.0 billion in the quarter (even after a $6.4 billion inflow in December), but positive $6.9 billion for all of 2016. The default rate decreased to 3.32% in December from 3.54% in September. The annual default rate conceals a significant decline in defaults during the second half of the year. Approximately 73% of defaults occurred during the first half primarily in two stressed industries, energy and commodities. With some commodity price relief in the latter half of the year, defaults declined and expectations for further reductions in 2017 grew. New issue activity totaled $52 billion in the quarter and $286.2 billion for the year. This was slightly lower than last year, but represented a recovery after negligible issuance during the first quarter of 2016.

The investment grade corporate bond index, the Bank of America Merrill Lynch U.S. Corporate Index (C0A0), was down -2.88% for the quarter, but was up 5.96% for the year. Corporate bonds continued to outperform during the quarter, completing a year of robust returns for the sector. During the quarter, the U.S. treasury index lost -3.84% as rates rose. Corporate bonds were supported by ample investor liquidity and ongoing demand from European and Japanese buyers. Corporate spreads narrowed by 12 b.p. to 130 b.p., while the yield to worst of the index increased from 2.83% to 3.40%. Issuance for the quarter slowed to the lightest pace of the year as rates rose. Total issuance was only $242.2 billion compared to $392.3 in the third quarter, but this amount sufficed to take year-to-date borrowings to $1.44 trillion completing a fifth consecutive annual record.

After successful performance during the first nine months, emerging markets subsided in the fourth quarter, but still delivered superior full year results. A combination of higher commodity prices, central bank support, and favorable fund flows helped the sector's performance. For the quarter, the JPM Emerging Markets Bond Index Plus (EMBI+), a dollar denominated sovereign index, was down -5.32%, the JPM Corporate Emerging Markets Broad Index (CEMBI Broad) declined -1.17%, and the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, returned -6.09%. The full year 2016 returns for each of these respectively were: 9.62%, 10.76%, and 9.94%.

Portfolios

Our *Core Plus Composite* consists of portfolios that can hold up to 30% in securities rated below investment grade. The Composite outperformed the Bloomberg Barclays U.S. Aggregate Index, net of fees, by 110 b.p. for the quarter, and was ahead by 378 b.p. over the last twelve months. During the quarter, the best performing sector was high yield followed by emerging markets and investment grade credit. In aggregate, the Composite had exposure exceeding 50.4% to credit

sectors, with exposure to non-investment grade rated securities approaching 16.6%. Exposures to high yield and emerging markets explain most of the outperformance. The portfolio was underweight government bonds, which underperformed as interest rates rose also aiding relative performance. Over the last 12 months all credit markets outperformed, with high yield and emerging markets doing particularly well. The portfolios held overweight exposures all year, which accounted for the bulk of the outperformance.

Global Credit Plus Composite consists of portfolios holding investment and non-investment grade credit related securities. The Composite is measured against a benchmark consisting 70% of the BofA Merrill Lynch U.S. Corporate Index and 30% of the BofA Merrill Lynch U.S. Cash Pay High Yield Index. The Composite underperformed the benchmark, net of fees, by 55 b.p. during the quarter, and was behind by 166 b.p. over the last twelve months. The portfolios had an allocation of approximately 73.8% U.S. investment grade, 10.7% high yield, and 15.5% emerging markets, of which 12.6% was investment grade rated. In the fourth quarter, U.S. high yield delivered the best performance in fixed income, while investment grade credit was held back by rising interest rates. For the quarter, the underweight in high yield caused all of the underperformance. Over the last twelve months, high yield generated the best credit sector performance. Emerging markets bonds did well, but underperformed high yield by over 7.0%. As with the quarter, the portfolios' underweight in high yield caused the Composite's poor relative performance.

Our *Global High Yield Composite* consists of portfolios investing primarily in U.S. high yield, higher yielding investment grade credit and emerging markets corporate bonds. The Composite outperformed the Bank of America Merrill High Yield Cash Pay Index by 72 b.p., net of fees, in the quarter, and was ahead of the index by 295 b.p. over the last 12 months. After the presidential election, energy, commodities and other basic industries received a price boost on expectations for higher economic growth. Similarly, many basic industry companies in emerging markets rallied in response to higher commodity prices. The Composite had meaningful exposure to these industries with lighter allocations to underperforming industries, like healthcare. Even though high yield outperformed emerging markets, the portfolio's security selection helped generate the excess return. The recovery that began in both high yield and emerging markets in February, continued through the end of the year, helping the Composite outperform. Over the last twelve months, the outperformance was attributable to a combination of favorable industry allocation and a recovery in certain emerging markets, like Brazil, which outperformed the high yield index.

Our *Emerging Market Debt Composite*[†] consists of portfolios investing in dollar denominated emerging market credit securities, primarily from corporate issuers. The Composite is measured against the BofA Merrill Lynch US Emerging Markets Plus Index (EMUB). During the quarter, the portfolio outperformed the benchmark by 114 b.p., net of fees, and was ahead by 293 b.p. over the last twelve months. During the quarter and over the last twelve months non-investment grade outperformed investment grade and Latin America outperformed Asia. The portfolio's overweight positions in Latin America, primarily Brazil, and in non-investment grade credit generated the bulk of the outperformance. Asian exposure in the emerging markets corporate indexes tends to be high quality and subject to movements in interest rates. Asia underperformed as interest rates rose at the end of the year, especially after the election.

Economy

Trump's election altered economic expectations. In December's *Wall Street Journal* Economic Survey economists raised their forecasts for growth every quarter (and for the full year) of 2017. The most remarkable statistic, however, was the respondents' shift answering the question: "Is the risk to your GDP growth forecast for the next 12 months more to the upside or downside?" In the Survey's September version 73.2% of the respondents said "downside." In the December Survey 53.5% said "upside."

While the incoming administration's indicated policy prescriptions include contradictory measures, some of the priorities could generate a meaningful growth boost. The most visible benefits could come from changes in corporate taxes, particularly a reduction in the income tax rate. In addition, scaling back regulations, especially in finance and energy, may

induce investment and hiring. A third priority, infrastructure spending, may be watered down or delayed due to the "deficit scoring" implications of tax reductions, but if the first two succeed, a jump in investment would contribute meaningfully to growth.

Arguing against a growth boost are a stronger dollar and the Administration's protectionist inclinations. The economy can sustain a strong dollar as long as domestic growth is robust. However, if the dollar is strong and global trade becomes constrained due to tariffs or other restrictive policies, we believe growth benefits from domestic initiatives will likely be short-lived. With the U.S. constituting about 28% of the global economy, dynamic consumer demand can still lift the world higher. That depends, however, on the U.S. import engine continuing its global trade leadership and other large economic blocks (Europe and Asia) pulling their weight domestically. Indicators for those regions look positive, boosted further now by weaker currencies. Only a global trade war would impede their progress.

While execution challenges will likely temper results during the next quarter, enthusiasm over economic prospects is palpable. We believe market valuations, especially in equities, already discount higher growth rates, better earnings, more inflation and freer markets. If a conducive policy environment can get enacted, the U.S. economy could shift to a higher growth rate by mid-2017 and beyond.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing between 2.0% and 2.5% in 1Q and between 2.5% and 3.0% 2Q 2017. We believe successful execution of corporate tax reform and deregulation will induce investment, hiring and wage growth. The U.S. economy already enjoys support from low unemployment, low oil prices, elevated consumer confidence, and low inflation. While stronger growth may change inflation expectations and push energy prices higher, we believe the economy has enough slack to accommodate the proposed policy changes. We believe infrastructure spending will be slower to materialize and budget deficits will begin to moderate as taxes from higher activity are applied. We expect the Fed to raise the Fed Funds Rate 2 to 3 times in 2017, but not before observing the effects of the policy-driven stimulus. PROBABILITY 60%

2. A second scenario has the economy recovering to trend or above-trend growth of 3.0% to 3.5% over the next six months. With an unemployment rate of 4.7%, new investment may consume economic slack quickly, boost consumption more than expected and push growth higher. According to the Bureau of Economic Analysis, the economy expanded at a 3.5% pace in 3Q 2016, and most economic indicators remained at healthy levels through year-end. In addition, some of the lagging foreign economies posted improvements as the year closed suggesting the global economy is on better footing. With ongoing monetary stimulus and now support from weaker currencies, Japan, Europe and China could all contribute to a faster pace of growth. PROBABILITY 25%

3. A third scenario has the economy declining to a 0.5% to 1.0% growth rate due to failure to enact growth-oriented tax reform, or worse, a prioritization of trade protectionism and tariffs. Obstruction or disagreement in congress could quickly erode confidence and delay business investment. Some of the economy's tailwinds, like wage and employment growth, and strong auto and housing markets, could also falter with higher economic uncertainty. Foreign economies remain fragile and without a catalyst could reverse the improvement they experienced in 4Q 2016. Put together, these conditions could weigh the U.S. economy down sapping its growth rate. PROBABILITY 15%

Market Outlook

The U.S. presidential election changed everything. Economists, investors and strategists altered their expectations for economic growth, the likely path inflation and implications for financial assets. In fixed income, we think the likely outcome is higher rates. If the incoming administration enacts some of its policy priorities, particularly lower corporate taxes and deregulation, economic growth and inflation will probably accelerate. For the first time since the 2008 crisis, the U.S. treasury market could become detached from the Federal Reserve with longer term interest rates reflecting economy- driven inflation expectations. We believe it will take a few months for the economy to react to new policies, leading to a gradual increase in rates. A better economy will likely help corporate creditworthiness, leading credit sectors to outperform, although with modest absolute returns over the next 3 to 6 months.

Commentary – About Normalizing Rates

The year of the unexpected might be a tame description for 2016. Financial markets had their share of surprises, but perhaps one of the most perplexing was fixed income markets' extensive experimentation with negative rates. In the U.S. we had brief periods of negative rates for short term treasury bills in 2015, but after the Brexit vote in June, monetary authorities were forced to contemplate that possibility. In Europe and Japan the majority of government bonds had negative yields during the year. This occurred because of central bank policies at a time of weak global economic growth. By the fourth quarter of 2016, we believe the world's major central banks realized negative rate policies were not generating the desired economic results. The November U.S. election and, now, likely enactment of decidedly pro-growth policies have triggered a move higher in rates, especially in longer term government bonds.

We have opposed the subsidization of interest rates through quantitative easing and negative policy rates. When investment decisions are made relying on subsidized rates, capital will likely be misallocated leading to economic distortions, like excess government debt. In our 3Q 2013 letter we wrote that the Fed should follow up on its initial tapering of quantitative easing with further withdrawal of excessive stimulus. Instead, the Fed balked because various markets, including long interest rates, reacted negatively. Three years later global economic conditions took yields in 44.3% of developed government bond markets into negative territory. It would be hard to argue this is evidence of successful monetary policy.

In "normal" markets interest rates are determined by market conditions. Factors like economic activity, inflation, supply and demand, government fiscal and monetary policy, and international competitiveness influence the price investors will pay to own bonds. We believe these same factors apply in shaping the yield curve with some having more influence on short term rates and others on long term rates. During its quantitative easing programs the Fed built its balance sheet to $4.5 trillion as of the end of 2016. The Fed owns about $2.5 trillion of the U.S. treasury's debt and $1.7 trillion in mortgage backed securities. When considered in the context of the Bloomberg Barclays Aggregate Index, the most commonly used benchmark by fixed income investors, the Fed owns more than 36% of the index's treasury securities and 32% of the mortgage backed securities. In total, it owns over 22% of the benchmark's securities.[1] At that size the Fed has had the ability to "manage" interest rates, the yield curve and mortgage rates.

Everything may soon change, not because the Fed has chosen to withdraw, but because it may get forced to. Two of the incoming administration's policy priorities could potentially lead to the normalization of interest rates because of their possible effect on the economy and inflation. These are corporate tax reform and deregulation. Both of these, if enacted

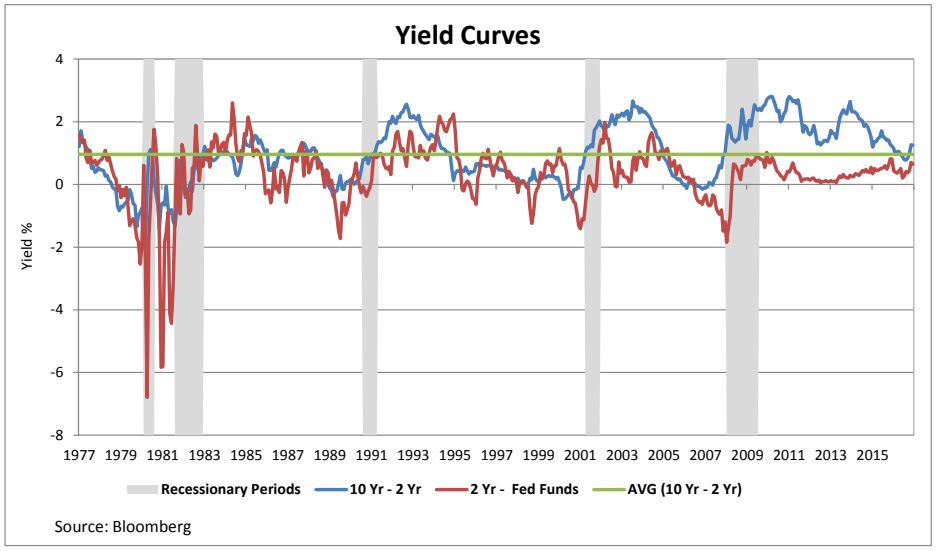
[1] The Federal Reserve reports holdings at face value. Bloomberg Barclays Aggregate Index data is at market value. Given the low level of interest rates, it is likely that these ratios are higher.

without offsetting measures, have the potential to stimulate investment and lending. Without debilitating regulation and high taxes, the U.S. is an attractive investment destination because we enjoy competitive and available natural resources, an educated workforce and the rule of law. Similarly, banks hold over $2.0 trillion in reserves at the Fed that they have had no incentive to lend because of regulations, capital requirements and low rates.

If this is true, the natural question is what might "normal" rates look like? And how soon can we get there? After raising the necessary caveats that this is a purely hypothetical exercise and subject to many unknowable factors, we can start by analyzing the possible impact of the policies. Investment constitutes about 15% of GDP, but has been about flat since the end of 2014. A 10% increase in investment would imply about 0.2% boost to GDP. The real impact on GDP and inflation would come from hiring at a time when unemployment is relatively low and wages have begun to rise. Other than one print at the end of the first quarter of 2015, the Bureau of Labor Statistics Employment Cost Index (ECI) posted the highest consecutive year-over-year readings in 2Q and 3Q 2016 since the end of 2008. These prints exceeded year-over-year CPI, which suggests the economy may already be experiencing real wage growth.

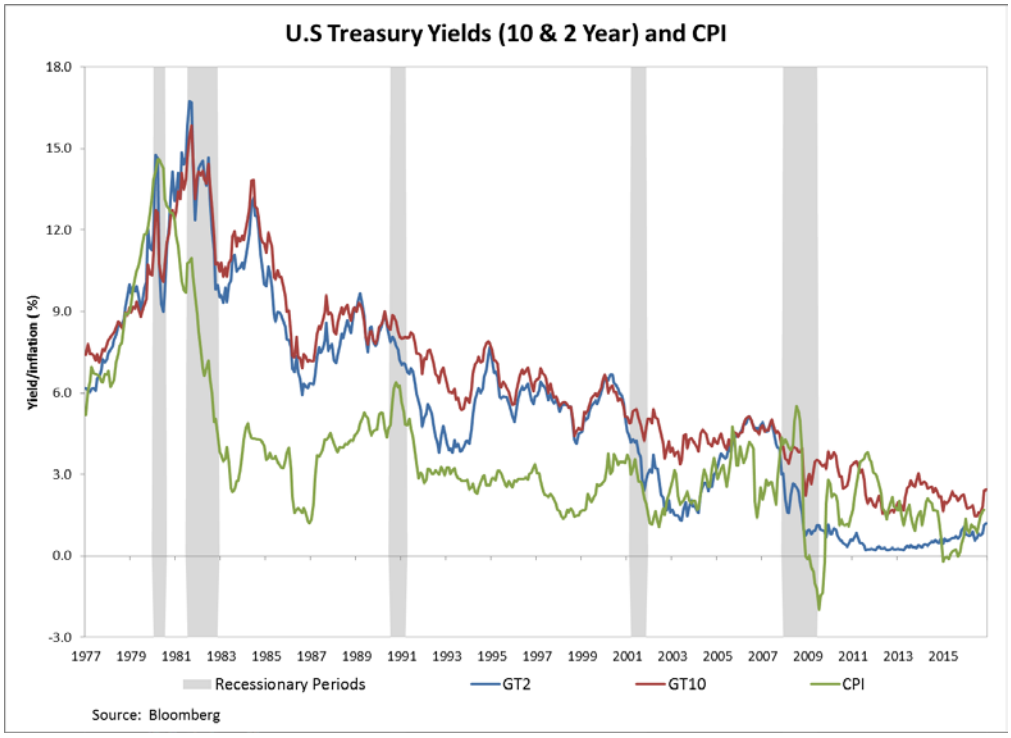
It is also worth noting that while year-over-year inflation numbers remain inside the Fed's 2.0% target, the last five monthly prints reflected an annualized rate in excess of 3.0%. This is likely due to the end of the oil price contribution to the year-over-year measurement. These factors suggest that investment led activity may push the inflation rate above the Fed's target leading the Central Bank to begin to target inflation for the first time since 2007.

The graph below shows the historical relationship between 10 and 2-year rates, and between 2 year rates and Fed Funds over a period that has witnessed four recessions. With some noise it shows that yield curves tend to be steep in periods of expansion, flatter as growth slows, and the Fed tends to raise rates ahead of recessions. Using this history as a guide and considering likely inflationary pressures, it would appear the yield curve should steepen again. Investors, including us, are expecting the Fed to raise rates 2 to 3 times in 2017. If the Fed delivers three 25 basis point hikes, the Fed Funds rate would be between 1.25% and 1.50% at the end of 2017. It is likely both of the curves in the graph trade at higher than historical averages to reflect growth and inflation expectations. Forward rates today indicate the 2 year could be about 1.85%, which makes sense to us. The 10 year, however, may move to a rate near 3.5% by the end of the year if inflation indeed picks up.



While these interest rates are not high by historical standards, in 2017 we think traders will likely focus more on the evolution of economic factors than on the Fed. It is feasible the Fed may be forced at act more aggressively bringing into

question the reinvestment policy that keeps their balance sheet elevated. Some in the market believe we may be reaching the end of a secular decline in long term interest rates. The observation is plausible because we reached such low levels over the last three years, especially in negative rate countries. However, with reasonable fiscal and monetary policies, there is no reason to conclude we are entering a secular move higher in rates and the economy's growth potential is limited. Historically, the economy has grown at desirable levels in periods of higher rates with equity and credit markets generating favorable returns. The value for global financial markets of a return to "normal" interest rates, however, would be *huge*.



January 15, 2017

† Please note net returns for the Emerging Markets Debt Composite have been recalculated from February 2014 to December 2016 to reflect management fees at 0.75 percent.

GIPS requires GIPS Disclosure Statement (please see attached disclosure)
GIPS requires GIA fee schedule disclosure "GIA's fees are (i) .35% annually for standard USA fixed income, (ii) .50% annually for enhanced fixed income and (iii) .75% annually for specialized products"

Important Information

GIA Partners, LLC ("GIA") is an SEC registered investment adviser.

This material is for information purposes only. It does not constitute an offer to or a recommendation to purchase or sell any shares in any security. Investors should consider the investment objectives, risks and expenses of any strategy or product carefully before investing.

Past Performance: The performance data quoted represents past performance. Past performance is not an indication of future performance provides no guarantee for the future and is not constant over time. The value of an investment may fluctuate and may be worth more or less than its original cost when redeemed. Current performance may be lower or higher than the performance data quoted.

Forecasts and Market Outlook: The forecasts and market outlook presented in this material reflect subjective judgements and assumptions of the investment manager and unexpected events may occur. There can be no assurance that developments transpire as forecasted in this material. Certain assumptions made in the preparation of the material may be subject to change without notice and GIA is under no obligation to update the information contained herewith.

Management Fees, as well as account minimums and other important information are described in GIA's Form ADV - Part IIA. Since management fees are deducted quarterly, the compounding effect will be to increase the impact of such fees by an amount directly related to the account's performance. For example, an account with a 10% gross annual return and a 1% annualized management fee that is deducted quarterly will have a net annual return of about 8.9%.

*Important GIPS disclosures pertaining to composite performance may be found at the back of this letter.

Index Definitions

Bloomberg Barclays US Aggregate Index

The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg Barclays US Treasury Index

This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg Barclays US Government/Credit Index

The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg Barclays US Credit Index

This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Bloomberg Barclays US Mortgage Backed Securities Index

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bank of America Merrill Lynch US Corporate & Yankees Index

The Bank of America Merrill Lynch US Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

Bank of America Merrill Lynch US Corporate Index

The Bank of America Merrill Lynch US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of

Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

Bank of America Merrill Lynch US High Yield Master Cash Pay Only Index
The US High Yield Master Cash Pay Only Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

Bank of America Merrill Lynch Global Government Excluding the U.S. Index (N0G1)
The Global Government Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

JP Morgan Corporate Emerging Markets Bond Index (CEMBI)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. Both indices are also available in Diversified versions.

JP Morgan EMBI+ Index
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI EAFE- Europe Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe.

MSCI EAFE- Japan Index
The index is a capitalization weighted index that monitors the performance of stocks from Japan.

MSCI Emerging Markets Equity
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.