

INVESTMENT INSIGHT

2016

FOURTH QUARTER



LEGACY WEALTH
MANAGEMENT[®]

In our third quarter *Investment Insight*, we wrote about the ups and downs of the markets through most of 2016 and warned that the uncertainty of the elections could cause more volatility. As stated in that article, “2016 has been and continues to be a year of uncertainty, with ‘uncertainty’ being a word that we have always said the market dislikes.” Well, the elections are over, and based on the market’s climb since then, all uncertainty has disappeared! Indeed we are pleased with the final push upward of the markets that we’ve experienced lately. There are reasons to believe markets will continue to do well, but uncertainty never disappears. In this *Investment Insight* we will explore the reasons for optimism, discuss reasons for caution, and describe the actions we are taking on your behalf to navigate the opportunities and potential pitfalls of the coming year(s).

With the election of Mr. Trump and the continued control of the Senate and House by Republicans, markets abound with optimism about several policies that could help business bottom lines. President-elect Trump has promised to provide regulatory relief for businesses, cut the business income tax, give companies with significant profits overseas tax breaks that would allow them to bring that cash back into the U.S., spend billions on infrastructure projects, repeal or

significantly reform the Affordable Care Act (aka Obamacare), and negotiate trade deals that are more favorable to U.S. companies. For many of these potential changes, he has the support of the Republicans in Congress, and in the case of business tax cuts and the repatriation of overseas profits, also widespread



support from the Democrats. Sounds like certainty, right? Markets think so.

If the President-elect and Congress are able to accomplish some or all of their objectives, then that should be positive for the U.S. economy. Tax reductions go straight to the bottom line, and repatriated profits will hopefully be reinvested by companies in their own growth. Significant infrastructure spending will benefit U.S. companies and workers alike. What’s good for U.S. businesses should be good for your portfolios. Over the last couple of years, we have

reduced our international exposure (particularly in Europe) and increased our investments in the U.S. More specifically, we have increased our allocation to middle-sized companies (mid-cap companies) in the U.S. Whereas large companies that make up the S&P 500 stock index attribute only about 50% of their earnings to

U.S. operations, approximately 80% of mid-cap company’s earnings are derived in the U.S. Policies being pursued by Mr. Trump, along with continued strength of the U.S. dollar, should benefit these mid-cap

U.S. companies more than their larger-cap counterparts. The same can be said for U.S. small cap companies where we also have a slightly larger allocation than one would find in a broad market index representative of the whole U.S. market.

Life/politics are rarely as easy as the markets depict them to be, and Mr. Trump hasn’t even taken office yet. We suspect that accomplishing the policies listed above will be much more difficult and messy than currently anticipated. The possibility

exists that some of them may not get accomplished, at least in the simple form offered in pre-election and pre-inauguration speeches. There will be bumps along the way which means that uncertainty will return to the markets, and volatility will accompany that uncertainty.

There are longer-term implications for the markets that cannot be known with any certainty until policies are enacted. For example, if Mr. Trump's policies add significantly to the national debt, that will be a big concern for markets moving forward. Decisions that look strictly political on their face could feed back into the economy and the markets, so topics like foreign relations have to be monitored.

With all of this in mind, we continue to believe that a balanced approach that includes international equities as well as high-quality fixed income makes the most sense. International equities are less expensive today than U.S. equities, so while we believe the U.S. is the best place to be invested in the near term, we continue to believe

that international equities have a place in the portfolio (our current weighting within equities in most portfolios is roughly 76% U.S. vs. 24% international). Likewise, we know that bonds are facing strong headwinds as the Federal Reserve begins to raise interest rates and the potential for inflation increases, but we also know that bonds have been the safest place to be when the unexpected occurs. Should President-elect Trump turn unpopular rhetoric into action overseas, we could easily see an equity market sell-off with a bond market rally as investors move to the safe haven of fixed income (particularly high-quality government bonds).

As we move into 2017, we remain cautiously optimistic that some of the policies that Mr. Trump and the Congress want to pursue will be accomplished *with positive near-term results for U.S. businesses and the economy*. We acknowledge that there are areas for concern, and we will continue to monitor the markets as closely as we always do. In the meantime, we remain certain about

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two things – uncertainty will always be present, and diversification works in the face of uncertainty as you pursue your long-term goals.

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