Polaris Greystone FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

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2016 Market Review & 2017 Outlook

Wow what a year! As we have written during the course of the year, 2016 will be remembered as a "year of firsts." Here are a few highlights of what happened during the course of the year that has never happened before:

- The first ten trading days marked the worst start to any calendar year in the S&P 500's history, dropping over 8% to begin the year.
- What was working in 2015 stopped working, and what wasn't working outperformed. According to the Wall Street Journal, the worst performing 50 S&P 500 stocks of 2015 outperformed the best performing 50 stocks of 2015 by approximately 13% in the first half of 2016, the largest disparity since they began tracking this data in 1990.
- The British departure from the European Union (aka Brexit) marked the first time that a country had left the EU. The Brexit vote sent the world markets down dramatically, only to see them rally after only two days. Weeks later, news emerged that several central banks invested over $500 billion into the markets to help stop the free fall that was occurring at the time.
- The 10-year Treasury made its own history when its yield hit 1.32% in July, an all-time low. Buying pressure from foreign investors seeking higher yields than their local bonds and a strong U.S. dollar were the primary causes of this rally. The 10-year Treasury's yield has since skyrocketed up to 2.60% in December and finished the year at 2.48%, financially harming long-term and intermediate-term bond investors.
- Donald Trump's election also marks a first. He will be the first president in American history that has lacked political and/or military service prior to taking office. The S&P 500 rallied over 6% after his election and finished the year up 9.5%.

Other 2016 Highlights

- The top performing sectors were energy, financials, and telecommunication services, up 23.65%, 18.64%, and 17.81% respectively.
- The worst performing sectors were health care, real estate, and consumer staples, with annual performance of -4.36%, -0.81%, and 2.58% respectively.
- Commodities were the top asset class, with the S&P GSCI surging 27.77% for the year.
- Gold's value increased 8.79%, ending a three year losing streak.
- Bonds eked out positive performance for the year, with U.S. Treasury bonds gaining 1.33%, T-Bills up 0.32%, and the Bloomberg Barclays U.S. Aggregate bond index posted 2.65% positive returns for the year.
- The Federal Reserve made its first move in a year, increasing Fed Fund rates by 25 basis points at its last meeting. More significant was its indication that it will make three more increases in 2017, which could have a significant and negative impact for bond investors.
- Developed international stocks lagged U.S. stocks. The MSCI EAFE (Morgan Stanley Capital International - Europe, Australia, Far East) Index rose 5.3% in local currency, but U.S. investors would have only seen 1.0% rise in U.S. dollar terms.

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2017 Outlook

Our outlook begins and ends with one person, President-elect Donald Trump. Was his rhetoric a stunt to get elected or does he mean to attempt to accomplish his campaign promises to "Make America Great Again?" Let's take a clinical look at what was promised and its potential impact on our economy:

			Economically	
Campaign Promise	**Rhetoric**	**Reality**	**Good**	**Bad**
Lowering Personal Taxes		X	X	
Lowering Corporate Taxes		X	X	
Eliminating the Affordable Care Act	?	?	?	?
Spending More Money on Military		X	X	
Increasing Infrastructure Spending		X	X	
Renegotiating / Eliminating Trade Deals		X		X
Building a Wall Across Mexican Border	X			X
Deportation of Undocumented Workers	X			X

Lowering Personal Taxes

With the Republican Party in control of Congress and the presidency, it is all but guaranteed that we will see a lowering of personal taxes. Since 70% of our economy is driven by personal consumption, more money in the hands of the average American should strengthen personal consumption and fuel economic growth. This is viewed by most as a good thing for the economy.

Lowering Corporate Taxes (and repatriating money held abroad)

Like personal consumption, the thought is that lower corporate taxes will mean more spending. This could take the form of research and development, hiring more employees, etc. In return for restructuring corporate taxes, U.S. companies would be forced to repatriate money held abroad. This flood of money back into the United States could be used for mergers and acquisitions, dividends, or share buy backs. All of these things are accretive and should benefit stock investors.

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Eliminating the Affordable Care Act (ACA)

I think that most people reading this educational email have a heart and want their fellow Americans to have access to affordable health care. The problem is that the ACA was not affordable and has countless flaws. I don't think that it is realistic to repeal the ACA but I do think that the Republicans will attempt to overhaul the ACA. As it stands, the ACA has been bad for our economy. Overhauling the system could create more chaos in an already muddied environment or the Republicans might fix a flawed health care program. We'll have to wait and see how this turns out.

Spending More Money on the Military

Government spending accounts for approximately 30% of our country's economic activity. President-elect Trump wants to double our military spending from $600 billion to well above $1 trillion annually. Increasing military spending is often not a difficult barrier. All the Republicans need to do is pass the budget. With control of both the House and the Senate, this does not seem like a difficult thing for them to do. This should be beneficial to the industrial sector in our economy.

Spending More Money on U.S. Infrastructure

Both Republicans and Democrats agree that our country's aging infrastructure is of major concern. Bridges, highways, and the electrical grid system are all on the list of needed improvements. Increasing spending in this much needed area would be a good thing for the country and a good thing for our economy.

Renegotiating or Eliminating Trade Deals

On the surface Trump's rhetoric about renegotiating trade deals sounds good. Why would we not like our own companies and our country to benefit from better terms regarding foreign trade? The issues are much more complex than saying we want a better trade deal. The likelihood of retaliatory action taken by our trade partners if we were to renegotiate or change the terms of our deals seems high. The result could become a "tit for tat" escalation of retaliatory actions which could have negative impacts on our economy.

Building a Wall Along Our Border with Mexico

Currently, there are already almost 700 miles of fencing along our border with Mexico. One could easily argue that the current wall has not stemmed the inflow of undocumented workers in our country. Which raises the question of why build Trump's wall?

Trump's wall would be solid concrete wall spanning almost 2,000 miles, at an estimated cost of $25 billion, according to the Washington Post. Trump's proposed wall will face serious ecological obstacles, would be a logistical nightmare, and would most certainly face countless legal battles. Without even getting into the ecological or logistical issues, 66% of the land that Trump wishes to build his wall on is either privately owned, owned by Native American tribes, or state owned (Counsel of the Americas). The government would have to claim eminent domain which could take years in court to settle.

Deportation of Undocumented Workers

Trump's platform to deport all "illegal immigrants" from this country is nothing more than rhetoric. The logistical issues alone would be enough to grind this effort to a halt, let alone looking at the humanitarian or legal issues. According to Pew Research Center, there are approximately 11 million undocumented immigrants in the United States. Eight million undocumented immigrants are in the U.S. civilian workforce, making up approximately 5% of the total workforce. A study by the non-partisan think tank American Action Forum determined that Trump's plan to deport all undocumented immigrants would cost our country between $400 and $600 billion.

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Conclusion

As we enter 2017, the U.S. economy is chugging along. S&P 500 companies have just ended a six quarter earnings recession, showing their first uptick since 2014. We weathered this earnings recession without having a "bear market" correction of 20%+, which would be typical in this type of recession. Most analyst expectations for 2017 are for continued improvement. All of this makes me comfortable with having a full exposure to the stock market, at this time.

Intermediate and long-term bonds continue to be our biggest concern for U.S. investors. The Federal Reserve looks to speed up its process of normalizing rates, projecting three increases in 2017. This could be a significant headwind for bond investors for the upcoming year and the foreseeable future.

We do have some concerns about Europe and Asia, as many countries are still trying to "jump start" their economies. We will continue to monitor their economic situations to ensure that we limit the impact this might have on you as an investor.

Donald Trump's presidency shall begin with a lot of question marks. He is the first president to enter the office without any political or military experience. While some of President-elect Trump's campaign promises could have very positive impacts on our economy, others carry significant moral and political potential pitfalls.

As like most years, we begin the year with many unknowns and just as many headwinds as tailwinds. This is why we tactically manage our strategies to play "defense" when risk rises in the markets and over allocate to equities when risk subsides. It is also why we change the weightings of our sectors, asset classes, or international regions, depending on which Polaris Greystone strategy in which you are investing. We are relentless in our effort to understand the markets. We weigh the inherent risks and opportunities and manage our portfolio strategies responsibly based upon this knowledge. It is our job to help each of our clients set and safely reach their long-term financial goals while working within the confines that the markets set for us.
We look forward to serving you and to a successful 2017.

If you would like to listen to an episode of our podcast on our 2017 Economic and Market Outlook click here.

https://soundcloud.com/pgfg/16-2017-economic-and-market-outlook-with-jeff-powell

As always, I welcome your comments and questions.

Sincerely,

Jeffrey J. Powell
Managing Partner