MANAGED ASSET PORTFOLIOS

MAP VIEWS
First Quarter 2017

Investors will likely remember 2016 as the year of surprises. Global markets suffered one of their worst openings ever, as commodity prices tumbled and recessionary fears mounted. As it became apparent that the Fed would not be as aggressive on the interest rate front as originally feared, thereby easing recessionary fears, stocks and commodity prices rebounded. Markets then responded negatively to the Brexit vote in the summer months, but then quickly shrugged off the surprise vote and moved higher. Furthermore, the markets confounded the pundits, and moved higher after Trump's surprise victory in November. By year-end, U.S. stocks logged their best showing since 2013, with the S&P 500 up 9.5%. Globally, however, stocks did not fare as well, with the MSCI All Country World (ACWI) Index up 4.89%, or 7.72% including dividends.

Bonds posted their second consecutive year of declines, as interest rates moved higher. Year-over-year, the yield on the 10-year Treasury moved from 2.273% at the end of 2015 to 2.44% at the end of 2016. While year-over-year changes were rather muted, the real story took place during the year. In early July, the benchmark 10-year Treasury traded at a record low of 1.466%. The final quarter of the year marked the largest sell off for bonds in over twenty years, as yields increased nearly 85 basis points. While we believe rate increases will be modest this year, we do believe, however, that the 35-year bull market for bonds has come to an end. Accordingly, we will be keeping our weighted average maturities short (currently at less than one year).

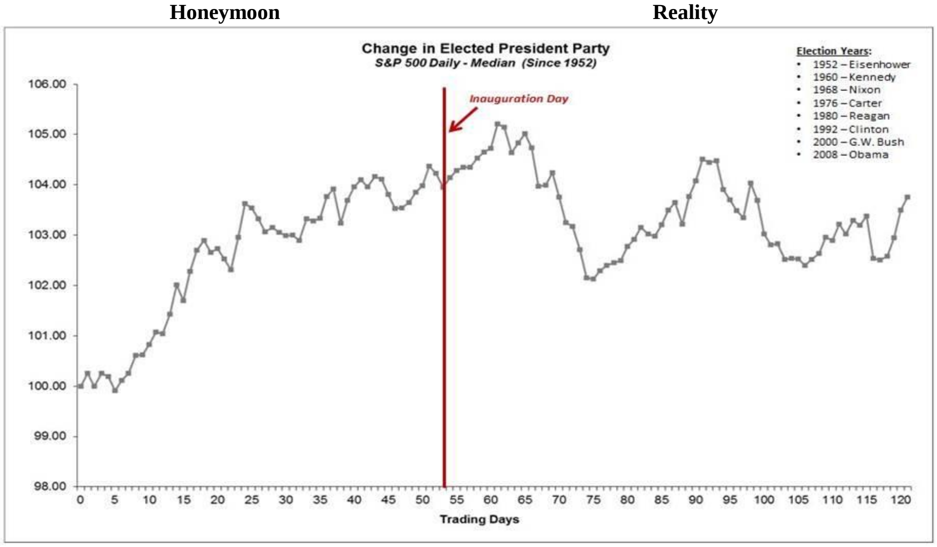
From a historical perspective, domestic stock valuations appear overly stretched. Stocks in the S&P 500 are trading at approximately 21 times trailing 12 month earnings, up from about 16 times earnings for the past ten years. The Bulls argue that given the low levels of inflation and interest and forecasts for higher earnings make stocks attractive. While we believe that low levels of interest rates and inflation make stocks an attractive alternative to bonds, we are skeptical of how much earnings improvement we will see. There are only three factors that contribute to equity returns: dividends, earnings and price/earnings (P/E) ratios. In the past five years, the MSCI World Index was up 87%. Of that 87% appreciation, dividends added 15 percentage points, earnings ***detracted*** 2 percentage points and P/E expansion contributed a whopping 74 percentage points. P/E multiple expansions have played right into the hands of indexers. Going forward, we believe success in the equity markets will play into the hands of stock pickers, as selectivity will become of greater significance.

What does 2017 hold?

Looking back, as 2015 wrapped up, the Fed raised interest rates for the first time in nearly a decade. With that, Wall Street economists were forecasting 4 more hikes during the course of 2016. What ultimately came to pass was that the Fed raised rates only one time during the year, and that was in December. Today, Wall Street economists are forecasting three rate hikes during 2017. To the contrary, we anticipate the Fed will only raise rates once or possibly twice.

In short, we do not consider the economy as strong enough to handle more than two interest rate increases. While we do believe lower taxes and less regulation are generally positives for the economy, we believe the new administration will be hard pressed to deliver on many of their campaign platforms. Accordingly, we believe that some of the biggest beneficiaries of the so-called "Trump Rally", namely the financials and economically sensitive sectors, will be challenged to continue their recent momentum. To further put this into perspective, it is interesting to note that from the time Ronald Reagan was elected in 1980, until the inauguration in 1981, the market rallied 9%. The market proceeded to fall 30% until the great Bull market began in August 1982. While we are not forecasting a repeat of such price action, we believe a certain level of cautiousness is warranted.

Honeymoon **Reality**



Source: Renaissance Macro Research

Since the US election, stock prices have rallied; however, the market has also pushed interest rates and the U.S. dollar higher. The latter recently traded at a 14-year high. Higher interest rates and a higher dollar make it more difficult for U.S. manufacturers and farmers to sell their products abroad. Recently, President-elect Trump commented that the dollar was too high and was hurting the competitiveness of U.S. companies. We have to wonder if Mr. Trump is going to try to "Tweet" the dollar lower. Nonetheless, we do believe the dollar has appreciated too high, too fast. A retreat in the dollar could help U.S. based multi-nationals and provide some currency relief for foreign holdings.

We sincerely appreciate the opportunity to service your investment needs. It is responsibility that we do not take lightly.   We would diligently every day to seek out the best risk adjusted returns for our clients' portfolios. Best wishes to you and your families for a happy, healthy, peaceful and prosperous New Year!

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