WINTHROP FINANCIAL
Investment & Life Planning Advisors

YEAR END 2016 AND A LOOK INTO 2017

The year 2016 was a most unusual year as several unexpected economic and political happenings occurred, as well as consensus forecasts failed to meet expectations. Some of these occurrences included:

- Brexit,
- Donald Trump's election,
- oil prices rising to $50/barrel,
- OPEC reaching production agreements,
- corporate profits finally rising after six straight quarters of declines,
- 10-year Treasury Note yields rising from a low of about 1.4% to a yearend rate of 2.5%,
- unemployment declining to 4.7%,
- Core Consumer Price Index at 2.2%,
- the US Dollar recovering from an early decline to climbing to a twelve year high, and
- Gross Domestic Product improving all year long to 3% by the third quarter.

Many economists and financial analysts forecast long term economic growth for the U.S. will be no more than 2%. Some call this the new normal based on an aging and slower growing U.S. population, a lack of capital investments and failure to spend enough money on research and development. Many corporations in the recent past found it better to hire additional employees rather than spend money on plant and equipment to meet additional demand. If demand were to falter, companies could lay off employees rather than be stuck with unused plants and equipment.

We are more optimistic; believing that with pro-business policies from Washington corporations will invest more for growth and productivity. Technology will develop new products and solutions to old problems and a healthier World economy should enable the U.S. economy to grow 2.5% to 3%. Investment total returns should be closer to 7% before inflation.

One of the reasons for being positive about the next few years is that we anticipate that the stock market will be driven by earnings growth rather than by low interest rates. Earnings per share growth of the S&P500 is expected to rise over 11% in 2017 compared to little earnings growth in 2016.

In addition to better U.S. economic performance ahead, we are also anticipating better World economic growth as 80% of the World's largest countries have rising leading economic indicators compared to only 40% last year. China is a big question mark, being our largest trading partner. Rising global interest rates and a strong Dollar are leading to a lower Yuan and capital outflows while contributing to higher local inter-bank rates. This could lead to a one time large devaluation of the Yuan to stem capital outflows. While we do expect this, we also anticipate continued declines in China's currency in 2017.

Additional positives for our economy include election promises from Donald Trump of personal and corporate tax cuts, $1 trillion infrastructure spending and deregulation in various industries. Even if these promises are kept and Mr. Trump is able to work with Congress, it will take time before these new laws and spending programs work their way through the economy. Some forecasters think Trump's policies could over-stimulate the economy and cause inflation to rise faster than anticipated, where the Fed would have to raise rates more than the three raises they have already mentioned for next year.

With all these positives, what can possibly go wrong?

- The economy does not perform as expected and heads into a recession,
- The Fed raises rates faster than expected,
- The U.S. Dollar rises from its already high levels and exports decline which results in a slower economy,
- Mr. Trump sends some disastrous tweets,
- Russia increases its presence on the geopolitical stage,
- China increases its willingness to show military strength,
- There are many more terrorist attacks,
- Software security breaches increase,
- The EU struggles to survive as elections in Germany, France, and the Netherlands alter the country's participation.

There has been much written (perhaps too much) about the high valuation of stocks and the Dow Jones Industrial Average reaching 20,000. Based on earnings estimated for the S&P500 for 2017 (traditionally these come down some during the year), the forward price to earnings ratio of the S&P 500 price is around 17 times expected earnings. This is only slightly above the historical average of 16 times earnings and, while high, it is not excessive. Further, psychologically the Dow at 20,000 is a nice round number but it is not much more than just that.

Since Mr. Trump's surprising election victory, the stock market has been strong with financials, industrials, energy and telecom segments leading the way. Much of this rally is based on hype and "guestimates" with no concrete details. Many of Mr. Trump's campaign promises must be enacted by Congress and that may take time and may not be all that he wanted. So the stock market may decline in the near term. In fact, the S&P 500 fell an average of 2.7% during the first year in office for the last five Republican Presidents. Nine out of ten Republican Presidents since Teddy Roosevelt each witnessed a recession in their first two years of office. Let's hope this time is different.

Bonds have been on a roller coaster ride this year with interest rates falling during the first part of the year and rising rapidly toward year end. Negative interest rates occurred in Japan, Germany, Switzerland, Denmark, and Sweden and at one point exceeding over $15 trillion in assets. We expect interest rates to rise further but slowly, as outlined by the Fed in their December meeting. We believe the best way to protect our bond investments is to buy high grade bonds in a laddered portfolio with one to five year maturities.

Finally, while we are reasonably optimistic about the U.S. economy and the stock market, there is absolutely no one who can predict the future. But, the following points based on statistics compiled since 1871, should be of interest to investors:

- 33% of market downturns recover within one month,
- 50% of market downturns recover within two months,
- 80% of market downturns recover within one year,
- 95% of the time the big once in a lifetime drops return back to even in three to four years with an appropriate portfolio,
- Collectively since 1871, the time it takes for the market to recover (top to trough to top again) is 7.9 months.

Again, there is no telling what the future holds but we are optimistic that it will be good and that we can guide you well through this rapidly changing world. We can't emphasize enough that we need to continue to keep a long term view. The next big market move is unknowable. All we know of the market is that it will trend upward over time, and downturns, in the market or in various sectors of the market, are a temporary phenomenon. We must hold good stocks through all markets.

We will continue the value approach to investing. We lean toward preparing our portfolios to withstand turbulence in the market, which in turn makes us comfortable in staying in the market for the long term. While we emphasize growth of earnings, we are aware that a stock's price should be reasonable in relation to its underlying fundamental prospects. And, we are stingy with what we will pay. We are not invested in the market, we are invested in a custom selection of undervalued businesses. We will continue to search for companies that have recurring revenue, strong balance sheets, good revenue and earnings growth prospects, reasonable valuations, and pay competitive and growing dividends. Industries that interest us include financial, industrial, energy, materials, technology, real estate, healthcare, and consumer staples. Consistency of application is essential to eliminate the emotional aspects of investment decision-making. Emotion, if unchecked, can destroy clear, unbiased analysis and drive decisions based on fads, tips and rumors with the result being badly structured portfolios and poor results. Thus, it is essential and critical that our investment philosophy be applied in a constant, disciplined manner.

Celebration is in order

As we celebrate our 5th birthday as Winthrop Financial this year we reflect on the many friends we have and the many friends who have passed on over the years. We reflect with kindness toward the past generations we've served and the continuation of families we still serve today. We reflect on our discouragement when an investment hasn't worked out as well as we'd hoped, and on the excitement we've shared with our clients when another investment outdoes our expectations. We reflect on the ways we've molded to the financial services industry throughout time as investors' needs change. Our commitment to the firm is confirmed through our longevity within the industry and, well, sticking power. There is no better place on earth to work. Any one of us is willing to jump in when a client needs something. We are here working for you to ensure smooth operations, correct transactions, and plain good service the old fashioned way. We reflect on all the changes, yet we remain the same. The principles on which we were founded have remained steadfast. And, we are committed to the simple tenet that the best interests of our clients must take precedence in every decision we make.

We are here to make sense of the complexities of the markets, investments, products, and services that proliferate so quickly. Webster's dictionary describes the word "managing" as guiding; to treat with care; to achieve one's purpose. We find so much satisfaction in getting to know the individuals we serve, whose trust we hold dear, and whose lifestyle needs and family pursuit are placed in our hands. It's a challenging, exciting, and competitive position to be in.

Ours is a client care model which is reminiscent of another day, and of a way of thinking about the relationship between advisor and client which has simply vanished. We have a level of service and care that cannot be replicated by the large institutional firms. It is the personal focus, in an atmosphere of time honored tradition – caring about the client first, taking the time to understand – which distinguishes us. Our uniqueness is that we remain independent.

Examining the Future

> *"Life must be understood backwards; but, …it must be lived forwards."*
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> Soren Kierkegaard

Looking at the past gives us knowledge to avoid repeating mistakes in developing our investment strategies. That knowledge includes the concepts of diversifying the portfolio, investing for the long term, and avoiding attempts at market timing. And it provides a basis for establishing our assumptions of the historical range of returns we use in testing our analysis. But the past in this sense is limited, we don't repeat it and we merely use it as a starting point to look at the future.

What are your realities, your concerns, and your current life transition? Knowing what is happening now puts perspective on where you have to go. In framing your future, we reflect on what is important to you and your very personal definition of retirement, family needs, and life planning issues. We cannot control the financial markets, the global economy, the regulators, or past history. What we can do is help you discover the steps you can control through your own actions toward your goals and in developing a discipline to achieve them. The truth is that some of your goals will not come to pass. Life gets in the way and restricts you logistically and financially. Parents age and may need assistance. There will be health challenges. Children are going to grow up, move on, move back, and continue to bring challenges. Companies will change direction and pensions are going to be affected. The best laid investment plans, and the markets, are not obliged to go along.

Let's anchor your plan in sound principles and stable investment philosophy. When reviewing your portfolio and asset growth, we learn the answers to a variety of questions, but most importantly, to the spending and savings questions that make your plan possible. Did you contribute the savings you said you would? Did you avoid increasing your debt or your spending? What is done or omitted is behind us, and we now must evaluate and build on what we do have.

We look forward to the coming year with ever watchful attention to the investments and employ the anticipation to make sure we can act when needed. Our decisions are not made in haste, but instead are made with purpose and the higher motivation of making sure the pieces all fit together to fulfill your very special goals. We take seriously our part in helping you make the most of the one life you have.

We send along our best wishes for the New Year. Live well and make some noise.
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