

# A Review of Asset Class Performance, Fed and Oil Pre and Post Election

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AAll Silicon Valley Chapter Board

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# Outline

- **2016 Asset Class Performance Review < Note- data cutoff Jan 6>**
  - **Domestic Equities**
    - A quarter at a time
    - Sector review, Oil, Infrastructure
    - Large Cap ETF
    - The Dow
    - Style Box shift
  - **Key International**
    - Brexit
    - EU markets
    - Hedging vs non hedging
    - Coming EU Elections
    - Asia
  - **Fixed Income**
  - **REITs**
  - **Commodities**

- **The Fed**
- **Market Valuations**
- **Review of key Policies**
- **Market strategies- Cash Rich and high tax rate companies**
- **Looking into a murky 2017**
- **aPolitical Analysis- what HAS happened and what has NOT happened**
- -----
- **No questions on Politics // Questions on anticipated Policy impacts OK**
- **Election data // My Tickers in Backup**
- -----

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**Today I have limited time after the presentation- Grand Daughter #3 getting married at 3PM // Send additional questions to me at my eMail**

# The Main Message

- 2017 is here, 4Q 2016 earnings season is starting- time to pay attention to GUIDANCE (high uncertainty)
- The Trump Administration has not been inaugurated
  - There has been no legislation
  - There has been no implementation of policy
  - We do not know what the priorities are in policy or how they will play out
  - Since the election the market has been driven by sentiment
- There has been rapid and radical repositioning of asset classes
- The Pundits don't know what's coming, they were wrong throughout 2016 in the US on the election and market response
- There are a number of key relationships you must study that will affect the markets
- There will be 'pushing and shoving" re: policy and legislation that has the potential to disrupt the agenda
- Remember that the economy is NOT the stock market
- Prioritization of policy and timeline of legislative rollout is not clear and the devil is always in the details
- To be successful you must watch and monitor asset classes as times roll on
- Expect VOLATILITY in 2017



# 2016 SP 500 Timeline

S&P 500 (^GSPC) 2,238.83 -10.43 (-0.46%) As of December 30 4:45 PM EST. Market closed.



# 1Q SP 500 Swoon- Jan, Feb 2016



1829.08 Close-low for 2016

- Jan 7- Worries about China-plunging Yuan and recession fears to start the year
  - The Dow lost 5.2 percent since the end of 2015 in the worst first four trading days since the 30-stock index was created in 1928. The S&P 500 was down 4.9 percent since Dec. 31, its worst four-day opening in its history, according to S&P Dow Jones Indices, while the Nasdaq was down 6.4 percent
- Jan 20- WTI Oil plunges to close at \$26.55/Barrel, on oversupply concerns. SP Close 1859.33
- Feb 11- WTI Oil plunges to close at \$26.07/Barrel, with continuing oversupply concerns; SP 500 closes at low for 2016 at 1829.08
- Investors chased yield, pushing up valuations of Utilities, Staples and other High div stocks to unsustainable levels
- The Fed met on Jan 26,27 and March 15,16 (Presser), remained on hold looking for “more data”
- SP 500 Return for 1Q= 1.5%

# 2Q SP 500



- The SP 500 remained in an earnings recession- 2 years old
- The SP 500 made some progress, peaked in early June, encountered Brexit, recovered and was up 1% for 2Q
- At 2Q end the UST 10 year closed at 1.4880, near 2016 lows
- Election rhetoric intensified on both sides
- In 2Q the Fed had two meetings- April 26-27 and June 14,15 (Presser) and remained on hold, citing the need for “more data”
- The SP 500 return was about 3.8%

# Brexit- Vote June 23,2016

- The referendum occurred 6/23 to consider staying in the EU or leaving the EU
- The Brits were unhappy with the relationship with the EU
  - Payments, Immigration, Brussels
- The PM, Cameron, wanted to settle it with the populous
- He set a referendum, thinking he had a safe vote
- It was widely expected that the vote would be “Remain”
- There are 4 Areas of the UK
  - England
  - Wales
  - Scotland
  - Northern Ireland
- The vote went “Leave”
- I had estimated a range of 48-52 for “Leave” based on population ratios and sentiment with likely 52 for “Leave”
- That’s what happened- the Pundits were out of touch
- The market was caught off guard and plunged
- The Pound Sterling crashed from around 1.50 vs USD to 1.30

# Brexit Market Impact

## SP 500



- The arrow denotes the SP 500 the day before the vote
- The Dot denotes the two day plunge followed by the rapid recovery

## ^FTSE



- The arrow denotes the FTSE the day before the vote
- The Dot denotes the two day plunge followed by the rapid recovery
- The market assessment appears to be “it is a 2 year process- no immediate worries”

## Pound Sterling



- The Dot indicates Pound Sterling vs USD at FTSE market close before Brexit Vote
- Note the plunge to 1.30 then lows around 1.22- no recovery

# Ramifications of the Brexit Vote

- Cameron resigned as UK PM
- Theresa May became UK PM
- To leave the EU the UK must invoke “Article 50”, a 2 year process
- This has not been invoked. It involves renegotiating a host of relationships and trade privileges- complex
- Later the UK Judiciary ruled that Parliament must affirm the vote to invoke Article 50
- London is the EU financial center as New York is in the US
- It is possible & probable that London will lose the financial center to continental Europe- possibly Germany, Netherlands, or to Dublin
- The Brexit Vote is emboldening populism across Europe
- Brussels is playing hardball with the UK re terms and conditions of the Exit
- Scotland will likely revive the independence referendum
- That calls into question the ownership of UK North Sea Oil
- It can cause instability in Ireland
- London is taking a big hit on Real Estate, potential for EU finance hub to move to Dublin, Netherlands or Frankfurt
- UK exports will be more attractive but their imports are more expensive, causing unwanted inflation
- Considerable tension has resulted between the UK and the EU leadership
- EU leadership is trying to avoid “Leave” votes in other areas of the EU in an effort to preserve the union
- Potential to dislocate a number of market assets as this unfolds over time



# 3Q SP 500



- **Key Events in 3Q >**
  - The US 10 year bottomed on July 8 at 1.366 a record low close. This was driven by worries about International markets
  - Election run-up
    - The Democratic convention was held July 25-28, nominating Hilary Clinton and Senator Tim Cain as their ticket
    - The Republican convention was held July 18-21, nominating Donald Trump and Governor Mike Pence as their ticket
    - The campaign rhetoric puts the market on edge
  - On Sept 9 the SP 500 Dropped 58 Points (2.66%) and the DOW Dropped 394 Points (2.2%)
  - The market response was a reaction to an ECB meeting where Draghi was concerned about Brexit impact but offered no additional stimulus and The Boston Fed Governor Eric Rosengren spoke hawkishly saying that the "degree of accommodation" provided by the Fed's relatively low benchmark interest rate "increases the chances of overheating the economy." It reminded us of May 2015 when we had the "taper tantrum"
  - The Fed held meetings on July 26,27 and Sept 20-21 (Presser), without taking action & again seeking "more data"
  - The SP 500 advanced 3.1% in 3Q

# 4Q SP 500



Pre Election swoon | Post Election Rally

The big reversal Election night into the am (11/8 into 11/9) >

## On Second Thought...

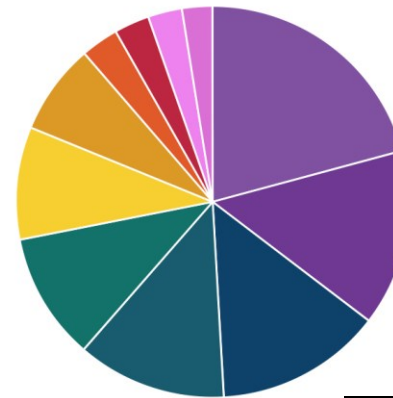
Futures on the Dow Jones industrials plunged Tuesday evening as the odds of a Trump victory grew. But they rebounded, and then some, early Wednesday after Trump's conciliatory address.




- The market drooped for 8 days prior to the election, fretting that Hillary Clinton was losing ground to Donald Trump & the market would tank if she lost
- The SP 500 turned around from an 800 point futures drop (Circuit Breakers kicked in) on election night to start a rally
- The SP 500 Peaked on Dec 13 at 2271.72
- Post election a broad rally occurred in Equities, and the USD. Big gains in financial, industrials & small caps occurred tilting to value
- Interest rates ramped, dropping prices
- Post Dec 13 the market consolidated in a sidewise move until profit taking and rebalancing took the market down
- The Fed
  - Fed meeting Nov 1,2: No action
  - Fed Meeting Dec 13,14 (Presser) raised FF rates .25 and forecasted 3 hikes in 2017
- Geopolitics came back near year end
  - UN resolution condemned Israel with the US abstaining vs prior vetoes
  - Russian Sanctions- dismissal of Russian diplomats from US soil
- The SP 500 returned just under 4% for the quarter

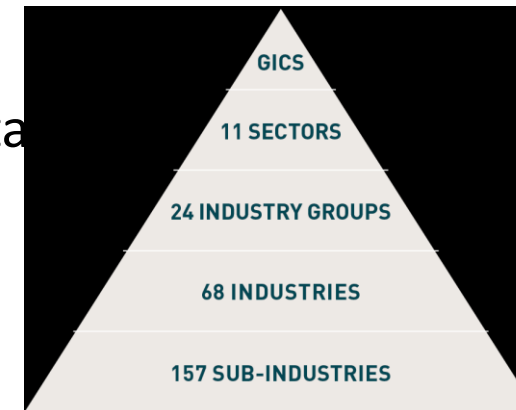
# SP 500 Sectors // Industries

- Sector Weights
- Most Sectors have large over weights in the top 10 positions- Check Yahoo Finance for top 10 to see the concentration in the sector



Information Technology	20.8%
Financials	14.6%
Health Care	13.7%
Consumer Discretionary	12.3%
Industrials	10.5%
Consumer Staples	9.3%
Energy	7.5%
Utilities	3.1%
Materials	2.9%
Real Estate	2.8%
Telecommunication Services	2.5%

- GICS Sectors/Industries 
- To optimize your investing results you need to understand Sector makeup and delve into industry subgroups
  - Example: Banks (up) vs REITS (Down)



# XLK- Technology

- **Big cap tech FANG Stocks were a crowded trade in 2016**
  - FANG= Facebook, Amazon, Netflix and Alphabet (Google)
  - Underperforming post election
- **XLK has a high % of overseas content. Strong US \$ and potential Trade impact have held them back**
- **Holding tons of overseas cash (include AAPL, MSFT, ORCL, IBM)**
- **Large potential gains if Repatriation and Corp Tax cuts are enacted**

**FANG Stocks  
underperformed  
vs SPY Post  
Election >**



# XLF- Financials

- **Note- REITS were separated from XLF to XLRE in 3Q**
- **Banks had been held back by low rates, a flat yield curve and some regulation overreach via Dodd Frank**
- **Bank Rally post election**
  - Increased rates
  - Steeper yield curve
  - Dodd Frank revisions expected- note, only 40% has been implemented
  - More bank friendly regulations expected
  - Regulation relief for non SIFI (smaller banks) as well as big banks
  - Increased economic activity expected- more loans
- **Conventional valuation measures for banks is book value**
  - Most of 2016 1.0X
  - Now 1.3X
  - Peak- about 1.5x
- **Bank earnings assessment per Tony Cresenzi, Pimco**
  - Steepening yield curve: 15-20%
  - Tax cuts: 15-20%
  - Less Regulation: 5%
  - Total EPS boost- 35-45%
  - I see increased trading activity due to increased VIX



# XLV- Health Care

- Election battleground
- A few egregious pricing issues came to light
  - Notable- EPI Pen from Mylan and Daraprim from Turing Pharmaceuticals
  - As a result, Tweet rhetoric from Hillary Clinton depressed Pharma & Biotech starting Sept 2015
- Trump promised to repeal & replace the ACA
  - Established as top priority
  - Timeline critical for Insurer readiness for 2018
- Rhetoric softened post election
  - Likely to survive are provisions for pre-existing conditions and age 26 coverage
- On the radar screen
  - ACA Overhaul
  - Pharma pricing
  - Scrutiny of the middlemen- PBM (Pharma Benefit Mgrs)
  - Govt negotiation of Pharma for Medicare





# XLY- Consumer Discretionary

- Abysmal performance for most big box retailers, apparel
- Persistent increase in eCommerce- secular change- Amazon is the winner
- Some wage gains in 2015
  - 19 states plus Washington DC raising minimum wage in 2017
- Demographics in play for spending
  - 10K retirees a day
  - Social Security “raises” nil
  - Household formation low among millennials, college debt a problem



# XLP- Consumer Staples

- One of the darlings in yield chase due to rich dividends coming into 2016 through 1H 2016
- Very high historical valuations
- Fell as rates rose off of lows and rates increased post election



# XLI- Industrials

- **Trump Infrastructure plan- promises \$1T in spend over 10 years on key infrastructure projects in partnership with states & municipalities**
- **Initial Fed funding likely via repatriation tax to Infrastructure Bank**
- **Roads/Bridges/Airports/Ports/Inner Cities/Water Systems etc**
- **Expectation- large impact on Industrials, Materials, and Engineering Design Co. Quite a bit already priced in**
- **Will take significant time to unfold- very long cycle effort**
  - **Select/Negotiate/Design/Permit/Build**
  - **Thorns- Time/Funding/Eminent Domain/Environmental Impact Reports**
  - **Likely realized in 2H2017 into 2018 and beyond**
  - **Think about cycle time of Bay Bridge, Anderson Dam refit, Bart etc**
- **Ref American Society of Civil Engineers (ASCE) Reports**
  - **Estimated Cost impact from failure to act (May 10, 2016)**
    - <http://news.asce.org/asce-report-estimates-failure-to-act-on-infrastructure-costs-families-3400-a-year>
- **ASCE 2013 Report on Infrastructure needs**  
<http://www.infrastructurereportcard.org/>



# The ASCE Report card on US Infrastructure

- 2013- latest published to the Public



- Not so good- Opinion: Reflects a lack of leadership
- The fix: or at least a partial fix coming with the new admin
- This is very daunting and complicated, requires Fed, State, County and local Agency funding, coordination and prioritization
- Will take a long time to plan and implement
- Refer to the ASCE site for recent legislative action on this

# ASCE Cost Assessment On the Cost to Fix

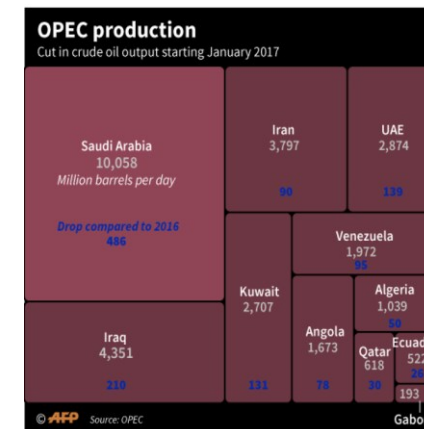
2013 REPORT CARD FOR AMERICA'S INFRASTRUCTURE ASCE			
GRADE SHEET: AMERICA'S INFRASTRUCTURE INVESTMENT NEEDS			
CUMULATIVE INFRASTRUCTURE NEEDS BY SYSTEM BASED ON CURRENT TRENDS EXTENDED TO 2020 (DOLLARS IN \$2010 BILLIONS)			
With each <i>Report Card</i> , ASCE estimates the investment needed in each infrastructure category to maintain a state of good repair. That is, approximately what amount of investment is needed to get to a grade of B?			
The table below provides the estimated cumulative investment needs by infrastructure category based on current trends extended to the year 2020 (dollars in \$2010 billions). Categories that are not shaded rely on data from ASCE's <i>Failure to Act</i> series.			
INFRASTRUCTURE SYSTEMS	TOTAL NEEDS	ESTIMATED FUNDING	FUNDING GAP
SURFACE TRANSPORTATION <sup>1</sup>	\$1,723	\$877	\$846
WATER/WASTEWATER INFRASTRUCTURE <sup>1</sup>	\$126	\$42	\$84
ELECTRICITY <sup>1</sup>	\$736	\$629	\$107
AIRPORTS <sup>1,2</sup>	\$134	\$95	\$39
INLAND WATERWAYS & MARINE PORTS <sup>1</sup>	\$30	\$14	\$16
DAMS <sup>3</sup>	\$21	\$6	\$15
HAZARDOUS & SOLID WASTE <sup>4</sup>	\$56	\$10	\$46
LEVEES <sup>5</sup>	\$80	\$8	\$72
PUBLIC PARKS & RECREATION <sup>6</sup>	\$238	\$134	\$104
RAIL <sup>7</sup>	\$100	\$89	\$11
SCHOOLS <sup>8</sup>	\$391	\$120	\$271
TOTALS	\$3,635	\$2,024	\$1,611
YEARLY INVESTMENT NEEDED	\$454	\$253	\$201

# XLE- Energy

- Oil has been under pressure since Mid 2014- recovering some in 2016
- The Saudis declared war on US Shale and overproduced to drive prices down starting Dec 2014 Prices ramped down from \$100+ to bottom a little over \$26 a barrel
- But this ate into their reserves so raising prices is now a priority
- Through the year OPEC has tried to come together on Production cuts
- Agreement reached at meetings in Nov & December OPEC & non OPEC w/o North America to “cut”
- Russia also chipped in 300K barrels per day
- Major Checkpoint next OPEC meeting- May 25, 2017
- US Rig count up 20 of 22 weeks as prices rebounded in 3Q, 4Q
- Oil export ban repealed
  - Export ban initiated in 1975
  - Congressional legislation approved 12/18/2015
  - First shipment at beginning of the year
  - Export depends in a large measure of spread Brent over WTI
- Oil production upside and strong dollar limit upside pricing
- US Shale is now more efficient as a result of the last 2 year price war
- Oil will rise and fall on rumors until we have hard data on production- trading range expected
  - The latest is that Libya wants to ramp production- not part of the OPEC/non OPEC deal



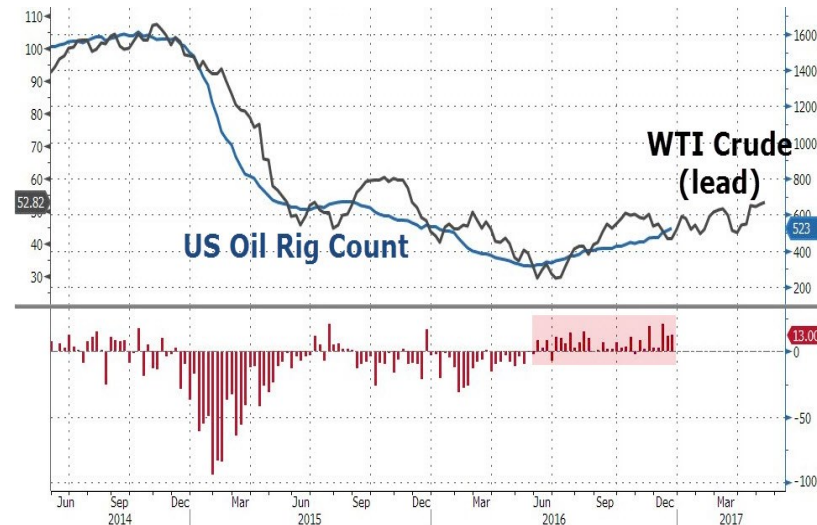
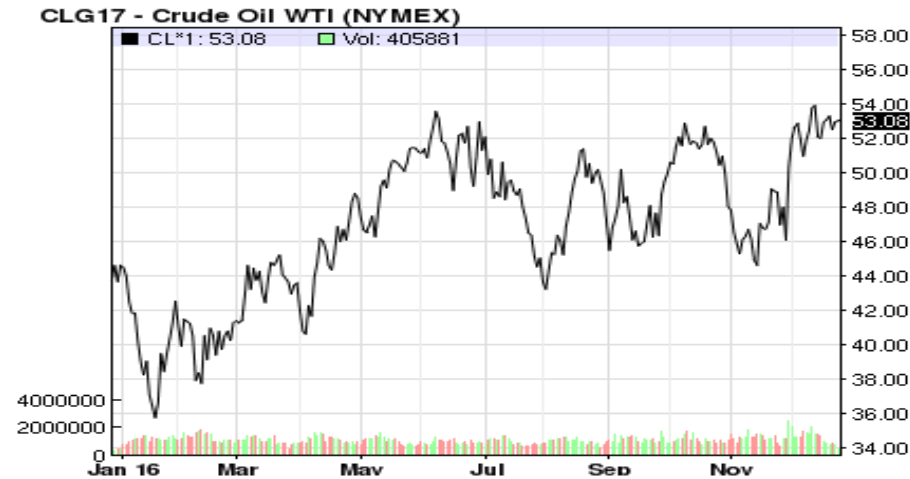
Where the OPEC cuts came from >





# Key 2016 West Texas Intermediate Oil Data

- 2016 WTI Price
- US Rig Count tracking price
  - Rigs up 9 weeks in a row



# XLU- Utilities

- Another yield chase darling
- Some volatility but more stable than most sectors
- Big hit from rates 2H
- Even with 2H hit just a little ahead of SP 500 return for 2016 as it moved with the SP 500 post election
- Vulnerable to rising interest rates
- Expect some focus on the Electric grid as part of IFR plans



# XLB- Materials

- Rocketed after the election
- Expectation of IFR build out
- Steel, metals, aggregates largely priced in
- Backing off YE
- Expect a pullback due to long cycle for implementation
- Already passed legislation yet to come to fruition on roads



# XLRE- Real Estate

- REITS transferred out of XLF to XLRE in 3Q
- Hammered from rates post election
- Also, eCommerce continues to gain ground, impacts malls, brick & mortar
- 2017 Caution- \$\$ of debt to be refinanced in 2017
- Potential selective opportunities down the road
  - Mall based big REITS less attractive
  - eCommerce persistently on the rise
  - REITS come in several other forms (examples- American Tower, Iron Mountain)



# XTL- Telecom

- Two big surprises here in this small sector
  - ATT (T) and Verizon (VZ) are not in this Sector, they are in XLK- Information Technology
  - But T Mobile is in here
  - And a very good march to great gains through the year



# SP 500 vs Mid Cap and Small Cap

- ^GSPC= SP 500 Index
- MDY= SP 400
- IWM= Russell Small Cap 2000

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## Notice the outperformance of MDY and IWM

- The Strong US Dollar Impacts the large multinational results more
- After the election this effect amplified the shift to smaller cap issues
- I prefer IJR to IWM

Moderating since mid December

Suggest considering equal weight ETF to avoid rotation whip

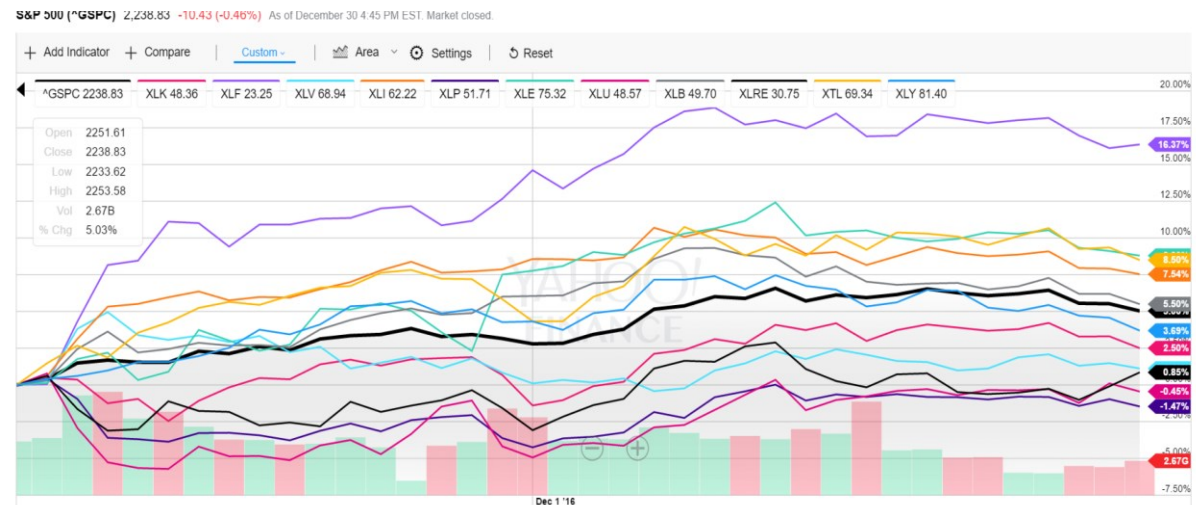




# SP 500 vs SECTOR PERFORMANCE

- **Overall 2016**

- **Top 3 Performers**
  - Little telecom XTL
  - Energy XLE
  - Financials XLF
- **Worst performer- Staples XLP**
- **What is striking is that through 2016 Utilities XLU did not participate in big selloffs**

[illegible]

- **Post Election Sector Data**

- **Big Outperformance in XLF (Financials) to Mid December**

- Then
  - XLE (Energy)
  - XLI (Industrials)

# SPY vs other Broad Large Cap ETF Tickers

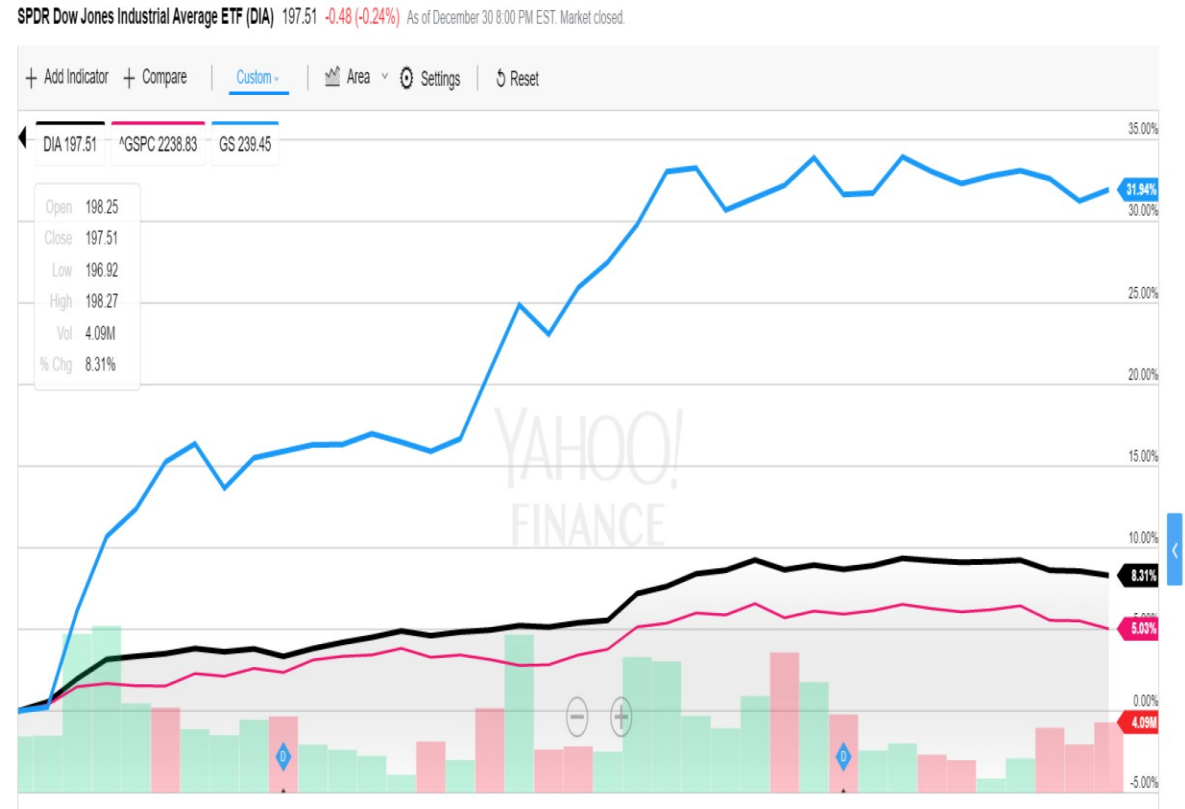
- Consider the following (best performers in Bold) since the election
  - RSP- Guggenheim Equal Wt SP 500 ETF
  - VUG- Vanguard Growth ETF
  - VTV- Vanguard Value ETF**
  - IWB- Russell 1000 ETF
  - IWF- Russell 1000 Growth ETF
  - IWD- Russell 1000 Value ETF**
  - EQAL- Russell 1000 Equal Wt**
  - ITOT- iShares Total Stock Market

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**Value and EQAL are the large Cap winners for the year & Post Election**



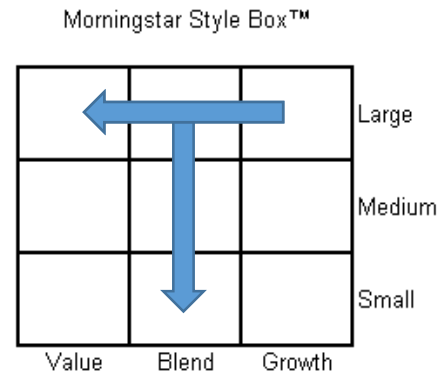
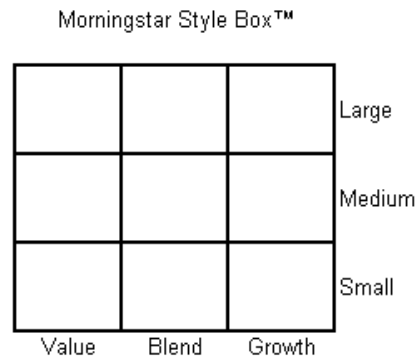
# THE DOW- Outperforming the SP 500 Post Election

- Most often quoted as “The Market”
- 30 Industrial stocks
- PRICE weighted vs SP 500 (Market Cap weighted)
- The math:(Divisor: 0.14602128057775) or Multiplier= 6.85
  - Highest priced stock in the Dow is GS at about \$240/share
    - A 1 \$ advance= 6.85 Points
    - A 1 % advance =  $2.40 * 6.85 = 16.44$  DOW points
  - The lowest priced stock in the Dow is Cisco at about \$30 per share
    - A 1 \$ advance= 6.85 points
    - A 1 % advance =  $.30 * 6.85 = 2.055$  Points
- Outperforming the SP 500 post election
- Why?
  - Goldman Sachs has a high price and has done very well
  - Ref the chart of GS, DIA and the SP 500
- The DIA ETF is not a bad place to be in a rising rate environment



# Morningstar Style Box Asset Shift

- Dimensions
  - Value/Blend/Growth
  - Large/Mid/Small Cap
- What happened Post Election
- Asset shift in Equities from a Large Growth tilt towards Value and Small cap
- Why- Financials, Energy, Industrials



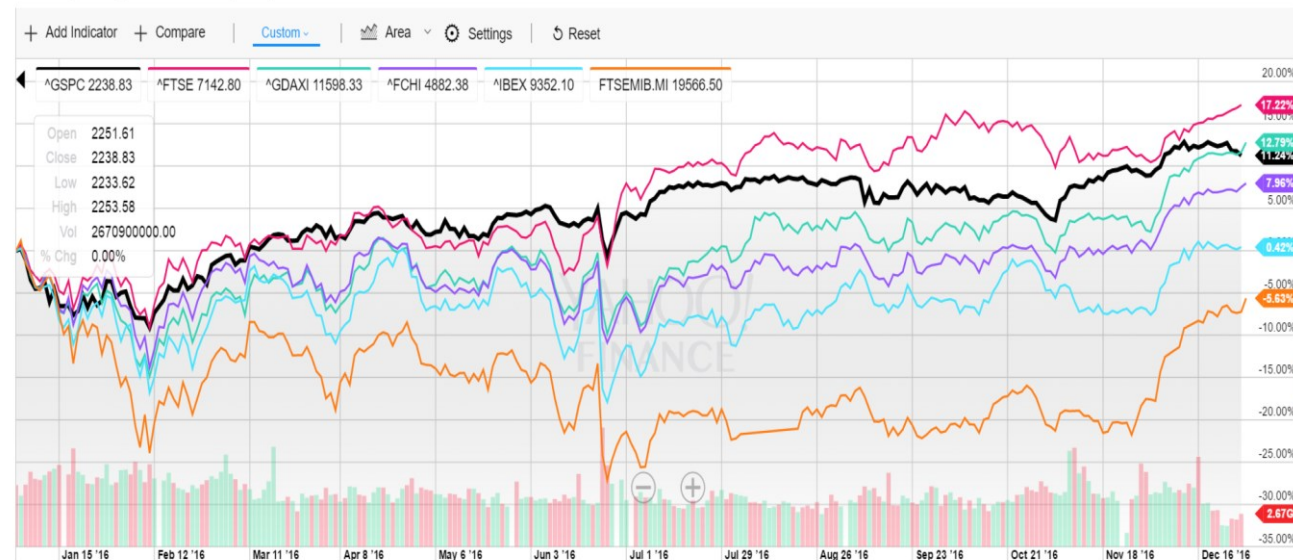
# Key Europe Issues & 2016 Market Performance

- Europe

- Lack of reform post 2008 crisis, Bank weakness, immigration, nationalism, liberal policies
- UK- Brexit
  - Transition Cameron to May
  - Article 50
  - Court rules that Parliament must vote to exit
  - Lots of uncertainty and ramifications
- Key Elections
  - Italian referendum rejected
  - Merkel election-Immigration backlash
  - Hollande at 4% approval- elections coming

- Anti Austerity coming?
- Issues- Fixes Needed
  - Return to growth
  - Immigration containment
  - High youth unemployment
  - Terrorism
- Weak Euro vs USD
- Hedging required in Investing in face of USD strength
- Draghi EU QE
  - Latest (Dec 8, 2016) position on QE is to stretch the bond buying to YE 2017
  - Euro 80B to April and Euro 60B to Ye 2017 and longer is needed

S&P 500 (^GSPC) 2,257.83 19.00 (0.85%) As of 4:42 PM EST. Market closed.



Color Legend (Note: all Data in Local Currencies) & Div Rates

- UK- ^FTSE- Red (3.85%)
- Germany- ^GDAXI (DAX) – Green (2.8%)
- France- ^FCHI (CAC40)- Light Purple (2.98%)
- Spain ^IBEX- Light Blue
- Italy- FTSEMIB.MI- Orange
- SP 500 for reference- Black



# HEDGING vs non Hedging ETFs- Europe ETFs as an Example

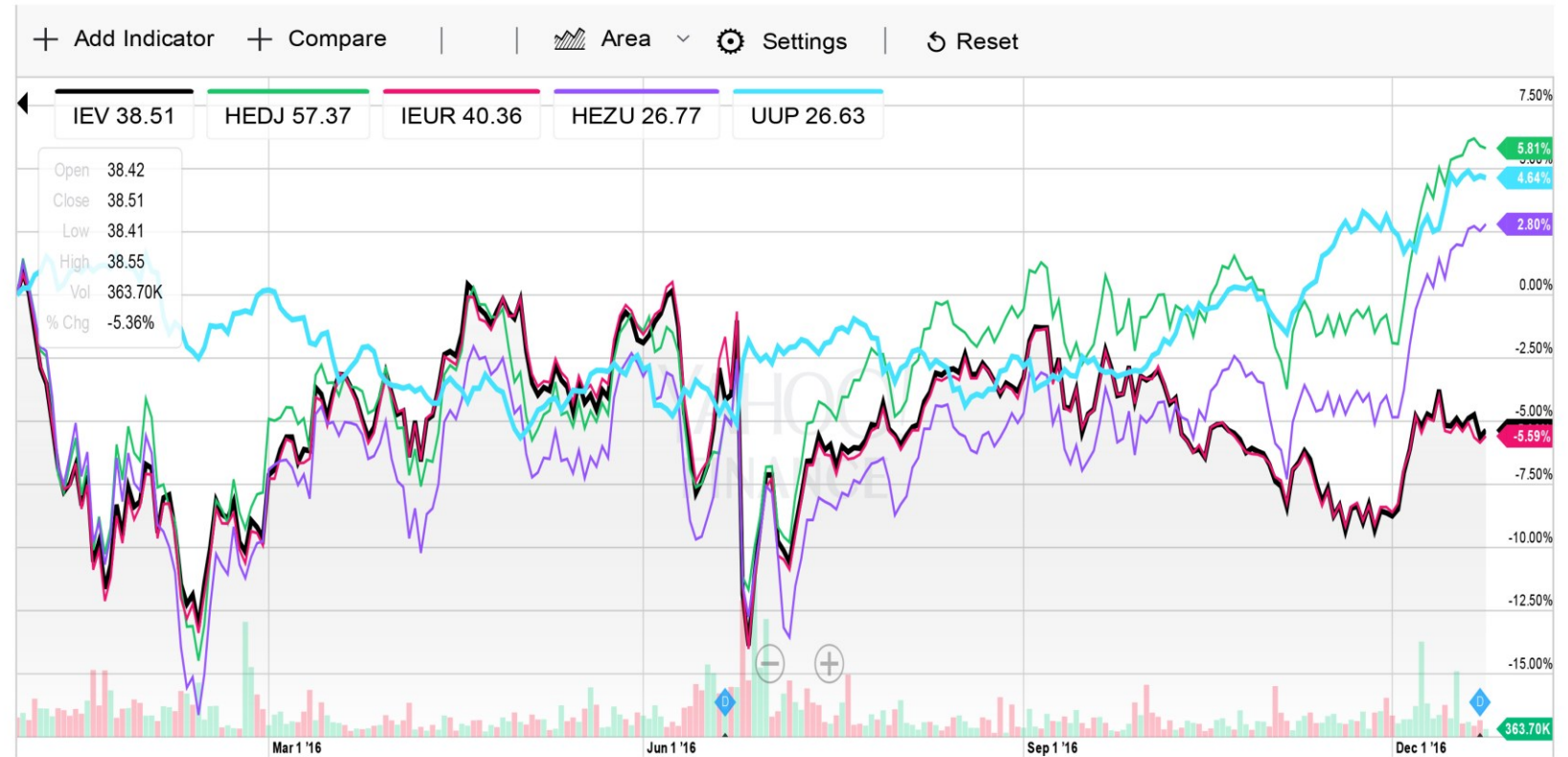
**Non Hedged-** IEV, IEUR

**Hedged-** HEDJ, HEZU

**Dollar Up ETF-** UUP

- In general, when the US Dollar is getting stronger Hedging will outperform
- Since the US election, the USD has surged to 103-104 vs the DXY basket

iShares Europe (IEV) 38.51 0.11 (0.29%) As of December 23 8:00 PM EST. Market closed.



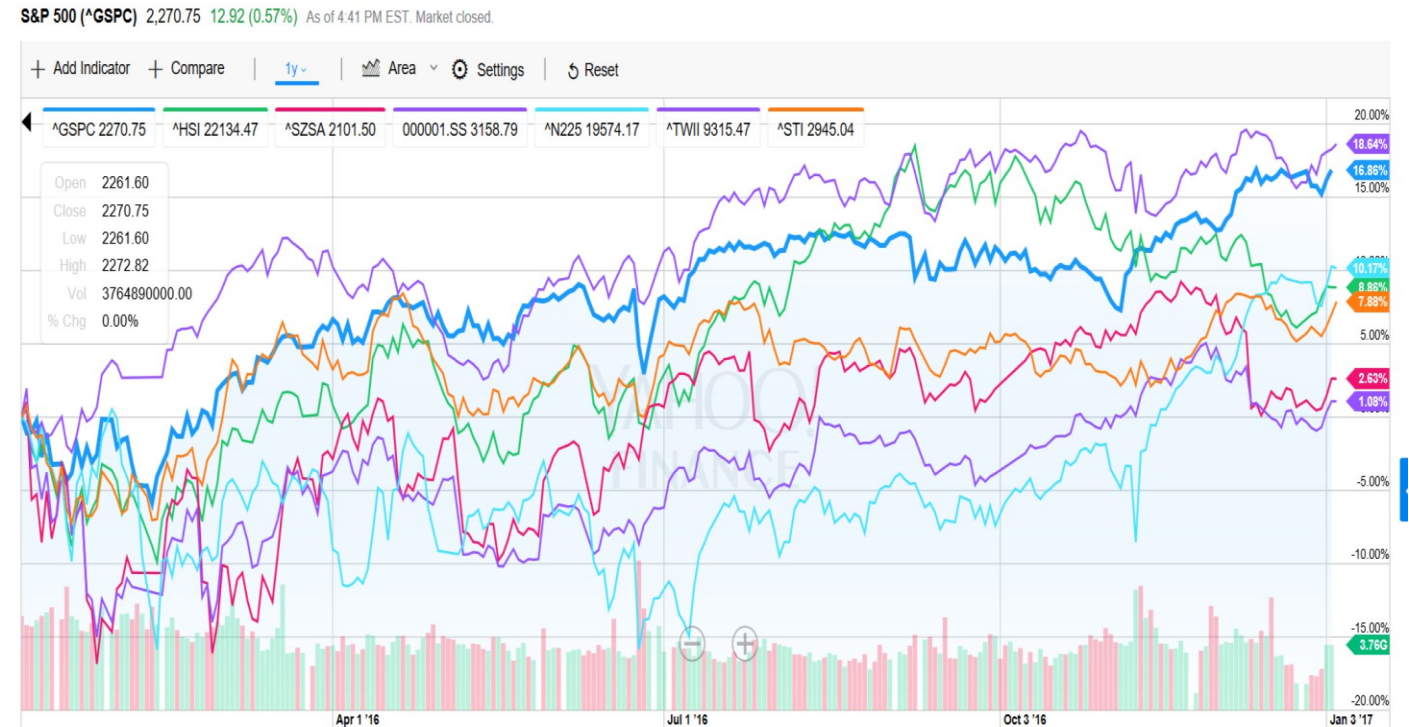


# Key European Elections in 2017- EU Trouble?

- **UK**
  - Brexit – Article 50?
  - Watch for a Scottish Referendum
- **Netherlands- March 15 (Issue NEXIT)**
- **France- First Round April 23, Second Round May 7**
  - Hollande at 4% approval rating- will not stand for re election
  - Les Republicians- Francois Fillon
  - Nationalist Front- Marine Le Pen
- **Germany- Federal Election October 22**
  - Christian Democratic Party (center-right)- Angela Merkel has been in power 11 yrs
  - Social Democratic Party (center-left)- Sigmar Gabriel
  - Alternative for Germany- (Anti Eurozone, immigration, right wing)
- **The EuroZone “Experiment” may be in trouble**
  - Created for several purposes
    - Eliminate war in Europe, have Peace and Harmony
    - Create a trading block
    - Have a unified currency
- **Keep your eye on this ball- At stake- UK Oil, US Dollar, EU cohesiveness, Bail outs, EU Survival, etc**

# International- Asia

- **China**
  - Capital flight
  - China is protecting their yuan in face of US election results , not depreciating
  - Hong Kong unrest
  - Xi regime crackdown
  - High debt and real estate risk
  - Extremely overbuilt- ghost cities
  - GDP slowdown
  - Market linkage from mainland to Hong Kong
  - Lack of transparency
  - Trade war??
    - China has tools to retaliate- caution
- **Japan**
  - Japan has targeted a 2% inflation rate and failed
  - In September Japan announced a major policy change in abandoning expanding their money supply by a move to control the yield curve
    - The strategy intends to peg the 10 year BOJ bond to zero They call it a “managed float”
    - Market forces will have some say about that
  - Strong USD helps exports
- **Key Asian Markets (by Index)**
  - ^HSI- Hong Kong- Market cap weighted, 307 stocks
  - ^SZSA- the Nasdaq of China, 300 stocks, Market cap weighted
  - 000001.SS– Shanghai Index- 50 China Red Chips, price weighted
  - ^N225- Price weighted Tokyo Index, 225 stocks
  - ^TWII- TSEC (Taiwan) Weighted Index, Index of Top 50 stocks
  - ^STI- Singapore Straights Times – top 30 Market cap weighted stocks
  - ^KOSPI- (would not plot)- South Korea. Has a total of 760 stocks in the market



# Mexico Stock Exchange in 2016

- Trump focus on jobs and immigration impacted the Mexican stock market
- Dropped as the election results came in
- Still pressured



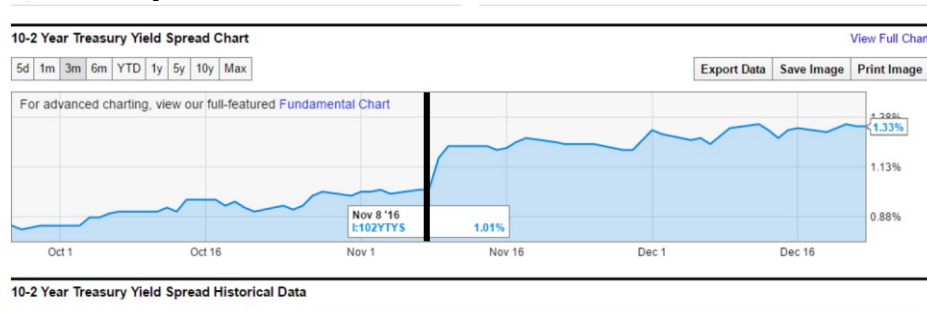
# Questions?

# Fixed Income

- Consider that individual Bonds are difficult to research and buy, so most fixed income is secured via Mutual Funds or ETFs
- Also, it is sometimes difficult to secure the actual commission of a purchase- “Principal Trades” often lack transparency
- Bonds at their issue may have zero commission to the buyer but lack diversification
- In the world of sovereign debt negative rates are fading as they have not proven to work and have unintended consequences- you pay the “lender” to park your money
- We are now in a rising rate environment so caution is advised on all fixed income Instruments due to duration risk
- NOTE- PIMCO is “derisking” Portfolios- More cash, fewer US Treasuries. They see more risk in fixed income with DJT policies
- A menu of offerings and some typical tickers
  - Treasuries (SHY, IEF, TLT)
  - Corporate (AGG)
  - TIPs (TIP)
  - High Yield
  - Preferreds (PFF)
  - Munis- California- (CMF, PWZ); (VCAIX, SWCAX, FCSTX, FCTFX, FCMAX)
  - Closed End Funds- Many, consult the Barron’s CEF pages. Leverage is used to boost returns. Traded on premium or discount
  - BABS (Build America Bonds)- (BNN, GBAB)
  - Bank Loans (BKLN, FLOT)
  - International, Sovereign < Currency comes into play so consider hedged instruments>

# US Treasuries

- Rates were in a down trend in 1H2016, then turned up and rocketed up on 11/9
- Election Bang!!!!!!!!!!!!- Rates escalated as a result of the election & a promise to return to greater growth
- Notice the black vertical line demarking the turn after election returns were in
- Low close of the 10 year was 1.37% on July 8
- High Close of the 10 year was 2.603 on Dec 15
- The UST 10 has broken a 25 yr channel trend – failed breakout so watch for a 3% close as key indicator on trend
- Potential for UST issuance longer than 30 Year under new Admin
- Note- what is very important for Financials is the 10 year minus 2 year spread- that is how banks are able to make money- ref chart below



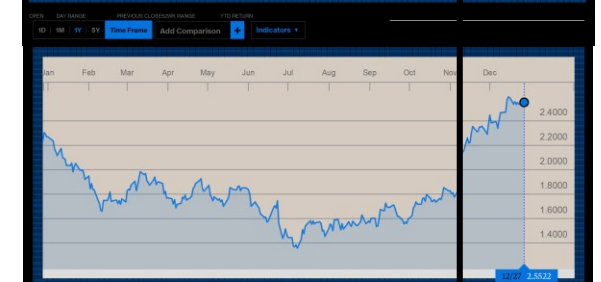
2 year UST



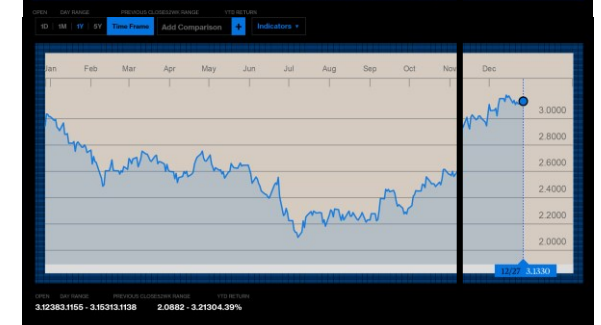
5 year UST



10 year UST



30 year UST





# US Credit

- “Credit” definition per Investopedia > “Credit is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest.”
- In the parlance of investing it usually refers to non Treasury Bond Investments- Corporate bond rates and their investable securities as a key example
- Because they involve credit risk (downgrades or default) these instruments provide higher rates vs US Treasuries
- A Common ETF for US Credit is “AGG” the iShares US Aggregate Bond ETF
- AGG peaked on July 8 at \$113.25/share just after the US 10 year treasury closed at the low for the year
- The 2016 return was near zero on NAV so the Coupon (monthly distribution) at approximately 2.36% is the return for the year



July 8, AGG Peak for 2016

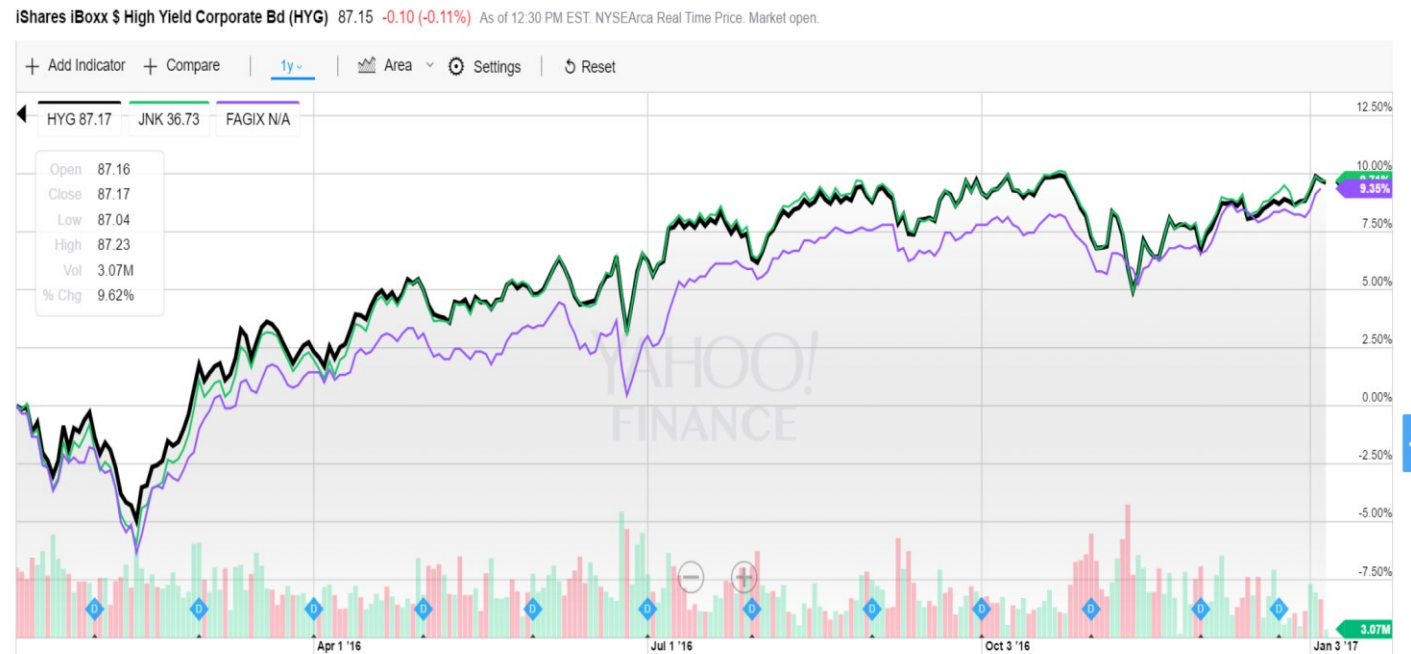
# Treasury Inflation Protected Securities-TIPs

- TIPS definition per Investopedia>Treasury inflation protected securities (TIPS) refer to a treasury security that is indexed to inflation in order to protect investors from the negative effects of inflation. TIPS are considered an extremely low-risk investment since they are backed by the U.S. government and because the par value rises with inflation, as measured by the Consumer Price Index, while the interest rate remains fixed
- The common ETF for this is “TIP”
- But, please notice that TIP is vulnerable just as other fixed income securities to a rise in rates. In the chart note that as rates were rising TIP fell after the election. The “dot” marks the spot and the line marks the low of the US ten year treasury
- Ref Morningstar articles
  - <http://beta.morningstar.com/articles/690490/tips-love-them-or-leave-them.html>
  - Also- Christine Benz article 11/20/2016- “The Trouble with TIPS (and some workarounds)”



# High Yield

- Non investment grade corporate debt- Mostly BB and B rated
- Effective duration 3.9 years
- Standard deviation less than the SP 500
- Traded in line with JNK and Fidelity Capital & Income (FAGIX)
- All perform better when risk of default is lower
- Has essentially recovered from the oil/energy downdraft



# Preferreds

- Subordinate to Bond holders
- Ranks higher than common stock in investor rights
- No voting rights
- Typically issued at \$25/share
- Typically higher dividend
- Many are callable



# Munis- non Taxable & Taxable (Build America Bonds)

- Munis have less incentive with likely lower tax rates coming
- Vulnerable to rising rates
- Note the fall in NAV after the election as other rates rose >>>>

- 
- **Build America Bonds (BABs)**
    - As part of the American Recovery and Reinvestment Act enacted by President Barack Obama in 2009, Build America Bonds (BABs) were introduced to provide much-needed funding infrastructure to local governments.
    - Orphaned in 2010
    - These are available in BBN, GBAB and NBB funds
    - Potential for more to fund IFR
  - **A primer on BABs**
    - <http://www.municipalbonds.com/education/what-are-build-america-bonds/>



# The Prime Rate- Pre Crisis to YE 2016

- The prime rate is the rate at which banks loan to their safest borrowers
- It usually follows the direction of the FF rate in like increments
- Some history from the market peak pre crisis to now >
- Still very accommodative

Just prior to the Market peak >>>>>  
Then starting the trend down

September 18, 2007	7.75
October 31, 2007	7.50
December 11, 2007	7.25
January 22, 2008	6.50
January 30, 2008	6.00
March 18, 2008	5.25
April 30, 2008	5.00
October 8, 2008	4.50
October 29, 2008	4.00

Bottom held until Fed increased FF rate .25% in Dec 2015

December 16, 2008	3.25
December 17, 2015	3.5

Uptick on Dec 2016 FF rate + .25%

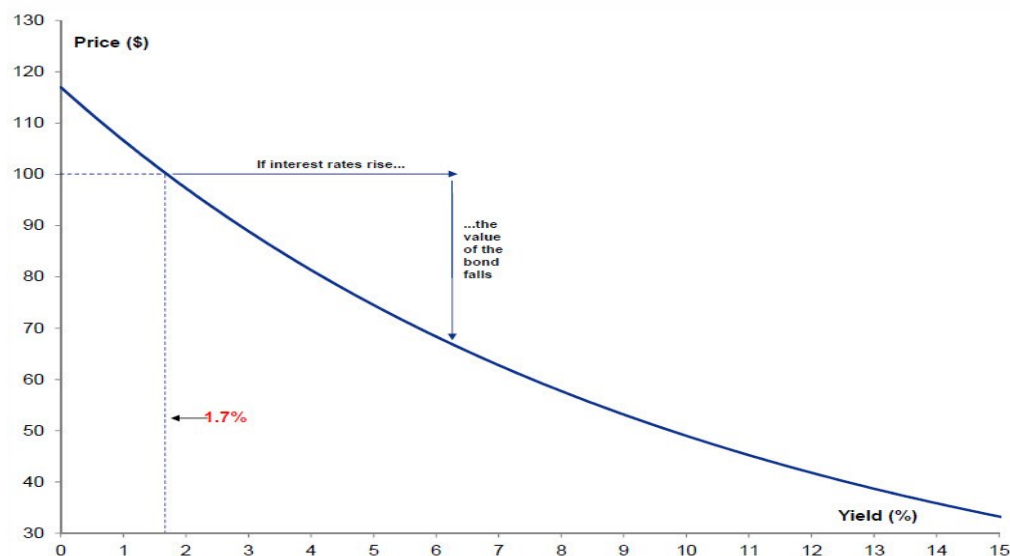
December 15, 2016

**3.75**  
(The Current U.S. Prime Rate)



# Bond Principal Risks

- After a 30 plus year bull market in bonds we are at the inflection point on rates. In a rising rate environment bond losses are sharp and painful
- Shorten your duration or go to Floating rate securities
- A 50/50 Portfolio may not work anymore



<http://www.zerohedge.com/news/2013-04-25/bonds-101-yields-prices-and-inflation>

# International Bonds- German 10 Yr Bund & Japan BOJ 10 Yr

- Be careful with International Bonds
- Reversal of some neg rates around the world
  - German & Japanese 10 Year rates went negative in 2016
  - Japan decided to peg the BOJ 10 year at zero as it's negative rates were not working
  - Read Article
    - <http://www.investopedia.com/terms/n/negative-interest-rate-policy-nirp.asp>
    - [http://www.nytimes.com/2016/09/21/business/international/japan-boj-negative-interest-rates.html?\\_r=0](http://www.nytimes.com/2016/09/21/business/international/japan-boj-negative-interest-rates.html?_r=0)
    - <http://www.wsj.com/articles/japans-negative-rate-experiment-is-floundering-1460644639>
- Currency spread in a rising rate environment demands hedging
  - Read Article
    - <https://www.thebalance.com/what-is-currency-hedging-416913>
- Spread US 10 year vs 10 Year Bund
  - Read Article
    - <http://www.wsj.com/articles/u-s-government-bond-yield-premium-highest-since-berlin-wall-fell-1479416450>

2016 10  
Year Bund  
@ zero  
rate  
>>>>>>>>

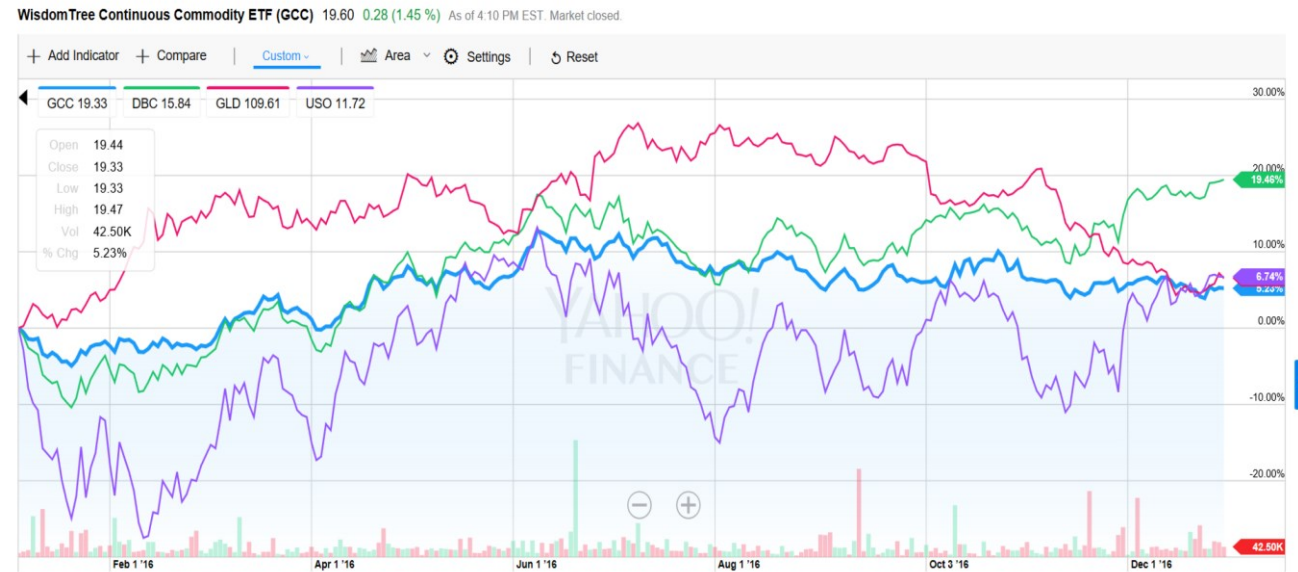


2016 10  
Year BOJ  
@ zero  
rate  
>>>>>>>>



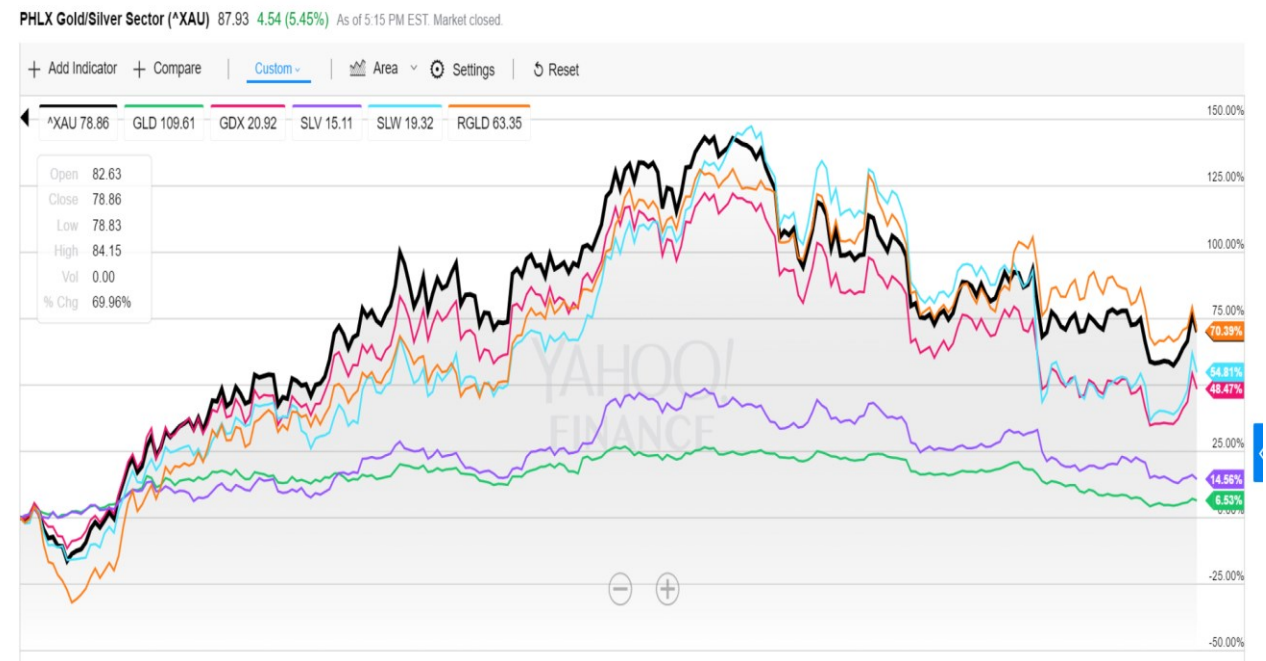
# Commodities

- Strong Dollar effect since election impacts commodities to downside
- These ETF are based on Futures contracts
- Wide variation in pricing delta since election- Gold/Oil/Base metals/Livestock/Grains
- Reflation trade boosts base metals and aggregates
- OPEC- low oil prices starving reserves
  - How much will they cheat?
  - < REPORT 1/3/2017 (Bloomberg): China Buying binge initiated to prevent commodity shortages>



# GOLD/PRECIOUS METALS

- Palladium is the only precious metal up since the election
- Best proxy for precious metals
  - Not GLD or SLV
  - Royal Gold- closest to Gold/Silver index: next best is Silver Wheaton
- Gold- what is Gold's true color?
  - Inflation Hedge?
  - Fiat currency?
  - Reacting to Fed and other Central banks
  - Looking tarnished
  - Taxed as a collectable
  - Costs to store
  - No dividend



# FOREX- Exchange rates

- Note- Forex is in pairs (Euro/US Dollar, US Dollar/Yen etc)
- The US Dollar rallied post election, approaching 104 then backing off to about 103 up 8%. This will cause an issue for Multinationals as 4Q earnings are reported in 1Q 2017
- A currency grows stronger as its economy gains strength and rates increase
- The US economy has been stronger on a relative basis so the USD strengthened coming into the election
- Post Election the US Dollar surged because other economies have been weaker and the US has had a surge in rates and a positive outlook for growth
- As the USD gains strength the international earnings & revenues come back depressed, so Multinationals will be impacted and Domestics are likely favored- thus a shift to mid and small caps
- Following the election the USD, rates & inflation expectations increased dramatically.

# The US Dollar (DXY)

- The US Dollar Index Currency Basket
  - Euro (EUR), 57.6% weight
  - Japanese Yen (JPY) 13.6% weight
  - UK Pound Sterling (GBP), 11.9% weight
  - Canadian dollar (CAD), 9.1% weight
  - Swedish krona (SEK), 4.2% weight
  - Swiss franc (CHF) 3.6% weight
- Chart DXY vs UUP ETF >>>>>>>>>>





# ^VIX vs VXX

- ^VIX is the [ticker symbol](#) for the [Chicago Board Options Exchange \(CBOE\)](#) Volatility Index, which shows the market's expectation of 30-day volatility. This volatility is meant to be [forward looking](#), is calculated from both calls and puts, and is a widely used measure of [market risk](#), often referred to as the "investor fear gauge."
- Only use this as a short term trade vs an investment
- VIX increases as a function of fear or for protecting positions
- Very Low VIX (approximately 12 or so) indicates complacency and is a contrary indicator
- VIX during the financial crisis rose to 89.53
- VIX is played by options or via an ETF- "VXX"
- "VXX" has a miserable history as it is based on futures. The options decay and expire worthless- the option roll makes it a bad bet
- Oil has its own VIX (^OVX)- it is a cousin of ^VIX- use it as a read on trader sentiment for oil
- Opinion- ^VIX is too low coming into 2017- sitting around 11-13
- Expect 2017 and beyond to have a lot of volatility



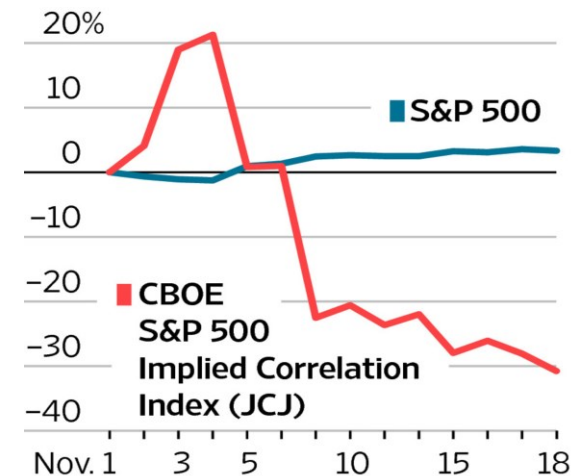
# Correlation

- In signs of stress correlation tends to be high
- In times of calm correlation collapses, favoring passive investments
- Correlation is breaking down since the election as winners and losers emerge into a massive rotation
- High correlation favors passive strategies
- This gives active managers a potential advantage vs a passive approach
- That assumes they are nimble and are good at security selection
- Check long term track records

## Uncoupling

The lockstep moves between stocks in the S&P 500 are breaking down

Percentage change since Nov. 1



Source: CBOE

THE WALL STREET JOURNAL.

# Questions?

# Fed Overview

- Controls the Fed Funds Rate, provides regulatory functions over banks
- The Fed is “politically independent” or so they say
- The Fed has 8 scheduled meetings per year- some with press conferences
- Fed Chairs during the 30 plus year bull market in bonds
  - Volcker, Greenspan, Bernanke, Yellen
  - Volcker broke the back of inflation in 1980, 1981, starting a bull market in bonds
- The term for current Chair Yellen expires in early 2018- plans to stay
- The Voting Fed Governors rotate and several chairs will be moved in early 2017- tilting hawkish
- There are two open seats that will be likely be filled by President Trump
- Net- the mix may change towards hawkish due to rotation of Fed voting seats

# Fed Governors 2016 > 2017

**Members of the Board** Janet Yellen Stanley Fischer Daniel Tarullo Jerome Powell Lael Brainard

Note- there are two open seats

**Chair**



**Vice Chair**



**Bank of New York- Permanent Voting Member – William Dudley**



**2016 Rotating Voting Governors** Eric Rosengren James Bullard Esther George Loretta Mester

**Boston**



**St Louis**



**Kansas City**



**Cleveland**



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**2017 Rotating Voting Members**

<Replacing 2016 Rotating Voting Members>

**Robert Kaplan**

**Dallas**

**Neel Kashkari**

**Minneapolis**

**Patrick Harker**

**Philadelphia**

**Charles Evans**

**Chicago**

# Fed Dove/Hawk Scorecard

Per WestPac 8/2016

FOMC permanent voters	2016 voters	2017	2018	
Yellen	George	Harker	Lacker	
Fischer	Mester	Kashkari	Mester	hawkish
Powell	Bullard	Kaplan	Williams	dovish
Brainard	Rosengren	Evans	Lockhart	
Tarullo				
Dudley				

Per Bloomberg- 12/2015

2016= 5 doves, 2 hawks and 2 neutral

2017= 7 doves, 0 hawks and 1 ?

Per Liesman at CNBC= 2017 less dovish

My Take= Hard to see a more dovish Fed than we have now based on 2015, 2016 votes

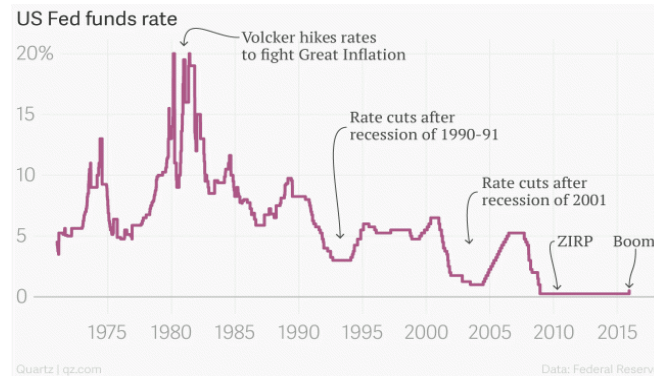
# Fed- Posture/Normalization

- Since the financial crisis the Fed has held rates low and conducted “QE” (Quantitative Easing) in several forms- holding the FF near zero
- In May 2013 Bernanke indicated a FF increase was likely- we had a TAPER TANTRUM and Bond prices fell quickly
- The Fed ended QE at the end of Oct 2014
- Since then the Fed has had the markets on a waltz as the bull market in stocks was supported by easy money
- All too frequent “Fed Speak” has been muddying the water
- Most of the 2016 Fed minutes and conferences indicate a need for “more data”. But we are NOT in crisis mode, just a 2% GDP economy
- The minutes have recently indicated a somewhat divided Fed
- The economy muddles along at 2% GDP but the election has changed the picture with hopes for better GDP
- In 2015 the Fed forecasted 4 hikes in 2016 and delivered 1
- The Fed delivered a .25% FF increase
- Also it surprised the market in forecasting 3 hikes in 2017 (mid Dec about 2 ½ hikes priced in)
- Yellen said that they are waiting to see actual policy and legislation to factor in the Trump Admin
- Consider: FF at .5-.75%, inflation at 1.7% so the real FF rate is -1%
- “Normal” FF should be approximately the GDP inflation adjusted growth rate- that’s currently about 1.7%
- Net, the Fed is still accommodative
- Normalization is intended to restore a higher and “normal” FF rate over time- about 3 years

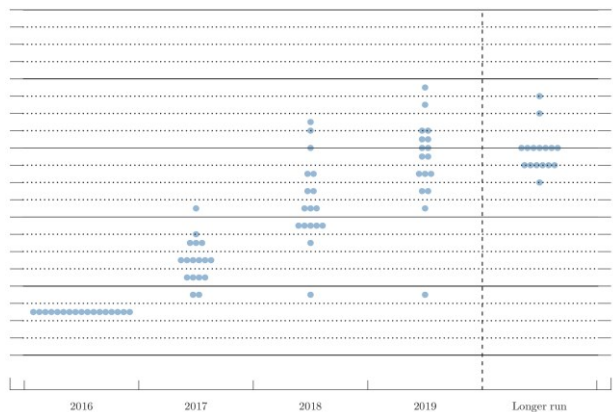


# Fed Funds Rate/ Fed Forecasts

- History



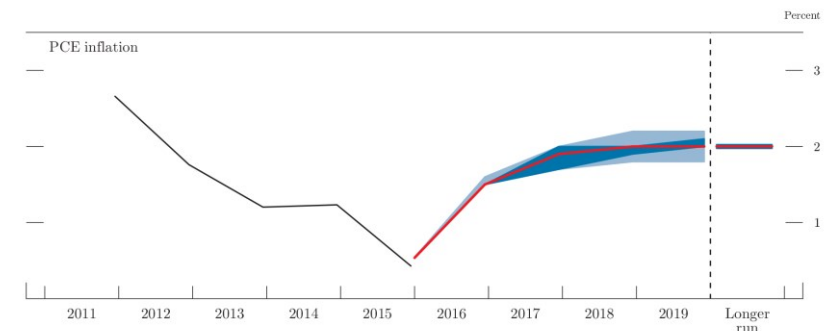
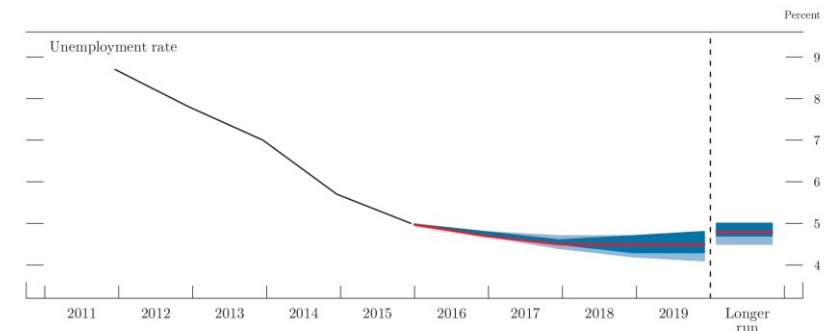
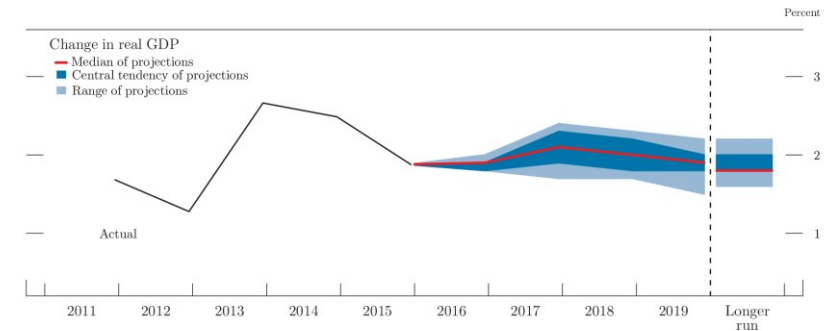
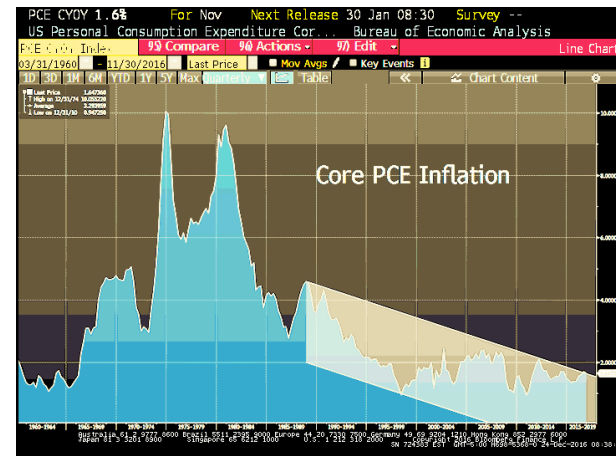
- Dot Plot Dispersion-  
They don't agree with each other



- Forecasts-  
Dec 2016

- GDP
- Unemployment Rate
- Inflation

- PCE Inflation - long term



# US vs ECB, BOJ, BOE

- The US took firm action to stem the 2008 Crisis
- Europe did **not** take decisive action and is **not** organized with a true central bank. Countries can operate independently on Sovereign Bonds, Debt, taxation etc. The UK does have a central bank
- The Eurozone has had some negative rates (Germany, Switzerland) and some very high rates where risk abounds (Greece etc.).
- Growth is stagnant, unemployment is high and liberal policies are the rule
- Japans BOJ has an aging population and low to negative growth. Abenomics have been in play for several years without much success. They now target the BOJ 10 year at zero
- World negative rates are slowly coming up
- The UK brought Carney from Canada to be the equivalent of the Fed Chair and is competent but now there is “Brexit” to deal with. The British pound plunged dramatically after Brexit vote

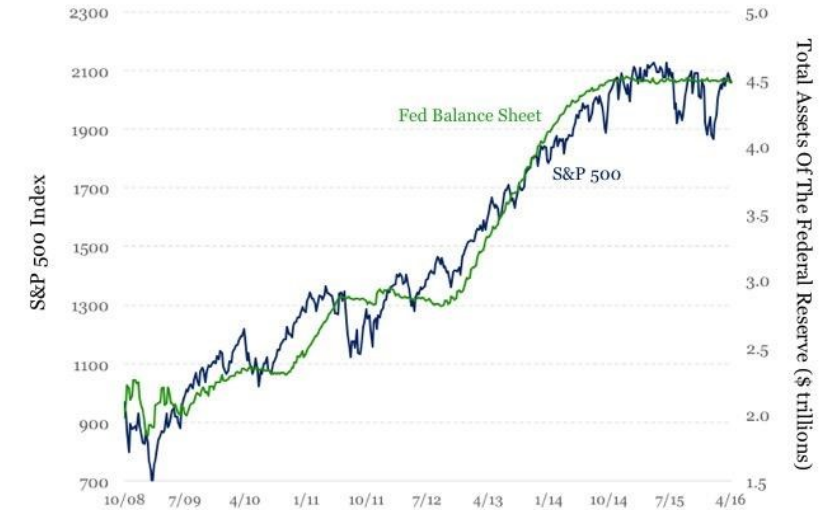
# 2016 Rotation Post Election

- Lack of focused Stimulus to Fiscal Stimulus
- Bonds to Stocks
- Large Cap to Small Cap, Growth to Value, Defensives to Cyclical
- Better advance decline ratio- the market advance is broadening out
- International to Domestic
- Oil up, Coal up
- Gold Down
- Less QE WW
- Disinflation to Inflationary outlook

# Is the Market Overvalued?

- Stocks and the Fed >>
- Consensus estimates are around \$132 per share
  - Policy changes are not factored in YET
- The trailing PE is approximately 20.8 (WSJ Jan 4)
- The forward PE is approximately 18.35 (Y Charts Jan 4)
- One measure is the Shiller CAPE ratio now at about 27.9, one Sigma above historical average
- AAI Bullish- contrarian indicator?
  - Late 2016 survey data
    - Bullish: 46.2%, up 0.6 points
    - Neutral: 28.6%, down 0.1 points
    - Bearish: 25.2%, down 0.5 points
- Note we have a 25T market in a 15T economy
- Early 2017 Earnings season here
  - 4Q 2016 reports beginning- Banks starting Friday Jan 13
  - Guidance- there will be little in the way of hard data to project updated guidance based on new policy
- I expect a lot of volatility in 2017
  - Legislative roll out likely messy due to conflict & complexity
  - Deferred implementation in new Health Care rules and infrastructure etc
  - EU elections and Brexit
  - Market richly valued

Stocks & The Fed's Balance Sheet: Intertwined



Source: Gerring Capital Partners, U.S. Federal Reserve

# 2017 YE SP 500 Forecasts (Bus Insider 12/19/16, Barron's )

Company	Forecast	Notable comments
• BA ML	2300	Lack of certainty and VIX
• Credit Suisse	2300	Rotation away from NIRP, margin squeeze
• UBS	2300	No recession, but 3 steps & a stumble
• Goldman Sachs	2300	Expecting + EPS revisions, risk- Fed, Rates+
• Citi	2325	Positive on valuation, EPS revisions coming
• Jeffries	2325	Election regime shift, Inflation & USD, buy the consumer
• BMO	2350	Move from PE to EPS driven, VIX
• Deutsche Bank	2350	Corp Tax cut early, other stimulus delayed
• JP Morgan	2400	Downside risk: USD & rates; upside DJT pro growth agenda
• Oppenheimer	2450	Positive on DJT agenda, Stimulus affects delayed

Bespoke valuation chart from 2009 >>

Possible SP 500 YE 2017= \$132 earn x17 PE= 2254

SP 500 Currently at 2273



## WALL STREET FORECASTS: 2017

Investment strategists expect stocks to keep climbing next year, even as bond yields rise and economic growth improves. Their mean S&P 500 forecast: 2380.

 <b>Stephen AUTH</b> Federated Investors S&P 500 2017 Year-End Target: 2350 S&P 500 EPS 2017: \$130 GDP Growth 2017: 3.0% 10-Year Treasury Yield 2017: 3.0% Favorite Sectors: Health Care, Telecom, Information Technology Avoid: Consumer Staples, Consumer Discretionary, REITs	 <b>Jonathan GLIONNA</b> Barclays Capital S&P 500 2017 Year-End Target: 2400 S&P 500 EPS 2017: \$127 GDP Growth 2017: 2.2% 10-Year Treasury Yield 2017: 2.40% Favorite Sectors: Financials, Health Care, Consumer Discretionary Avoid: Consumer Staples	 <b>Jeffrey KNIGHT</b> Columbia Threadneedle S&P 500 2017 Year-End Target: 2450 S&P 500 EPS 2017: \$135 GDP Growth 2017: 3.0% 10-Year Treasury Yield 2017: 2.90% Favorite Sectors: Financials, Telecom, Information Technology Avoid: Telecom, Utilities, REITs	 <b>David KOSTIN</b> Goldman Sachs S&P 500 2017 Year-End Target: 2300 S&P 500 EPS 2017: \$116 GDP Growth 2017: 2.2% 10-Year Treasury Yield 2017: 2.75% Favorite Sectors: Financials, Information Technology, Health Care Avoid: Consumer Staples, Telecom, Utilities, REITs	 <b>Dubravko LAKOS-BUJAS</b> JPMorgan S&P 500 2017 Year-End Target: 2400 S&P 500 EPS 2017: \$128 GDP Growth 2017: 2.1% 10-Year Treasury Yield 2017: 2.55% Favorite Sectors: Financials, Energy, Materials, Health Care Avoid: Consumer Staples, Consumer Discretionary
 <b>Tobias LEVKOVICH</b> Citi Research S&P 500 2017 Year-End Target: 2325 S&P 500 EPS 2017: \$129 GDP Growth 2017: 1.8% 10-Year Treasury Yield 2017: 2.60% Favorite Sectors: Financials, Information Technology, Energy Avoid: Health Care, Consumer Staples, Telecom	 <b>Adam PARKER</b> Morgan Stanley S&P 500 2017 Year-End Target: 2300 S&P 500 EPS 2017: \$128.70 GDP Growth 2017: 2.0% 10-Year Treasury Yield 2017: 2.50% Favorite Sectors: Financials, Utilities, Health Care Avoid: Consumer Staples, Materials, Information Technology, Consumer Discretionary	 <b>John PRAVEEN</b> Prudential Int'l Investment Advisors S&P 500 2017 Year-End Target: 2575 S&P 500 EPS 2017: \$122.20 GDP Growth 2017: 3.0% 10-Year Treasury Yield 2017: 2.75% Favorite Sectors: Financials, Industrials Avoid: Utilities, Consumer Staples	 <b>Heidi RICHARDSON</b> BlackRock S&P 500 2017 Year-End Target: 2400 S&P 500 EPS 2017: \$127 GDP Growth 2017: 2.4% 10-Year Treasury Yield 2017: 2.5-3.0% Favorite Sectors: Financials Avoid: Consumer Staples	 <b>Savita SUBRAMANIAN</b> Bank of America Merrill Lynch S&P 500 2017 Year-End Target: 2300 S&P 500 EPS 2017: \$129 GDP Growth 2017: 2.0% 10-Year Treasury Yield 2017: 2.65% Favorite Sectors: Health Care, Financials, Telecom, Consumer Discretionary Avoid: Consumer Staples, Utilities, Materials

Note: Some GDP and yield estimates are from Fitch's economists. Bond strategists.

**EPS Range \$116 to \$135. Consensus \$132.61**  
**2016 Est \$118/share**

For a full blown estimate of 2017 markets go to  
<http://www.yardeni.com/pub/PEACOCKFEVAL.pdf>

# The DJT Agenda- complex

- 27 Point Agenda
  - Prioritization will be very difficult & unraveling complex & contentious
  - Jobs, jobs, jobs, but..
  - 85% of jobs lost to technology and 15 % to offshoring per Michael Sonnennfeldt-Tiger 21 Chairman (\$45B AUM)
  - Note- value add to Auto assembly is only about 11% vs almost 90% in the supply chain
  - Moving jobs is very complex
    - Toyota US CEO- “6 years to get a plant in place”
  - Most supply chains are entrenched & not in the US
  - Significant lag time to realization will occur
  - Consider that Technology is deflationary & requires FEWER people
  - JOLTS job data indicate jobs are available today but employers have a hard time finding applicants with skill



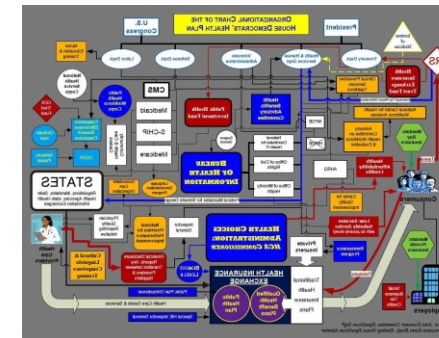
# Policy- It will be a busy 2017

- Key Areas
  - ACA- Repeal, Replace- priority 1 per VP Pence Jan 4, 2017
  - Tax Reform
    - Repatriation of overseas cash
    - Business & Personal Tax reform
  - Dodd- Frank
  - Some Deregulation
  - TPP
  - TRADE- NAFTA Example- Auto Industry
    - Parts are Globalized
    - 11% of value add is in assembly
    - 3M vehicles imported from Mexico to US
    - Ford reversed decision to move Ford Focus to Mexico
    - Many Mexican based auto exports to other parts of the world
  - Immigration

# ACA

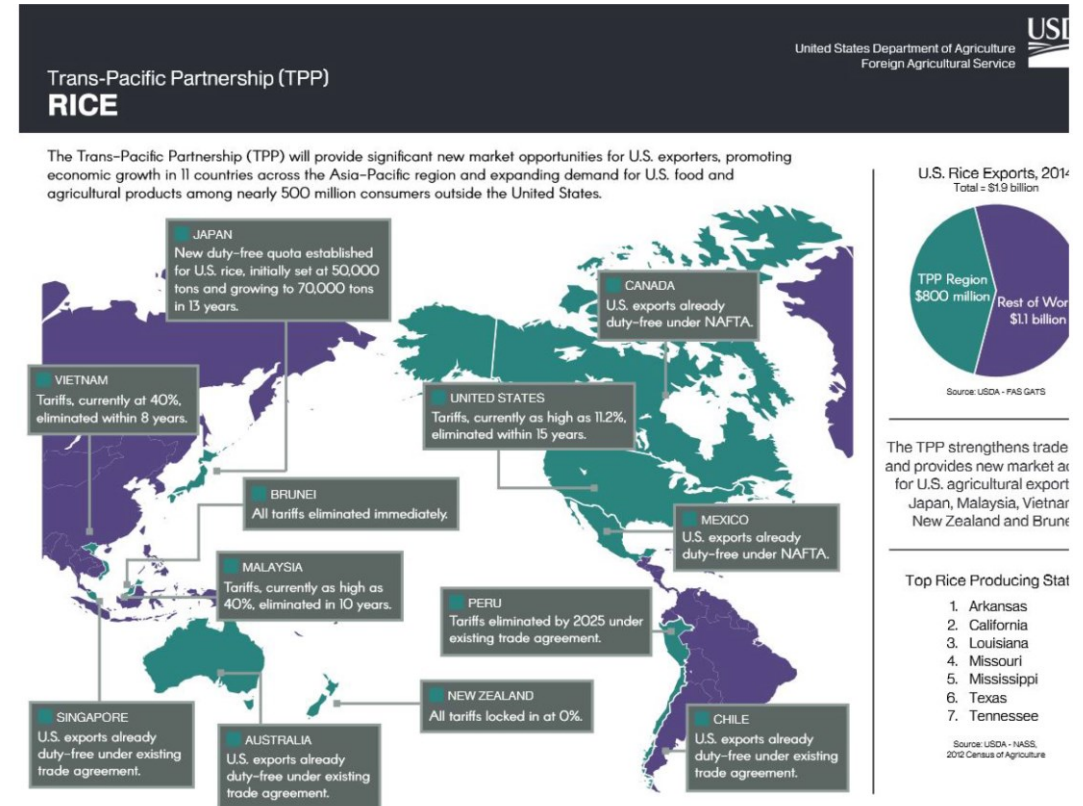
- **Repeal/Replace Established as Priority 1 per VP Elect Pence**
  - Focus on lack of disruption to the populous
- 2700 pages of legislation
- So long and complex the Supreme Court refused to read it
- Over 20,000 pages of regulation
- Promise to Repeal & Replace, but there will be congressional pushback
- Rhetoric softened post election
  - Expect retention of preexisting conditions and coverage of children to age 26
- Likely direction is to open up competition across state lines
- Has not contained costs, deductibles high
- Has not been stable
- Insurers pulling out leaving lack of choice in some states
- Fines escalating for failure to enroll
- Key issue is youth subsidizing elderly
- The ACA flow chart >>>>>>>>>>>>>>
- **Critical Timeline- Implementation likely into 2019 as reform not in time for insurers**

**Submit 2018 rates Rates Finalized Confirm Participation Open Enrollment Begins**



# TRADE- TPP- Trans Pacific Partnership

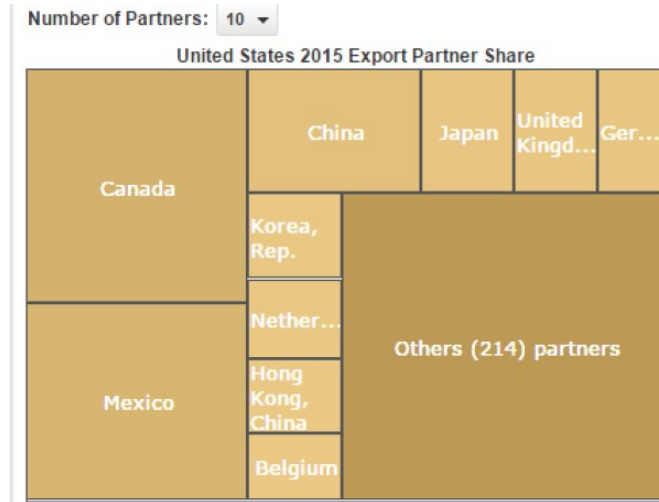
- Involves 12 Pacific Rim Countries
- Note that China is not in the TPP
- BHO Admin forced Black Box during negotiations
- 7 Years of negotiations
- Signed Feb 4, 2016
- Not yet ratified
- Challenged by DJT
- Provides an opening for China
- Rice example shown here
- Wiki has a good summary
  - [https://en.wikipedia.org/wiki/Trans-Pacific\\_Partnership](https://en.wikipedia.org/wiki/Trans-Pacific_Partnership)



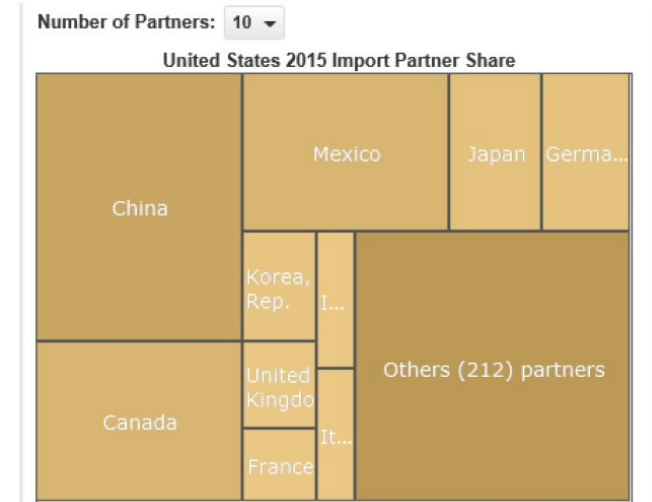
# Top 10 Trade Partners- Import and Export

Rank in Export	Rank in import
1. Canada	China
2. Mexico	Canada
3. China	Mexico
4. Japan	Japan
5. UK	Germany
6. Germany	South Korea
7. South Korea	UK
8. Netherlands	France
9. Hong Kong	India
10. Belgium	Italy

## Export

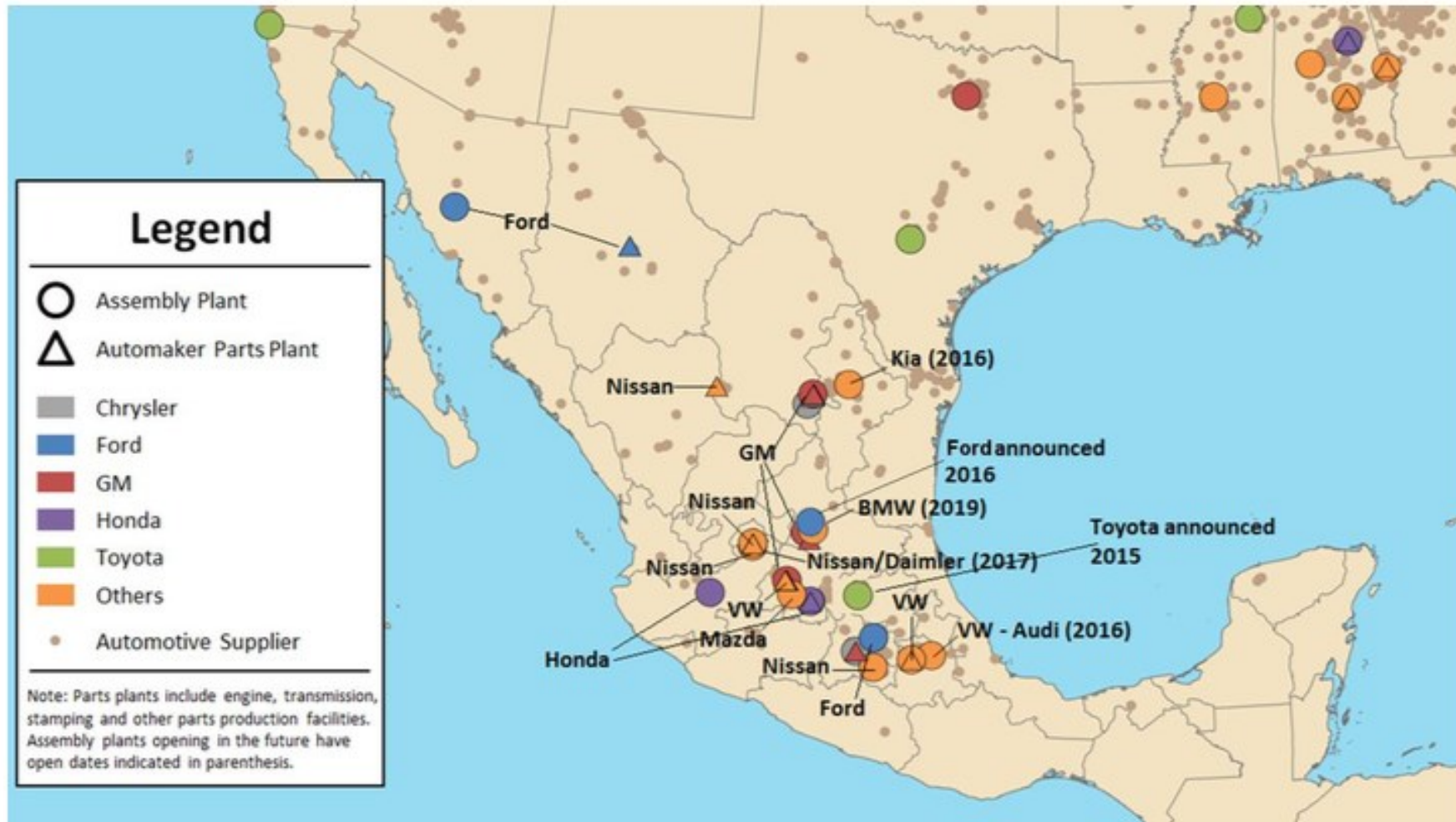


## Import



# Auto Assembly & Parts Suppliers in Mexico

Figure 2: Mexican Automaker Assembly Plants and Automaker-owned Parts Plants as of June 2016

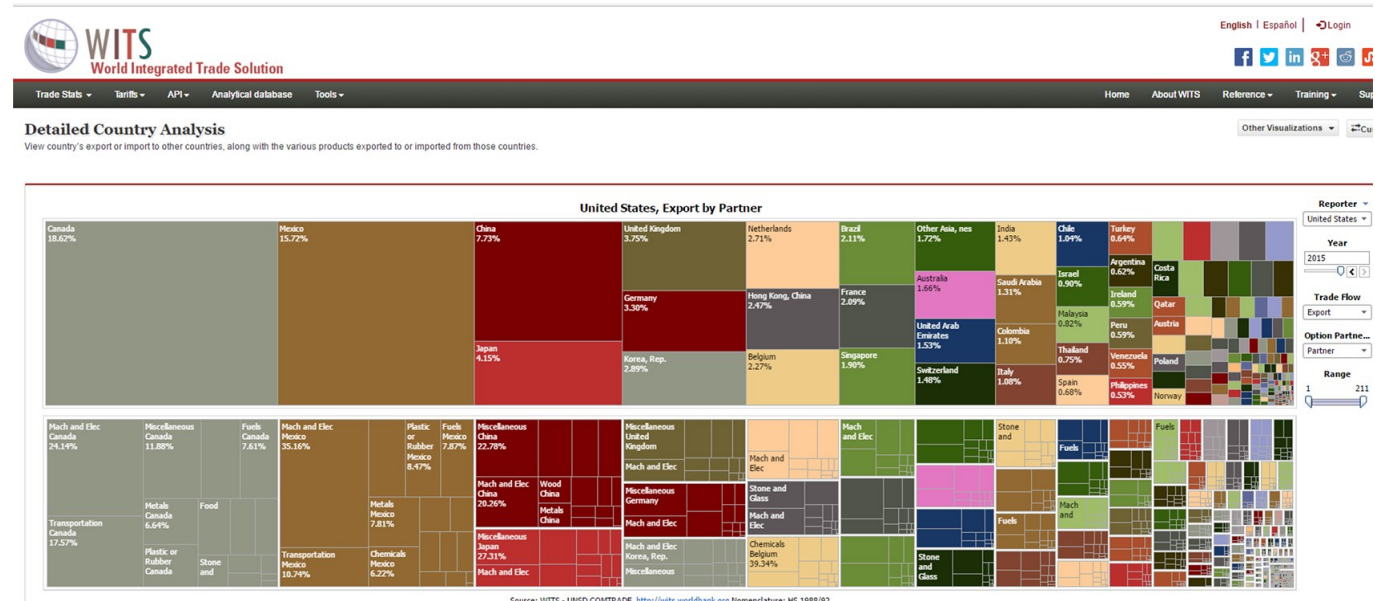




# Trade Complexity- Renegotiation “Difficult”

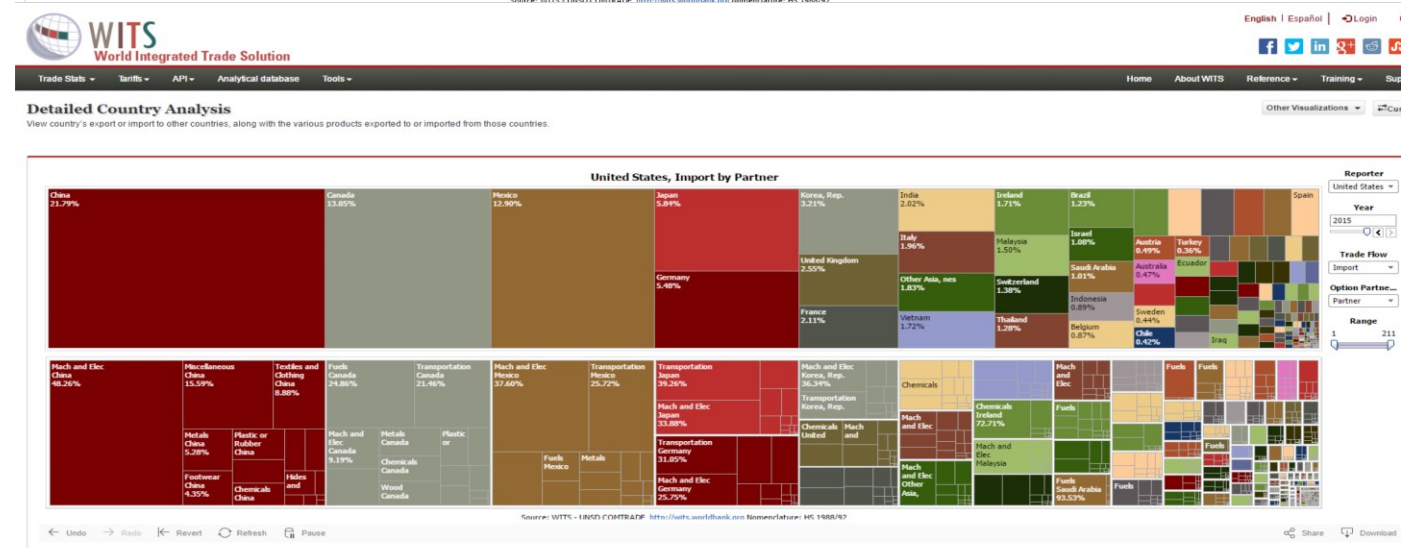
**US Export by Partner in upper set >>>>>>>**

**Commodities shown in  
lower set >>>>>>>**



**US Import by Partner in  
upper set >>>>>>>**

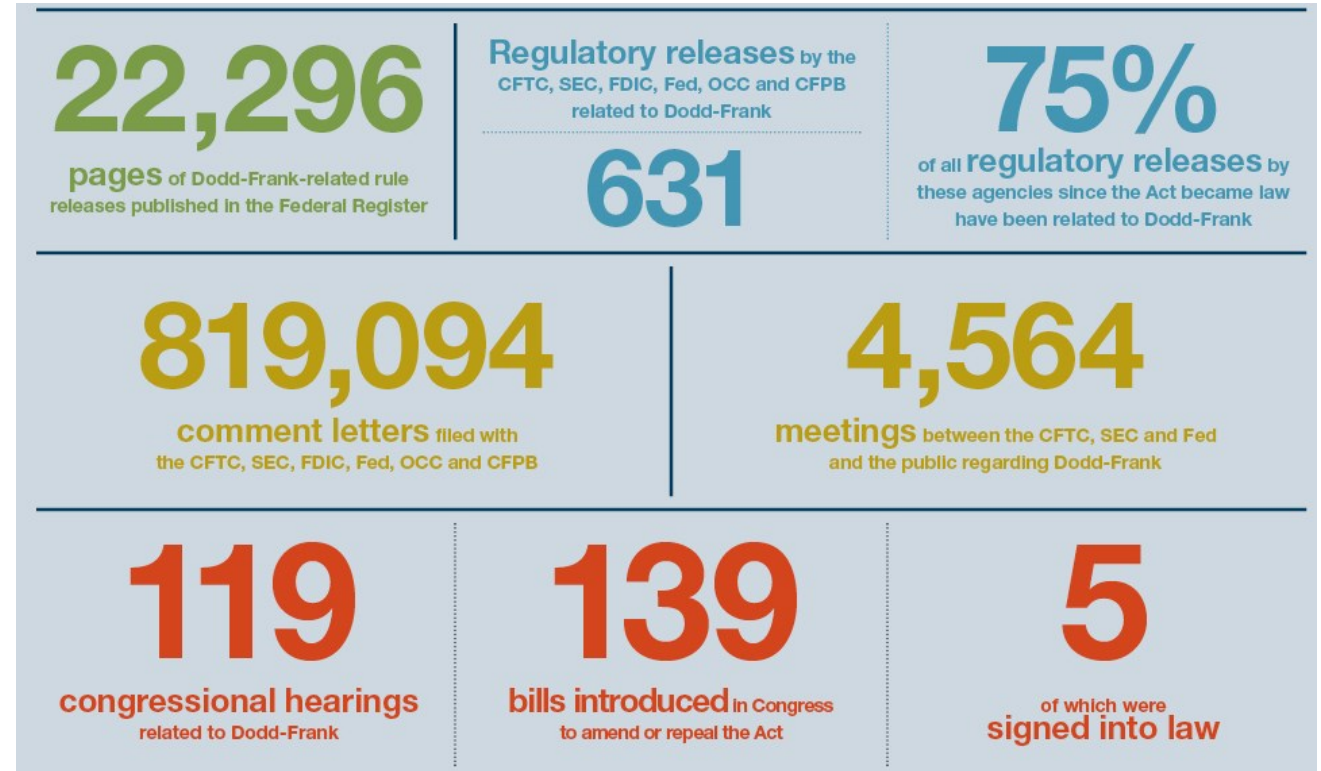
**Commodities shown in lower set >>>>>>>**





# DODD FRANK

- 2,300 pages of legislation passed July 21, 2010
- Over 20,000 pages of regulation
- Only 70 % of the rules have been written as of 7/17/2016
  - <http://www.washingtonexaminer.com/six-years-later-70-percent-of-dodd-frank-rules-written/article/2596953>
- Big SIFI Banks are still too big to fail, but have vastly improved capital reserves
- CCAR & Living wills implemented
- Complex regulation is especially difficult for smaller banks
- 1 community bank or Credit Union is gone every day



# Regulation Explosion and Rollback

- Legislation goes to Federal Agencies to translate into the Federal Register for implementation
- Regulations have run wild
  - Here are the 80,000 pages of JUST the 2013 Federal Register regulation release  
>>>>>>>>>>>>>>>>>>>>>>>>>
- This is choking business
- Expect some roll back
  - ACA in Health Care
  - Dodd Frank in Financials
  - EPA
  - Energy
  - Education
  - etc

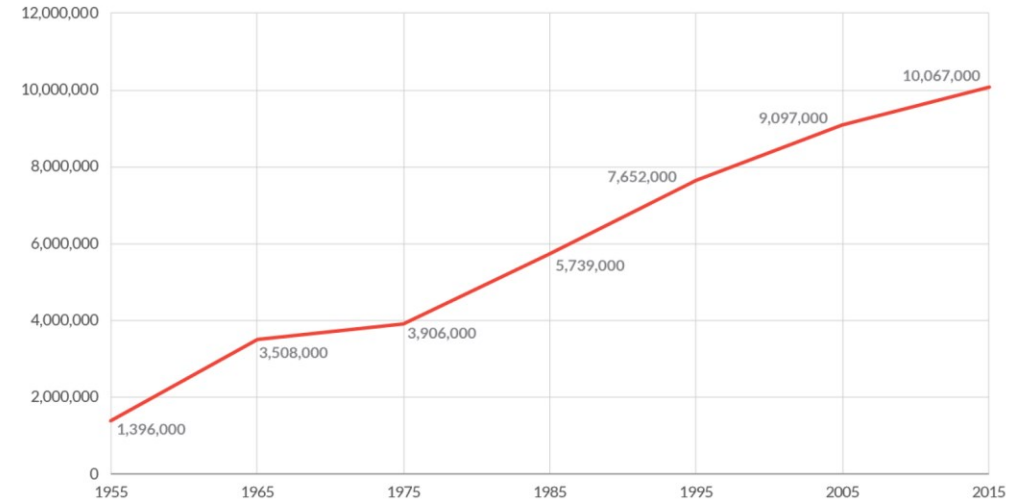


# Tax Reform

- Corp Tax
  - Corp Tax Rates at 35% / Effective Rate 27%-28%%
  - DJT Campaign 15%
  - Ryan House 20%
  - Offset to strong \$ impact on Multinationals
- Personal rate from 7 to 3 tiers
- The Federal tax code is now over 10 Million words- reference chart
- Tax reform has been talked about but real reform has only occurred under Kennedy & Reagan in modern times
- The lobbyists & special interests will come out in force so this will be a tough slog and take time

## The Federal Tax Code and Regulations are Now Over 10 Million Words in Length

Number of Words in Title 26 of the U.S. Code and Title 26 of the Code of Federal Regulations



Sources: Government Publishing Office (2005, 2013), West Publishing Company (1955-2005)

Notes: Figures from the West Publishing Company were first obtained for a 2005 Tax Foundation report: The Rising Cost of Complying with the Federal Income Tax. 2015 figures have been adjusted downward from a simple word count of the tax and regulatory codes, in order not to measure the length of appendices, tables of contents, references, etc.

TAX FOUNDATION

@TaxFoundation

# Repatriation of Overseas Cash

- Approximately \$2.5T locked up overseas
- Inhibitor to repatriation has been lack of action on 35% tax rate & Tax reform
- The US Corporate Tax Rate is the highest in the developed world
- Effective rate near 27%-28%
- Partial stimulant to “Inversion” (Transfer of Corporate HQ overseas)
- A low tax rate will blunt inversion
- DJT promises 15 % tax rate
- Even if not totally achieved will have dramatic impact on cash rich co
- M&A, Dividends, Buybacks
- Requirements, strings attached are not known but should provide huge market stimulus

# Cash Rich Companies

- An idea- buy cash rich co that will repatriate WHEN legislation reduces the repatriation tax rate
- 4 lists are shown in the next page Note- The overall effective Federal tax rate is about 27-28% vs the often publicized 35%
- Per Moody's 12/12/2016 the most cash rich industries are Tech, H Care/Pharma, Consumer Products & Energy
- Repatriation offers a big opportunity for investors in cash rich companies
  - One way to approach this is via the Top 50 ETF (XLG) for a concentrated bet
  - The TOP 50= about 50% of the SP 500 Market Cap
  - And none of these lists agree
  - But the strategy should work

# 4 Lists of Cash Rich Companies

## • Wall Street Journal 12/26-27/2016

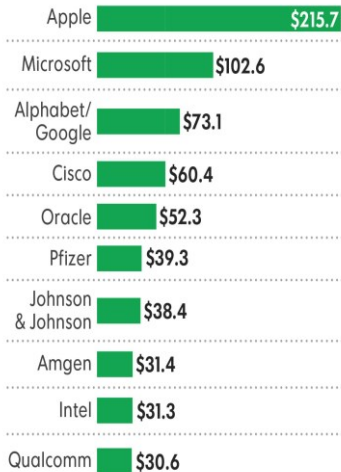
- Microsoft **\$108B**
- GE **\$104B**
- Apple **\$92B**
- Pfizer **\$80B**
- IBM **\$68B**
- Merck **\$60B**
- Alphabet **\$59B**
- J & J **\$58B**
- Cisco **\$58B**
- Exxon Mobil **\$56B**

## USA Today

5/22/2016 Cash & %  
Offshore YE 2015

### COMPANIES WITH THE MOST CASH

The top 10 companies by cash and cash equivalents held<sup>1</sup> (in billions):



<sup>1</sup>—as of end of 2015  
SOURCE: Moody's Investor Service  
George Petras, USA TODAY



- Apple 93%
- Microsoft 94%
- Alphabet 59%
- Cisco 94%
- Oracle 87%

## USA Today

11/25/2016, YE 2015,  
source S&P Global

### Market Intel

- Apple \$237.6B
- Microsoft \$147.3
- Alphabet \$88.8B
- Cisco \$71.0B
- Oracle \$68.5B
- GE \$57.0B
- Yahoo \$51.5B
- Coca-Cola \$45.1B
- Aetna \$43.3B
- J & J \$41.0B

## Factset 12/21/2016

Top 10 Companies by Cash & Short-Term Investments						
ID	Company	Sector	Cash & ST Investments (Qtr)	1 Year Growth	Cash to Debt	1 Yr Total Return
MSFT	Microsoft Corporation	Information Technology	\$136,932	37.8%	180.8%	20.7%
GOOGL	Alphabet Inc. Class A	Information Technology	\$83,056	14.1%	2109.1%	7.4%
CSCO	Cisco Systems, Inc.	Information Technology	\$70,968	20.1%	204.0%	21.2%
ORCL	Oracle Corporation	Information Technology	\$68,396	22.3%	126.5%	8.7%
AAPL	Apple Inc.	Information Technology	\$67,155	61.4%	77.2%	12.5%
GE	General Electric Company	Industrials	\$52,530	(47.0%)	35.2%	7.9%
JNJ	Johnson & Johnson	Health Care	\$40,433	8.4%	149.8%	17.0%
AMGN	Amgen Inc.	Health Care	\$37,980	22.0%	107.5%	(4.5%)
F	Ford Motor Company	Consumer Discretionary	\$34,165	7.3%	24.9%	(1.9%)
AGN	Allergan plc	Health Care	\$27,392	1222.7%	83.6%	(37.2%)

Source: FactSet

**Note- Allergan is on this list but is not Domestic**

# Another Tax Related Strategy- High Tax Rate Co

- If and when legislation drops US Company Federal tax rates here is a list of potentially big beneficiaries
- The common element is very high effective tax rates (40% or more over the last 5 year period)
- Here is the list with rates paid over the last 12 months:
  - Centene (53.8%) Health Care Insurer
  - AES (51.6%) Utility
  - Humana (51.1%) Health Care
  - Leucadia National (47.7%) Financial Conglomerate
  - Cardinal Health (38.4%) Healthcare Services
  - Best Buy (36.4%) Tech Retail
  - Century Link (33.0%) Telecom & Data Services
  - Alexion Pharma (31.7%) Rare Disease Biotech
  - S&P Global (30.2%) Financial Information & Analytics
  - Also, SCHWAB (SCHW) has a high tax rate and is likely to benefit from increased trading activity



# Some Key Relationships in Markets

- First, markets are interconnected in many ways World Wide. Here are some relationships>
  - A strengthening US economy tends to boost US interest rates, incents the Fed to raise FF rates to control inflation, & usually will move the US dollar higher
  - A strengthening US Dollar tends to depress the following
    - Gold prices & inflation as imported goods are purchased at lower prices
    - Oil prices as many WW oil contracts are priced in US dollars
    - Earnings of US multinational companies from overseas operations
  - Rising rates affect the following
    - The 10-2 UST spread increase allows banks & insurance companies to become more solvent
    - Savers are able to earn more from CDs, money market funds, etc
    - In general, as rates rise & inflation increases Retirees will have better Social Security flows
  - As international markets improve the affects reverse

# Early 2017 Indications- First week

- **December jobs report**
  - 156K vs consensus 178K
  - Unemployment rate at 4.7%
  - Wage gains 2.9%, minimum wage increases should be in next months report
  - October revised down, November revised up, net about 19K jobs
- **Markets**
  - **US Equities**
    - Some gains to all time records in the SP 500 & Nasdaq, Dow hit Intraday record
    - Some consolidation in hot post election sectors since mid December- hot spots backing off some
    - Good start vs prior years
    - Dollar weakened
  - **International Equities**
    - China PMI positive, focus on defending Yuan
    - EuroZone Inflation peeking up; Implies less ECB QE
    - UK PM May Brexit Envoy quit. Issue- lack of hard Brexit plans. New Envoy in place
  - **Fixed Income**
    - Fixed income recovered a bit
- **The Agenda**
  - ACA legislation “sometime this year” per Ryan

# What I am Watching in Early 2017

- The USD, Rates, market data
- Company Guidance in 4Q reports- the strong USD will likely impact earnings and but lack hard data for new policy therefore impact the Market
- Administration Leadership
  - Cabinet confirmation
  - ACA
  - Trade policy
  - Regulation roll back
  - Dodd Frank Mods
  - etc
- The Fed- Dove shift to hawks
- Geo Political events- EU elections, Middle East, Russia
- Oil
- Budget
- Entitlements, National Debt- Social Security, Medicare have not been addressed

# Questions?

**That's it folks- I hope you leave better armed for 2017 markets.**

**Check AAll Silicon Valley Archives for this pitch to be posted in full color**

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**Please enjoy Michael Yoshikami- he is great!**

**Happy new year, Bill Jump**

# Back Up

- Election
- Trump vs Reagan
- Trends
- My Tickers

# Election Microscope- What happened?

- The Pundits are out of Touch

## [A Summary of Electoral College Vote Projections](#)

October 5, 2016

With just [under five weeks](#) to go until the 2016 presidential election, here's the state of the race from the viewpoint of 14 forecasters. You can find all the associated maps, as well as a few others, on our [2016 Presidential Election Forecasts](#) page.



## Electoral College Projections

As of October 5th



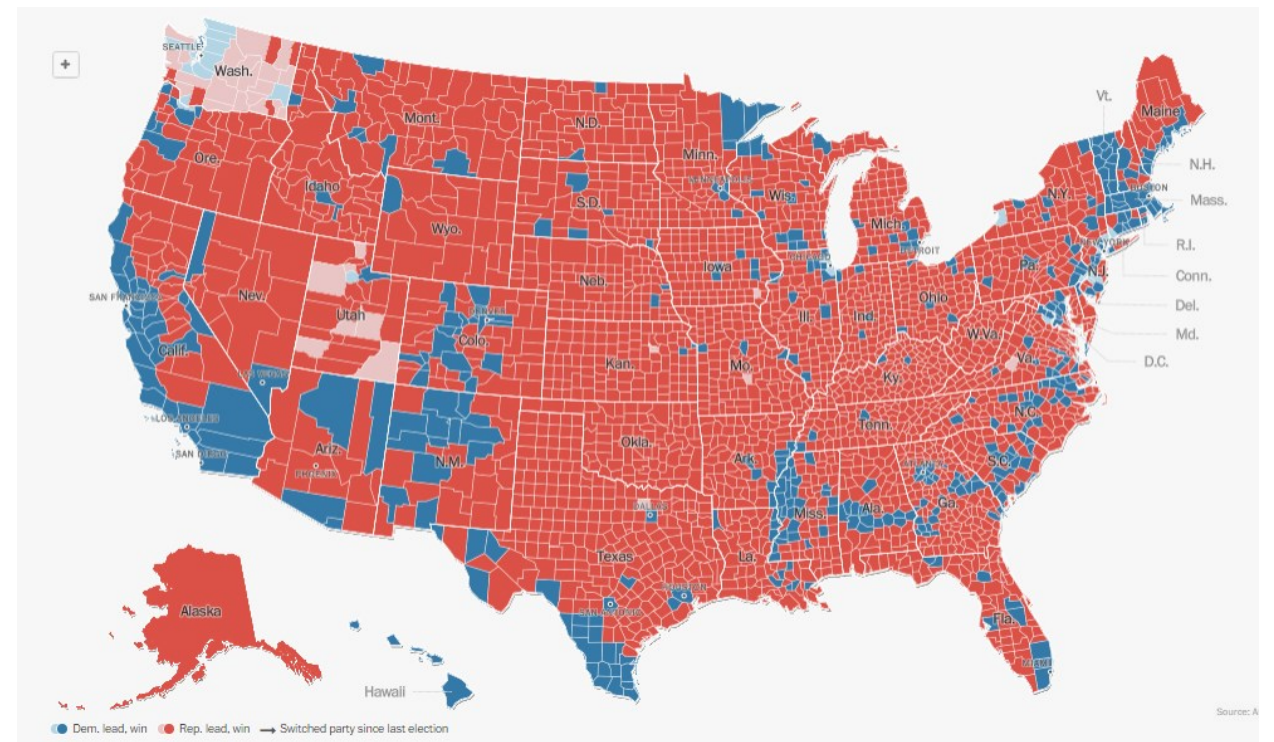
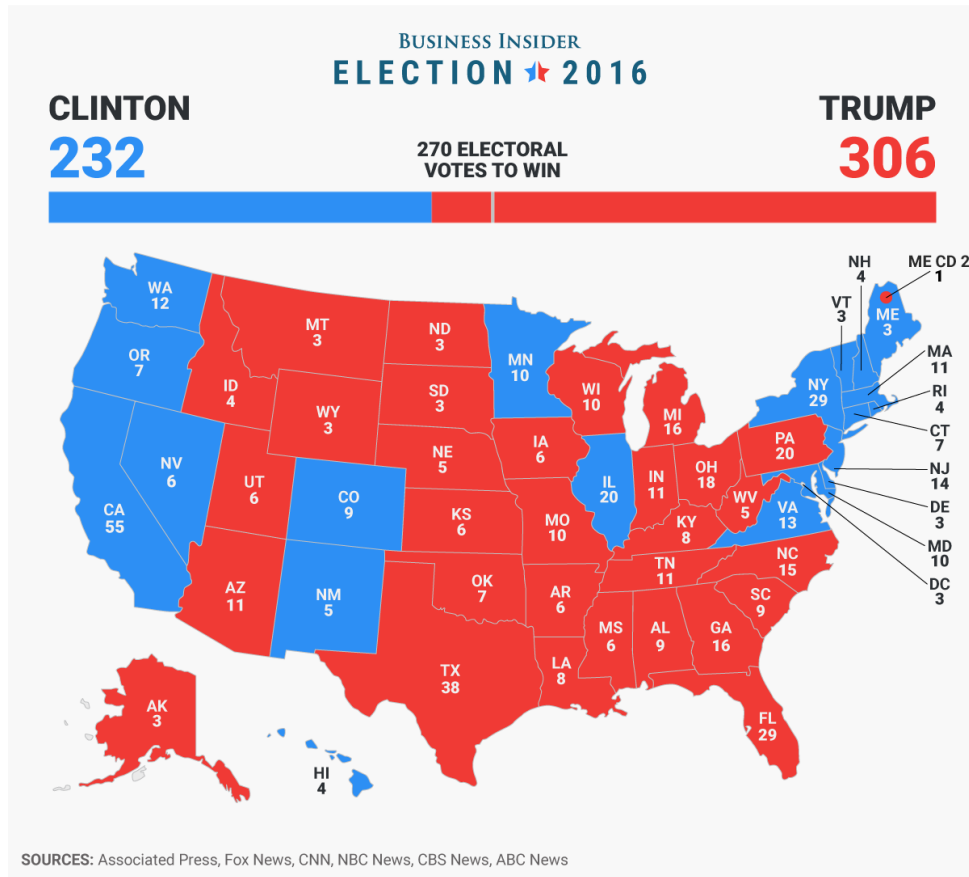
Forecast	Hillary Clinton / Tim Kaine			Donald Trump / Mike Pence			Toss-up
	Favored	Lean	Total	Favored	Lean	Total	
Sabato's Crystal Ball	200	72	272	163	27	190	76
Cook Political	213	59	272	163	34	197	69
Rothenberg & Gonzales	217	62	279	164	27	191	68
FiveThirtyEight*	239	33	272	179	13	192	74
Princeton	278	39	317	180	35	215	6
PredictWise	272	50	322	190	1	191	25
NYT Upshot	262	45	307	179	13	192	39
ABC	200	72	272	153	44	197	69
Associated Press	200	72	272	147	50	197	69
CNN	200	72	272	163	33	196	70
FOX	190	73	263	153	18	171	104
NBC	200	72	272	132	42	174	92
NPR	200	72	272	163	42	205	61
The Fix (Wash. Post)	196	57	253	164	33	197	88

The shaded rows are statistical models from which we've derived projections based on probabilities in each state.

The other forecasters assign states to different categories, some use more than others. We've converted all projections into five categories for easier comparison. \*Polls Plus

# The Electoral Map

- The Unexpected Happened
- Just Like Brexit





# Balance of Power Altered

- Republican Sweep
  - White House
  - Senate- R 52 vs D 46 and Independent 2 (But voting will be tight)
  - House- R 241 vs D 194
  - Governorships- R 33 vs D 16 and Independent 1
  - State Houses- R 32 vs D 13 and 5 divided
- Things will get done in DC but there will be pushback
- Things will take time due to complexity and pushback

# Trump vs Reagan

- Governing experience- Reagan Ca Governor, DJT no experience
  - Mike Pence key
- The economy- Pre & Post Reagan boom bust era, now 2%
- Rates- Volker escalated rates under Reagan- 30+ bond bull, now bearish
- Inflation- Reagan inherited high inflation, DJT gets low inflation
- Debt- Reagan had deficits but relatively low Natl debt, DJT gets \$20
- Direct to the people- speeches vs Twitter
- Geo Politics- more complex now

# Some Trends to Think About

- Rise of Populism
- Anger & Division
- Aging demographics
- Media Shift: Print & Cable media to the Internet
- The share economy
- Speed of change
- Fintek rising
- Autonomous driving
- Fossil fuel to Electrification of the Automobile (Shifts emissions to Power Plants)
- Mutual Funds to ETFs
- Race to the bottom on expense ratios
- Robo Advisor
- IoT (Internet of Things)
- Passive vs Active
- AI- Artificial Intelligence

# Disclosure: My tickers

- Very Long term: IBM, ETR, MSFT, ORCL, AMAT, WBA, PG, IBM Proprietary Income Fund & other Institutional ETF like holdings
- Long term: AGN, AAPL, DIV, WES, SPKKY, FPURX, KR, GOOGL
- Recent (Many of these will be TRADES, not long term holdings): ITOT, RSP, IWD, VTV, EQAL, XLI, XLF, RYE, BHI, MRO, PAA, SLCA, WDC, PFN, MRK, BMY, RTM, DXJ, BKLN
- And lots of spare cash