McBork Report
4th Quarter 2016

My son Leo, summer 2016

December 1, 2016

I sent a draft of this letter out to Mike McGillicuddy for comment. One of his observations merits repeating: "Your commentary is spot on, Greg, but I wonder if people are ready for an analytical approach you have undertaken here. Most people I know are still in shock, trying to come to grips with the events of November 2016."

Mike is right. Many people find themselves baffled by the election results and perhaps still more inclined to be passionate rather than dispassionate about current events, including the investment climate. But that's the job you hired me to do and it is a particularly important job in volatile times such as these. So with no pretensions to moral or political commentary, here's my read on the investment climate as we transition from 2016 to 2017.

The US electorate surprised many by voting Mr. Trump into office. The Democrats were able to take a few Senate and House seats away from the Republicans, but not enough to gain control of either chamber. In the last McBork Report, I noted that historically Republican control of the executive and legislative branches has been followed by an S&P 500 Index average annual rate of 7%. So is this return feasible under a Trump presidency?

As you know, there are no guarantees when it comes to investment returns. After some overnight election result jitters in which the S&P futures were down more than 5%, the US and global markets appeared to adopt a narrative about Trump's future policy actions. The market's post-election behavior seems to hinge on three economic drivers that many analysts predict may happen sooner rather than later: lower taxes, reduced regulation, and shrinking government. When combined with anticipated fiscal stimulus infrastructure spending, these drivers have fueled market optimism and November was a banner month for stocks.

First we should expect a strong push for overall tax reform. If corporate tax rates go from 35% to 15%, the expected result is increased corporate revenues. Under this scenario US companies would be more competitive in the global market. Our equity market could look reasonably cheap due to its lower price to earnings (P/E) multiple compared to other developed markets.

Second, we should see a strong push for deregulation. The prospect of financial deregulation and expectation of higher interest rates drove the S&P 500 Financial Index up almost 8% the two days after the election. I expect our new congress to enact modifications to existing environmental regulations as well as to the financial industry. The incoming regime has made no secret of its desire to do away with parts of Dodd-Frank and may also oppose the Department of Labor's new Best Interest Rule scheduled to go into effect in 2017.

The third driver would be the expected 10 year/$1 trillion focus on infrastructure spending for roads, bridges, schools, hospitals, airports. President-elect Trump is convinced that this massive outlay will both stimulate the economy and put many people to work.

These drivers under a Republican led legislation have persuaded the stock market to adopt a "risk-on" mentality. While the S&P 500 Index is up 2.8% since the election (and at all-time highs), not everyone agrees that the outlook is so rosy. According to Ryan Detrick, a senior analyst at LPL Financial, the Monday after the election saw more than 300 companies issued on the New York Stock Exchange (NYSE) advance to 52 week highs, and more than the same number of companies fell to new lows.

So why isn't the prevailing sentiment unanimous? There are several obstacles that could leave investors with a bitter taste in their mouths and perhaps may cause some stocks to drop considerably. First of all, we have to remember that President-elect Trump's policy ideas won't be fully implemented because of the inherent checks and balances in our government. Some analysts are also predicting that the massive overhaul in tax reform and large infrastructure spending will not be as significant as previously thought. Over the last few years Republicans have advocated for a balanced budget by almost any means, including shutting down the Federal government. Many Republicans may balk at unfunded tax cuts or spending increases. So if the new administration's proposals stall in congress, stock market enthusiasm may wane on the expectation that stimulative initiatives may be neither as robust nor as rapid as expected.

If companies are allowed to repatriate earnings that have been sitting overseas, we could see a few trillion dollars coming back to the US. Many Republicans in Washington see this money "trickling down" throughout the economy, but please note that this "trickle down" did not play out as expected when it was attempted in 2004 during George W. Bush's presidency. A few years after repatriating the money, President Bush's chief economic advisors said the majority of the money was used for share buybacks, increasing stock dividends, and corporate bonuses. There was no evidence that it resulted in job creation or any noticeable pickup in investment.

While much of President-elect Trump's platform is pro-growth, one big exception is trade. He will have full control of negotiating and vetoing trade agreements without legislative approval and that could cause ripples throughout the global markets. If he were to increase tariffs and trade restrictions it could have a significant negative effect on global growth and pose serious problems for our trade with both developed and emerging international markets, particularly Mexico and China, along with US based multinationals that deal in goods and services. We have already seen the MSCI Emerging Market Index retreat around 4.4% since the election. On the flip-side small cap companies domiciled in the US have seen their stocks go up. The Russell 2000, an index which tracks US small cap stocks is up 10.6% since the election based on expectations of increased US manufacturing as well as the likelihood that credit will be more readily available.

Even though the anticipated tax reform package would benefit corporations, it is not at all clear that the same would hold true for middle class families. While the President-elect's plan would translate to lower taxes for many, the individuals who would most benefit would be the highest earners. Factcheck.org has stated that the claims that Trump's tax cut would benefit the middle class are somewhat misleading, so it remains to be seen if these individuals will be better off. It appears single parents might actually have to pay more in taxes because of the elimination of the head of household filing status. A proposal to eliminate personal exemptions may cause large families to pay more in taxes. Because household spending is a driver of growth in our economy and meaningful tax reform for the middle class is suspect, I am unsure what will happen with consumer spending. We will have to wait until we see the full effect of the tax reform.

We also do not know the fate of the current Federal Reserve Chair, Janet Yellon. Her contract matures in February 2018, and President-elect Trump has called her out many times over the past year. The composition of the Trump cabinet and the details of his immigration and health care plans must also be addressed before we know the long-term implications on the markets and economy. Because of the large number of unknowns under a Trump presidency it is hard to predict what will happen except that we know that volatility will be a factor. In short, I expect the markets to go both up and down in 2017 and the swings may be both rapid and sharp.

The prospect of tax cuts as well as the promised infrastructure spending can be expected to lead to higher inflation. In addition, the Federal Reserve will most likely increase interest rates in December of this year and again in 2017. This is not good news for the bond market and thus the Barclays Aggregate Bond Index has dropped 2.2% since the election. Please note that the index is still up 2.5% for the year and we feel that bonds should still be included in everyone's portfolio because they are a key part of the "foundation" of a solid investment portfolio.

Fidelity's bond portfolio manager Ford O'Neil recently stated, "It's almost like we're – in the short term – pricing in all the good news and not really pricing in any of the bad news. It's unclear to me in what direction we will truly go." I completely agree with him. I positioned portfolios cautiously as we approached the election and now during this period of uncertainty.

Some year-end household financial reminders:

(1) If you are over 70 1/2 and have retirement plan assets, you will need to take your **RMD (required minimum distribution)** by the end of the year. If you have not done so yet or cannot recall whether you have so, please get in touch with us as soon as possible.

(2) For those of you that typically **"gift" your RMD** to a charity, Congress last year made this a permanent tax code.

(3) At the end of each year many clients make **gifts of appreciated assets** to charitable organizations from their non-retirement accounts. The charity receives the same benefits as they would have obtained if you were to have written a check, but you avoid paying the capital gains tax on the appreciated asset. Please let us know by early December if you wish to gift appreciated assets in 2016 or if you have any questions on gifting.

(4) Remember that **Traditional and Roth IRA** contributions may still make sense. While there are income limits on the amounts that you can contribute as well as limits on participation for participants in employer sponsored plans, many individuals are wise to do so before the April 15, 2017 deadline for 2016 contributions. For example, some individuals over 50 may place up to $6,500 into Traditional or Roth IRA while the comparable limits for individuals under 50 is $5,500. Please call if you would like to discuss the advisability of making IRA contributions.

(5) Quick reminder to those of you with **high school, college-age or young adults** in your life itching to learn more about the world of money and investment: We are happy to sit down or teleconference with your children and grandchildren to offer them "Investments 101." Winter break provides a great opportunity for such a briefing. Just give us a call and we will make the connection.

Please have a great holiday season. We are all truly blessed.

Sincerely,

Gregory Bork Jr.

Leo gettin' it done!

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