Quarterly Economic Update

Fourth Quarter 2016

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For many investors, 2016 was a year of surprises. When viewing the final results of equity returns in 2016, they do not reflect the year's wild ride for both equity and bond investors. In the final quarter of the year, stocks surged, continuing the bull market that is now almost eight years old. Donald Trump's victory as the next President had the investing community thinking about lower taxes, less regulation, pro-business initiatives, and what could be a bumpy ride to unwinding many of the Obama administration's policies.

Since the November 8 election, the stock and bond markets have had large moves. The stock market finished strong after November and December post-election results sent equities higher and higher almost every day. For some analysts it seems like the late gains in 2016 were so strong that they may have eaten into some expected equity gains for 2017 - even if many policies and earnings recoveries do come about. The Dow Jones Industrial Average may have not hit the elusive 20,000 mark, but it closed out the year 2016 at 19,762.60 on December 30 with a gain of 13.4%. The S&P 500 closed out the year up 9.5% and the NASDAQ closed at a gain of 7.5%.

In December, the Fed raised interest rates once again by 0.25%, elevating the U.S. Federal Funds rate to 0.50% - - 0.75%. The 10-year Treasury ended 2016 with a yield of 2.44%. The 30-year Treasury closed out 2016 with a yield of 3.06%. On the last day of 2015, the 10-year yield was 2.27% and the 30-year yield was 3.01%.

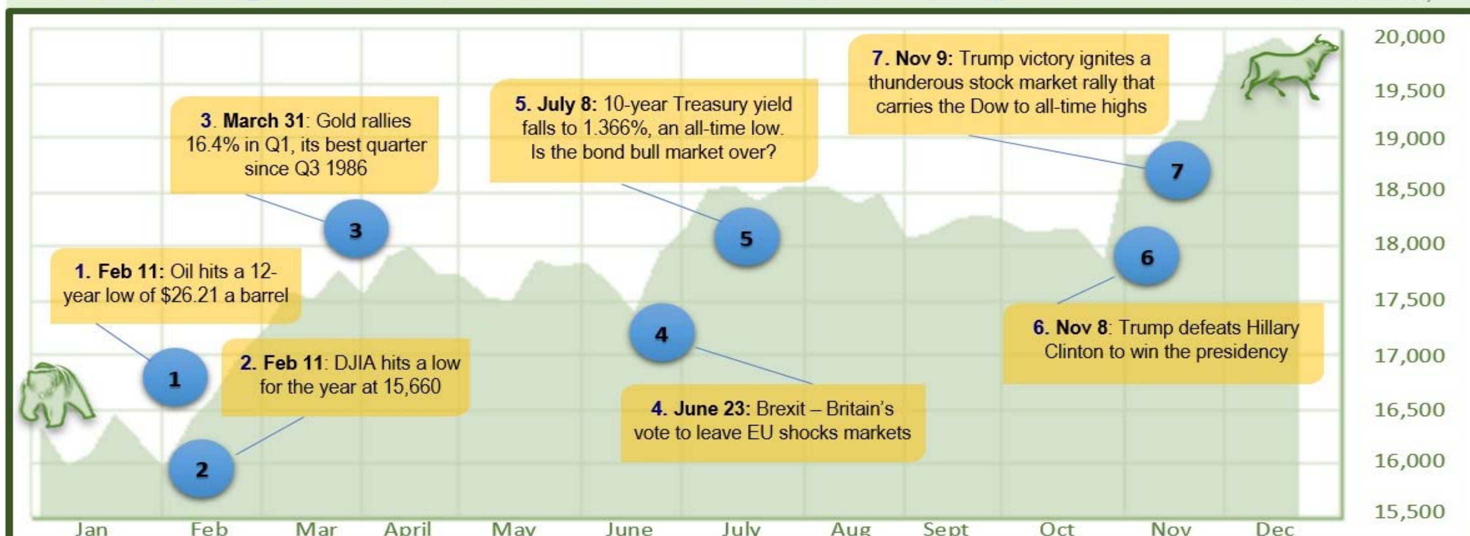
A Review of 2016

The year 2016 was one that defied predictions. Equity markets started poorly as the Federal Reserve's forecast in 2015 was to have four rate hikes in 2016, but they only had one. Also, early in the year, oil hit a low of $26.21 a barrel. At that price, some analysts were then forecasting potential mass oil company bankruptcies and a possible U.S. recession, neither of which came true.

One of the next big confusions of 2016 came when polls showed that the United Kingdom was probably going to remain in the European Union when the actual vote was to leave. This event known as "BREXIT" caused the markets to plunge. After a sharp two day drop, the S&P 500 started racing higher again.

The biggest prediction gone wrong was when most polls predicted a victory for Hillary Clinton, but Donald Trump was elected to be the President of the United States.

Despite all the forecasts of doom and gloom, equity markets ended the year with strong results, mostly coming from the post-election hopes that included looser regulations and tax cuts. ***(Source: Barron's 1/2/2017)***



Interest Rates

Although the US Federal Reserve's had only one 0.25% rate increase in December of 2016, all year, the prospect of rising rates had many investors paying careful attention.

Many overseas sovereign debts during 2016 were at negative interest rates. The central bankers' ability to offer negative interest rates is a very important story from 2016. It started back on June of 2014 when the European Central Bank (ECB) first offered negative interest rates at -0.10%. Rather than demanding that the central bank pay interest to borrow its money, banks now had to pay the central bank to lend it money.

Negative rates also appeared in Germany, Denmark, Sweden, and Switzerland. Following this trend, the Bank of Japan (BOJ) began charging interest to deposit funds at a rate of -0.10% in January 2016, continuing that trend throughout the year. ***(Source: seeking Alpha 12/26/2016)***

While rates have turned slightly positive in several countries, for investors in 2017 some major questions are: Will the central banks be able to keep markets stable as the Fed tries to lift rates? Will the markets erupt and force the central bank to reduce rates back down towards zero?

2017 Outlook

Due in large part to recent gains, investors need to be watchful of the current valuations of equities. The year 2017 starts with the S&P 500 index trading at 19 times last year's earnings. Based on historical results this is considered ambitious, but not ridiculous. Recent corporate earnings have shown slight growth after a year of shrinking and energy stocks are still not near their all-time highs. FactSet tallied estimates for earnings growth of 12% in 2017, but Goldman Sachs is less optimistic. They feel that investors have ridden the bull market for eight years and while they don't expect the ride to end in 2017, they are warning investors to stay vigilant. They are predicting that the S&P 500 will increase by 3% in 2017. ***(Source: Barron's 1/2/2017, Goldman Sachs 2017 Outlook)***

All eyes on interest rates

In December of 2016, the Fed's so-called "dot plot" showed the central bank penciled in three rate hikes in 2017 instead of two under its prior forecast.

David Payne, Staff Economist at Kiplinger's magazine, feels that despite the Fed's expectation of three rate hikes, figure on just two in 2017. Diversified portfolios usually have exposure to bonds or interest rate sensitive investments. Even in a rising rate environment, interest rate sensitive investments could play a role in most portfolios. At times, they have offered investors the potential to possibly offset losses in the event of a stock sell off. Investors need to monitor their bond and yield sensitive exposures in 2017, because rising rates can cause bonds to experience a short-term price loss. ***(Source: Kiplinger 12/16/2016)***

Global issues also need to be watched

Investors need to be watchful in 2017 for a potential global recession caused by potential blow-ups in China and Europe.

The 2nd and 3rd largest economies in the world enter the year facing many challenges.

China's main challenge is making the shift from an export economy to a consumption economy. In Europe, there are a slew of elections due to take place in 2017. Also, the potential for bank failures in Italy - Europe's third largest economy - could, cause big problems. Any major global crisis will only add to uncertainty and investors know that the equity markets do not like uncertainty. ***(Source: Seeking Alpha 1/11/2017)***

Conclusion: What Should an Investor Do?

Investors are concerned about the market for 2017. The year kicks off with a new president, higher rates, stocks at all-time highs and new risks and opportunities. Goldman Sachs in their 2017 Outlook predicts that, "while we recommend clients remain invested, we have modest return expectations. We expect that a moderate-risk well diversified taxable portfolio will have a return of about 3% in 2017." ***(Source: Goldman Sachs 2017 Outlook)***

A USA TODAY review of predictions from 15 Wall Street strategists finds that America's fortunes won't add up to big stock market gains in 2017. They report that the group feels the Standard & Poor's 500 should produce a gain of approximately 4.5%. ***(Source: USA TODAY 12/27/2016)***

CAUTION is still necessary for investors.

Michael Sonnenfeldt, the founder and chairman of TIGER 21 feels the only certainty in 2017 is uncertainty. He shares in Forbes that, "perhaps the biggest lesson of 2016, one which certainly carries over into 2017, is that there is no safety in safety." ***(Source: Forbes 12/17/2016)***

Many analysts are predicting a volatile ride in equities for 2017. They feel investors need to prepare for equity market pullbacks and/or corrections.

Sadly, safety comes with a price. According to Deposit Accounts January charts, the rates on one year certificates of deposit (CD's) were 0.50%. Investors' portfolios do not grow fast when they lock in rates of less than 1%. ***(Source: www.DepositAccounts.com)***

For many investors today's traditional fixed rates will not help them achieve their desired financial goals. Most investors attempt to build a plan that includes risk awareness. Many times this can lead to safer but lower returns. Traditionally, bonds have been used as a nice hedge against market risk, but with interest rates projected to rise investors need to be extremely cautious.

8 Key Points

1. 2016 was a year of surprises.
2. Since the Nov. 8 election, equity markets have risen.
3. Many foreign countries still have interest rates at or near 0%.
4. Analysts are expecting low, but positive returns for 2017.
5. Investors need to be watchful of interest rate increases in 2017.
6. Global issues could potentially create challenges in 2017.
7. Volatility is expected in 2017 and investors should be cautious.
8. **Investors need to focus on their own situations and objectives.**

For 2017, let's revisit YOUR Strategy. Investors need to be prepared. Market volatility should cause you to be concerned, but panic is not a plan. Market downturns do happen and so do recoveries. This is the ideal time to ensure that you fully understand your time horizons, goals and risk tolerances. Reexamining your entire picture can be a helpful exercise in determining your strategy.

We focus on your own personal objectives. We try to understand your personal goals so we can offer suggestions that fit your specific situation.

Now is the time to make sure you are comfortable with your investments. Equity markets will continue to move up and down. Even if your time horizons are long, you could see some short term downward movements in your portfolios. Rather than focusing on the turbulence, you

might want to make sure your investing plan is centered on your personal goals and timelines. Peaks and valleys have always been a part of financial markets and it is highly likely that trend will continue.

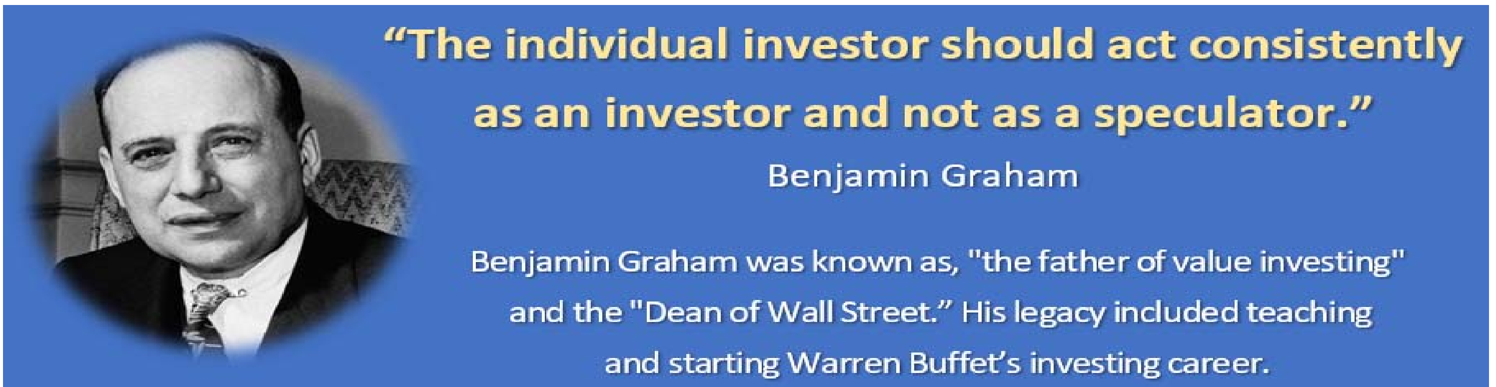
Discuss any concerns with us.

Our advice is not one-size-fits-all. We will always consider your feelings about risk and the markets and review your unique financial situation when making recommendations.

We pride ourselves in offering:

- ✓ consistent and strong communication,
- ✓ a schedule of regular client meetings, and
- ✓ continuing education for every member of our team on the issues that affect our clients.

A good financial advisor can help make your journey easier. Our goal is to understand our clients' needs and then try to create a plan to address those needs. We continually monitor your portfolio. While we cannot control financial markets or interest rates, we keep a watchful eye on them. No one can predict the future with complete accuracy, so we keep the lines of communication open with our clients. Our primary objective is to take the emotions out of investing for our clients. We can discuss your specific situation at your next review meeting or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial matters.



Help us grow in 2017!

This year, one of our goals is to offer our services to several other people just like you! Many of our best relationships have come from introductions from our clients. Do you know someone who could benefit from our services?

We would be honored if you would:

- ✓ Add a name to our mailing list,
- ✓ Have someone come in for a complimentary financial checkup.

Please call Mike at Kerntke Otto McGlone Wealth Management Group, (920) 733-3874 and we would be happy to assist you!

Kerntke Otto McGlone Wealth Management Group, a Registered Investment Advisor.
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