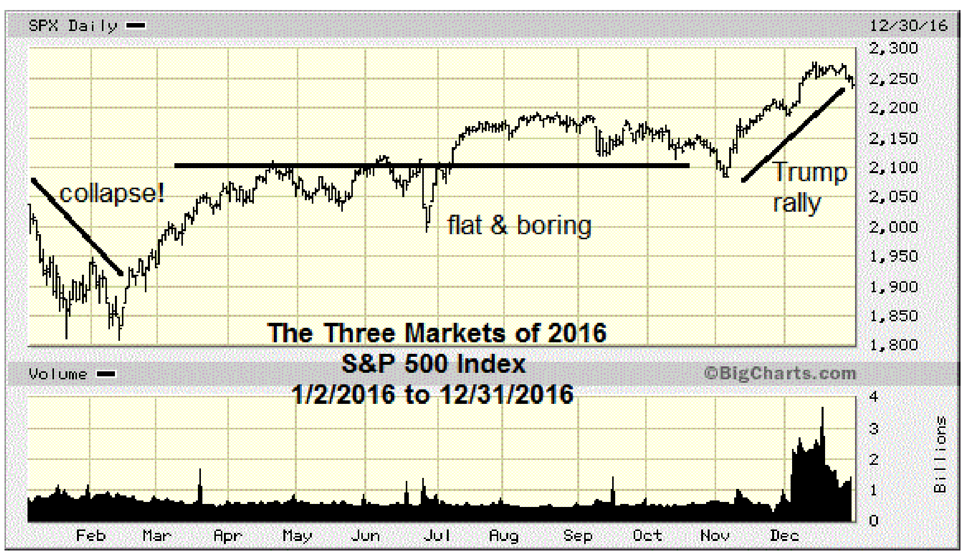
American Heritage Financial

January Update January 3, 2017

Three-for-One

If you love bargains, then you must have loved 2016 because, as far as the market was concerned, it was like *a three-for-one sale*. As the year opened, markets went through a near-panic selloff in January and February as the bottom fell out of oil prices, China appeared on the verge of collapse and U.S. growth slowed to a crawl. Stocks were off by more than 10% in the first six weeks of the year with investors and businesses worrying about rising interest rates and sluggish conditions. By March, some of the global and domestic economic issues began to stabilize and the Fed made it clear they would continue accommodative policies as long as the "data" remained weak. Thus, began a multi-month balancing act where massive liquidity, mediocre economic conditions and ambivalent investors combined to support a flat and uninspiring market. Stock prices slowly rebounded but were barely in positive territory by mid-year and bond yields were again plunging to new record lows.

Uncertainty became an over-used buzz word as investors anticipated the November elections. Then…the *Mother of All Uncertainty* became *reality* and markets once again proved that no one has a crystal ball as the "Trump Rally" inflated the S&P 500 by 7.5% from early November to the end of the year.



So, we saw fear of financial collapse for two months, boredom with growing anxiety for about eight months and then an environment of bewildering optimism—all in one year! Final numbers on the market for the year were good—and much better than most investors had hoped possible. The S&P 500 advanced a solid 9.5% for 2016 while the Dow Jones Industrial Average surged 13.4%, not including dividends. Commodities, one of the main culprits of 2015 weakness, gained about 10% according to the CRB Index (Commodity Research Bureau), while the most critical commodity, oil, advanced 52% to over $50 per barrel. Importantly, the higher stock prices of 2016 were at least partially supported by a pick-up in economic conditions and corporate profits. Third quarter GDP (Gross Domestic Product) grew by 3.5%, providing the strongest U.S. growth in two years including the prior three quarters where growth struggled to reach 1%. Similarly, profits turned a four quarter negative streak positive in the 3rd quarter, advancing by about 5% over previous year's results.

Interest rates can be considered a barometer for future economic expectations and rates (measured by the Ten-Year US Treasury) bottomed at a multi-year low of 1.35% in July, recovered to 1.8% by early November and sky-rocketed to 2.45% by yearend. The increase in interest rates is even more significant than the increase in stock prices. It reflects expectations by the most serious and professional investors that growth (and possibly inflation) will pick-up. It is also great news for savers and those of us who have struggled to find value in fixed income investments—we may finally begin to get paid for the conservative portion of our portfolios!

You may notice from the above that conditions were definitely turning up **prior to** November 8th. Yet, there is no denying that stocks and bonds have been in a “Trump Rally” beginning November 9 and the new optimism reflected in financial asset prices and the economic outlook is based on expectations that the new administration, along with a cooperative Congress, will deliver on promises to cut regulation, reduce taxes and spend on infrastructure. Added to an already improving economy, the new optimism, along with follow-through on political promises, could result in great growth, strong profits and a corresponding response from stocks in 2017.

But our crystal ball (for what it is worth—see comment on crystal balls) tells us to expect a reality check before too long. This strange new world of economic optimism will be tested when President Trump and his Congress try to implement all the wonderful promises. We are optimistic that the economy will be strong in coming quarters and exciting new opportunities have surfaced in the financial markets—at the very least we have left an era of depressing over-regulation. Yet, a lot of progress and promise is already built into stock prices and any hiccup could lead to a correction where investors reevaluate possibilities. The good side of that likely outcome is that it will give those who sat out the amazing end of 2016 a chance to participate in what should be solid new opportunities for the long-term.

We hope you enjoyed the markets and the Holidays at the end of 2016 and we wish you Health, Happiness and Prosperity for 2017!

Best regards,

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Questions or comments?
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