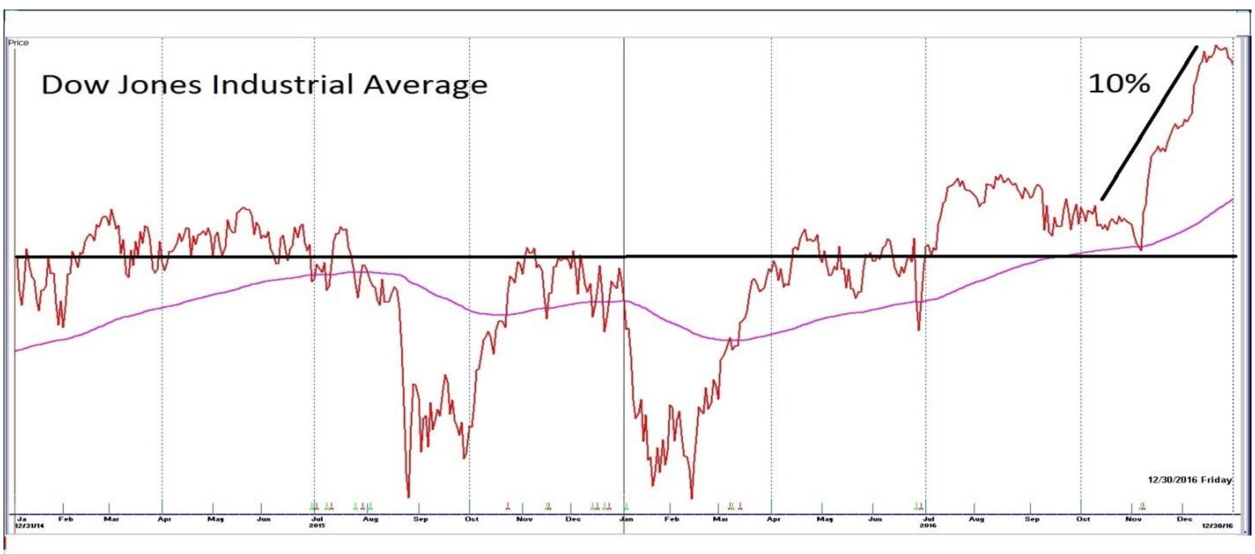
Financial Services Advisory
GROW WISER®

That's Why They Play the Game

Year End Market Update—January 9, 2017

Sports are often a great metaphor for life in general. Concepts like teamwork, planning, perseverance, dedication, and focus apply to so much of what we do every day. Sports remind us that just by being in the game, we have a chance to win, even if the odds seem very slim. We saw it in the 1980 Olympic hockey game final, when the scrappy kids from America beat the vaunted Russian squad. It happened again in 1983 when North Carolina State's improbable run through the NCAA basketball tournament ended with a thrilling last-second win against the University of Houston's powerful "Phi Slamma Jamma" team. Long-shot victories like these always amaze us, even though each team, at least statistically, has a 50-50 shot at victory.

The latest election brought us the political version of the upset victory as Donald Trump, who will assume the presidency on January 20, managed to win against all odds. Stocks seemed to breathe a sigh of relief that the election was over, climbing almost 10%. Finally, investors could begin to focus on what might lie ahead. For nearly two years, stocks had achieved virtually no gain (in fact, they were under water most of the time) as investors fretted over the future direction of the country and the economy (see chart below). All of the price return for the Dow Jones Industrial Average came in the few weeks immediately following the election.



This ongoing choppiness, with no clear trend, has weighed on FSA portfolios over the past few years. Most of our investing strategies achieved gains in 2016, but the weakness leading into the election prevented us from being too aggressively positioned for the so-called Trump rally.

The other interesting aspect of this year-end rally was the change in market leadership. In the first half of the year, more defensive and income-oriented areas of the market (such as bonds, equity income funds, utilities, and real estate) led the way. After the election, small-cap stocks, financial stocks, energy, and industrials headed the charge. Bonds and other areas of the market sensitive to rising interest rates actually fell in value. While the broad stock market has moved on an upward trend, there has been a big shift in leadership among the sectors underneath the broader indexes.

<u>Outlook for 2017</u>

The chart above makes it clear that the broader U.S. stock market has finally broken into an uptrend. As trend followers, we see an uptrend as a positive catalyst for things to continue going well. For this reason, we have moved more of the portfolios into equities and have reduced our bond allocations.

Stocks have moved higher, largely on hopes that a Republican president, working with a Republican-controlled Congress, will lower taxes for businesses and consumers, reduce regulation, and fund a large infrastructure program. All these initiatives could push stocks higher, if, and this is a big IF, they get passed into law. As the challenges of getting anything done in Washington bubble to the surface, we envision plenty of opportunities for stocks to pause and reconsider their bullish leanings. So for now, FSA portfolios have relatively low money-market levels, but we remain alert for an abrupt shift in market direction as political goals run into political realities.

<u>Portfolio Review</u>

Below, we review the six broad strategies that FSA manages. Keep in mind that your specific portfolio may differ to some degree from the averages, as our portfolios are individually managed.

Income (Strategy 1)

In the aftermath of the election, high-quality bonds sold off, forcing us to eliminate those positions in this strategy. In total, we sold 55% of the portfolio to money market, but then reinvested some of that money in other bond funds that were trending upward. Those bonds included high-yield bonds, floating-rate funds, and non-traditional bonds. As of year-end, this strategy was 80% invested in bonds, with the money-market allocation at 20%.

Income & Growth (Strategy 2)

As high-quality bonds turned down in the fourth quarter, we exited the two positions we held in this balanced strategy. At the same time, we increased the high-yield and floating-rate bond funds, as those areas continued to exhibit strength. The equity component remained at 40%, even though we did sell a more defensive and eclectic fund, while increasing our allocation to equity income funds. At year-end, our money market position was 15%.

Conservative Growth (Strategy 3)
During the quarter, we increased the equity allocation from roughly 35% to 50%, including the addition of a small-cap fund. At the same time, we sold most of the high-quality bond funds, while increasing the high-yield and floating-rate funds. This leaves our overall bond allocation at 35% - 40%. Currently, these portfolios hold 10% - 15% in money-market funds.

Core Equity (Strategy 4)
As stocks broke higher after the election, we increased the equity allocation of this more aggressive strategy from roughly 75% to 90%. We purchased small-cap funds and increased our large-cap allocation. At the same time, we sold some of the more defensive areas, such as the Consumer Staples and Infrastructure funds. If stocks continue to move higher this year, this strategy is poised to participate quite nicely.

Tactical Growth (Strategy 5)
Clients in this strategy saw a fair amount of trading as stocks went from stalling to soaring within a few weeks. Even though the money-market allocation remained about the same at year-end, we reduced or exited several areas that lagged after the election, such as emerging markets, real estate, and high-yield municipal bonds. Conversely, we added to our mid-cap fund, as well as technology. Overall, these accounts are roughly 85% invested.

Sector Rotation (Strategy 6)
As we moved through the fourth quarter, this strategy began to show some signs of life as it picked up technology, financials, and energy funds. For January, the strategy is weighted heavily toward Financials and Industrials stocks, along with a technology fund and a consumer-oriented fund. Obviously, this strategy is poised to benefit from a continuation of the current rally.

Please remember to let us know about any changes in your lives that could have an impact on your investment objectives, and if you want to talk before our next review.

FSA Investment Team

Disclosures: Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Financial Services Advisory, or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions or applicable laws, the content may no longer be reflective of current opinions or positions.

Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from FSA.

Financial Services Advisory is neither a law firm, accounting firm nor insurance agency and no portion of this newsletter should be construed as legal, tax, insurance or accounting advice. FSA advisors are not attorneys, accountants, insurance agents or comprehensive financial planners and no portion of its services should be construed as legal, accounting, insurance, or tax advice.