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OPTIMISM… AND CAUTION

The topic that seems to be on most investors' minds, as well as the general population, is what will President Trump mean for the markets and economy? In truth, the answer is that no one knows. Because Trump is unpredictable, one can make only guesses. Clearly, the financial markets have brought into the scenario that corporate tax cuts and reform, together with fewer regulations and more federal spending, will lead to higher corporate earnings and much stronger growth. From skepticism and despair last January, the markets are now reflecting a great deal of optimism. Whether such optimism is warranted will play out over the next year.

If corporate tax cuts take hold, earnings should rise much more than previously anticipated. Repatriation of overseas earnings will provide a boost to cash available for corporate uses such as reinvestment, dividends and share repurchases. These factors should provide support for stock prices and might not send interest rates too much higher.

However, risks do exist:

- Perfection from Trump and the Republicans is largely priced in over the near term;
- There is bound to be a disappointment at some point – either not enough stimulus or deregulation vis-à-vis market expectations or it doesn't come quickly enough;
- A few reports I have seen indicate that some businesses may be delaying further investments or other strategic actions until the new administration's policies become clearer; if they are forced to wait indefinitely it could start to hurt the overall economy;
- The same goes for many investors, who likely held off on selling positions last year with the expectation that lower taxes would be coming. The question now becomes - do we see a round of delayed selling as soon as we get a better idea about the tax implications?
- Considering investors everywhere are refreshing Twitter every few minutes to see what Donald Trump will say next, the market is always one tweet away from being scared off certain companies or industries.

1 Look for better growth, prepare for higher inflation

- Focus less on political news and more on economic data.
- Expect economic growth to accelerate in 2017, which could be positive for stocks and corporate bonds.

2 Earnings growth could provide opportunities, but watch valuations

- Improved earnings expectations translate into actual earnings growth, and we believe it should tend to support the stock market.
- Keep an eye on valuations – if earnings expectations rise before actual earnings, that could push a fairly valued market to become overvalued.
- An improvement in earnings momentum could push small-cap and mid-cap stocks into outperformance after a period of underperformance.

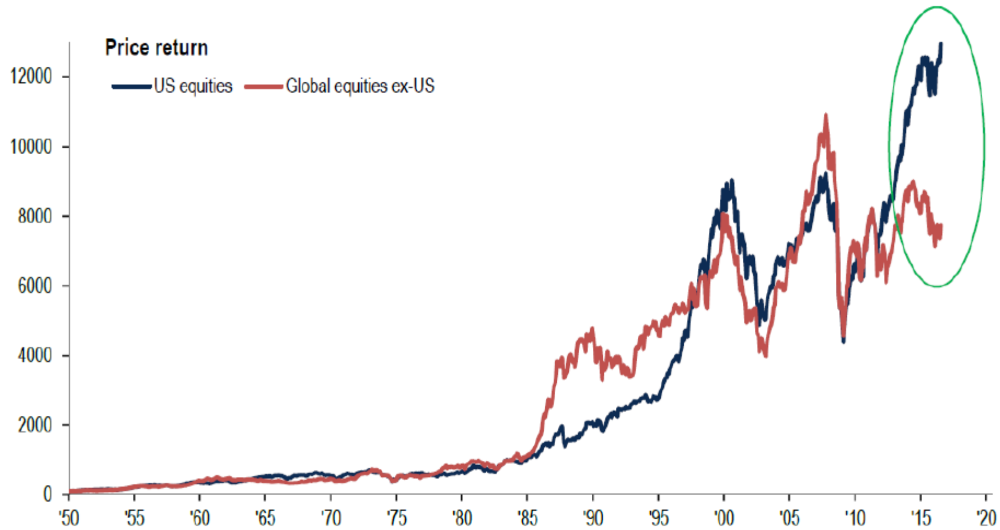
3 Expect volatility as bond markets adjust to a change in fundamentals

- Bonds are reacting to prospects of fiscal initiatives and faster economic growth – contributing to short-term volatility.
- The Federal Reserve (Fed) seems set to continue raising short-term interest rates, albeit at a moderate pace.
- If corporate earnings growth remains acceptable, then credit-sensitive bonds could outperform interest-rate sensitive bonds in a higher-rate environment.

So, it is not unreasonable to think we may start to see some weakness in the coming sessions as inauguration day approaches. Jeff Saut, Raymond James Chief Investment Strategist, wrote last week: "Our models continue to telegraph a move higher into late month, although approaching mid-month, we are trimming some of our enthusiasm. That view rests on the fact that we have played the rally pretty aggressively. However, from a tactical standpoint, we are taking a more cautious stance as mid-January approaches consistent with our model's cautionary call for late January."

What about International Equities?

I detect a strong "home bias" in my client meetings with the US stock market outperforming foreign over the last six years. Most clients don't see any reason to invest in overseas stocks at all! But, based on valuation metrics, foreign stocks are still greatly undervalued and the Central banks are stimulating those economies with very low and even negative interest rates. The chart illustrates the gap between the US and foreign stock performance.



Diversification hurt returns in 2014 and 2015.

The US large cap market beat almost everything in performance in 2014 and 2015. A more normal return pattern occurred in 2016 and a diverse strategy again proved helpful.

Diversification may not work <u>all the time,</u> but it typically works very well over time. Diverse portfolios have historically produced returns very acceptable to investors while reducing the risk compared to a concentrated portfolio.

*Source: Fidelity Investments

<u>Qualified Charitable Distributions (QCDs) Are Here to Stay</u>

There is good news for retirees 70 1/2 years old or older who have a traditional IRA and want to donate to charity. After years of temporary extensions of the provision for qualified charitable distributions, Congress finally made the deduction permanent last December.

As a result, charitable donations through a QCD can provide significant tax savings, depending on a person's situation. The potential tax savings means this tool should now be a regular part of an advisor's planning conversation with clients.

In order to generate a QCD, IRA owners may choose to distribute up to $100,000 of their IRA each year directly to a qualified charity (note: the IRS has ruled that donor–advised funds and supporting organizations are not eligible recipients for QCDs.) The primary tax advantage of making a qualified charitable distribution is that it counts toward the individuals required minimum distribution, but isn't included in his or her adjusted gross income. Reducing AGI can help high income tax payers avoid the phase-out of itemized deductions and the 3.8% Medicare tax on investment income. They can also make it easier to deduct expenses subject to AGI floors such as miscellaneous itemized deductions.

It was a great honor to be recognized by my peers and joined by my family at the Raymond James National Conference for hosting the Annual Prayer Lunch over the last 20 years.
(left to right - Ashleigh, Ryan, Dudley, Claire and Brook)

It is a pleasure working with you and we welcome your questions and comments.

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