Monthly Commentary

February 6, 2017

Right Prescription, For Your Good!

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The *Ebers Papyrus* is one of the oldest medical books in the world, dating from about 1500 BC. You would probably not want to try most of the prescriptions found on its pages. To cure baldness for example, the physicians of Egypt applied a mixture of six fats from the horse, the hippopotamus, the crocodile, the cat, goat, and the snake. To remove splinters, doctors used worm blood and donkey dung. Consider too, that Moses lived in Egypt while Egyptian doctors were developing these prescriptions. Yet the medical treatments in his books of Exodus, Leviticus, Numbers, and Deuteronomy were centuries ahead of their time. Moses instructed about sanitation, quarantines, dietary restrictions, marital behavior, childbirth, and lifestyle choices. His advice kept the Israelites from the kind of diseases that plagued the Egyptians. Amazing how medical and social science evolves over the centuries and years. Thank goodness for the significant health advancements that enrich our lives.

When I read this "right prescription" narrative, I considered several recent client discussions – tossing aside long-term investing principles because of current distracting news media about politics. Be careful to not let emotions ruin sound prescriptions for long-term investment success. Client portfolios enjoy new high valuations as the stock market is hitting new milestones. Even *Barron's* predicts a "Dow 30,000" on its cover (after achieving 20,000 on 1/25/2017 following its 2nd fastest 1000 point rise over just 40 days). Barron's cover page hedges itself with a target date of 2025, implying a paltry 4.8% average annual increase from now to then. Recall though, recent market highs are a far cry from last January, when the S&P500 was in the middle of a -15% decline that occurred over the first 6 weeks of 2016; establishing it as the worst start to any year ever. Further, many comments indicate a meaningful unease about the new Presidential administration and its perceived potential, thinking it may create a "black swan" event in either global markets or geopolitically. Very few offer bullish enthusiasm, but rather share uncertain concern for continued market advances. These ideas suggest most are cautious and perhaps entertaining the idea of being less risky in their portfolios. We too are reminded that this bull market is 95 months old (since 3/9/2009), with the longest running bull market lasting 120 months (from 1990 to 2000). What is the right prescription, for your good, as we invest client portfolios in early 2017?

Regardless of anyone's political comfort, January was a good performance month. While the new US administration is making consistent headlines, the stock market is quietly establishing new highs. During January, the S&P500 advanced 1.9%, and client portfolios experienced rising values. Growing portfolio values are encouraging because the environment of the past 2 years was a flat, a go no-where, range-bound experience. The past environment was due to a sluggish domestic and global economy, and very accommodative monetary policy that lost its economic effectiveness. The change in leadership is being viewed positively by the markets. That's because the regulatory environment is poised to ease substantially, tax reform will be instituted, and fiscal stimulus is on the way. The next big thing for this bull market cycle is government pursuing a pro-growth policy. A pro-growth backdrop will provide the bridge to more normal economic growth.

Style	January
Foreign Stocks	+3.5%
Mid-Cap Stocks	+1.9%
S&P 500	*+1.9%*
Large-Cap Stocks	+1.8%
Avg US Stock Fund	+1.8%
Small-Cap Stocks	+0.4%
Barclays Bond Idx	+0.2%

Client Objectives (Stocks/Bonds)	January
20/80	+0.8%
35/65	+1.0%
50/50	+1.2%
65/35	+1.6%
80/20	+1.9%
95/5	+2.2%

Recall January stock market history, sometimes called the January barometer. Data since 1950 suggests that when January stock performance is *positive*, 88% of the remainder of the year experiences produced an average full-year return of 12%. If January stock returns were *negative*, 59% of the observations produced a 1% positive full-year return (and often the returns ended negative for the year). And, historical information in general showed that full year positive returns occurred 76% of the time, providing an average 7.7% advance for the year. Thus, January (2017) producing a strong positive performance, would suggest we have an 88% chance the whole year will be rewarding!

Possibly the recent new highs re-establish the current bull market in the traditional sense, whereby both growth and value-style stocks work higher together, breadth expands and sectors/stocks trend higher rather than rotate randomly at one another's expense (like the last couple of years). This advance is also broadening out globally with stocks in Europe and Japan advancing in strong technical directions (both are earlier in their economic stage than the US, and offer better valuations).

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Hold on though; lest this commentary sound too bullish, we are reminded about the historical perspective of February during the first year of a new president. History (see charts on page 3) reveals that February, the first month in office for a new president, often results in the stock market experiencing a pullback. The 1st month historical average decline is -4%. It would not be surprising to see the stock market retreat in February following a strong advance since Election Day. That's because new presidents often make mistakes early in their administrations as they seek to get their "sea legs." No doubt, Trump will "butt a few heads" with Congress or a public who will not see everything his way. This will create market questions about whether pro-growth policies will be enacted – as some ideas meet resistance the market could retreat because this would cause investors to question the prospects for economic growth advances; and, stocks would be vulnerable because of current full valuations. It is not easy to run the US government, and Trump will have more than his share of challenges given his limited government experience and blunt, win-the-deal approach.

The markets are carefully watching. Trump's pro-business, pro-growth stance inspires, but economic growth is not assured. The biggest risk our domestic and the global economy faces is the potential for protectionism. Will the new Administration's "tough," blunt negotiating rhetoric cause temporary domestic and global economic softness? Trump's negotiating style starts at one extreme (not in the middle), because negotiations usually evolve toward the middle; if one starts too moderate, the final result is even more diluted than what was desired. Central bankers and world leaders are treading lightly until the protection and implementation of the new administration's initiatives come to light. At the same time, most developed countries are battling populism and having difficult rates of success. They are experiencing rising energy prices, falling unemployment, and a modest economic recovery (early phase compared to the late stage in the US), while growing at different speeds.

What is the correct Rx – prescription for investing; one that will work for your good? Emotions enter into our thoughts when we are uncertain about the economic outlook and/or political environment. Nvest is closely monitoring the new administration's path. If it were not pro-business and pro-growth oriented, we would not be as positive for the continuation of the current bull market. The pursuit of pro -growth provides a bridge for economic advance to continue for another couple years. With more normal economic growth, company revenues and earnings can advance, providing support for additional rising stock and portfolio values. We know, regardless of who is in office or which party controls Congress or government, one key ingredient to investing is managing an investment portfolio within that backdrop. While some investments work best under one administration, they may not work well under another. We are aware of the current aging bull market, and of a Fed that is likely to raise interest rates slowly toward more normal rates. We do not see investor exuberance or widespread public talk about owning stocks (like back in 2000 when everyone talked about owning tech); there is not irrational exuberance. Thus, the current Rx to investing client portfolios advocates to stay invested pursuing your long-term investment objective (which helps you achieve your personal/family goals). We will closely monitor the investment landscape, and adjust risk within the bond and stock allocation of the portfolio as/if the environment looks risky. We will dial risk back when it appears to be rising relative to return expectations that appear full; or visa versa, dial risk up when the return opportunity appears attractive.

At current, the reward/risk outlook appears better for foreign relative to domestic. Domestic stocks are no longer cheap; their future return is greatly dependent on success of pro-growth policies. The next up-leg of the Trump-trade (bull market) will come from more specifics in the area of corporate tax reform (flattening the differences in effective tax rates) and deregulation. Global stocks are cheap compared to global bonds. Japan and Europe appear to offer better return for the level of risk; they appear cheaper; except investors' fear that Europe will experience "neverendum" (continuing political issues) which will weigh on risky assets. To us, research we review about the domestic and global landscape looks for more "sunny days" ahead for stocks; and that bodes well for retaining long term investment strategies.

Most investors are aware of Warren Buffett, the billionaire investor from Omaha Nebraska. Buffett, who supported Hillary Clinton, offered some thoughts on the eve of Trump's Inauguration as the 45th President. "America works. We have the secret sauce. I've said it before, it doesn't work all the time perfectly, but you just look at where we go, milestone after milestone. Never bet against America. It's going to be higher 10 years, and 20 years from now. There will be hiccups, but we will do well over time." Warren Buffett is a great example of being a "time in the market" investor. He succeeds by remaining invested through many different Presidents and changes of power in Congress. He does not sell out and then attempt to determine when to get back in. If he did, his wealth would be much less, as the payment of taxes on investment gains would reduce his total to invest.

One last thought. Care with investing is very appropriate. Trump enters the current bull market when valuations are full. Bonds remain expensive, and stocks are not inexpensive (particularly dividend oriented names). Obama took office after the market tanked and was cheap; he oversaw a 166% gain in the S&P500. Shares went from dirt cheap to richly valued. The total value of all US stocks (in March 2009) was 85% of the US gross domestic product; whereas today, the total value of all US stocks is 177% of US GDP. The key to continuing this bull market advance, is pro-growth strategies which would boost earnings. The Rx for investing is maintaining a long-term investment focus rooted on personal goals, trying to avoid emotional decisions that make time an ineffective ally, and closely monitoring the investment landscape that alters risk/return expectations. Nvest is watching the current landscape closely.

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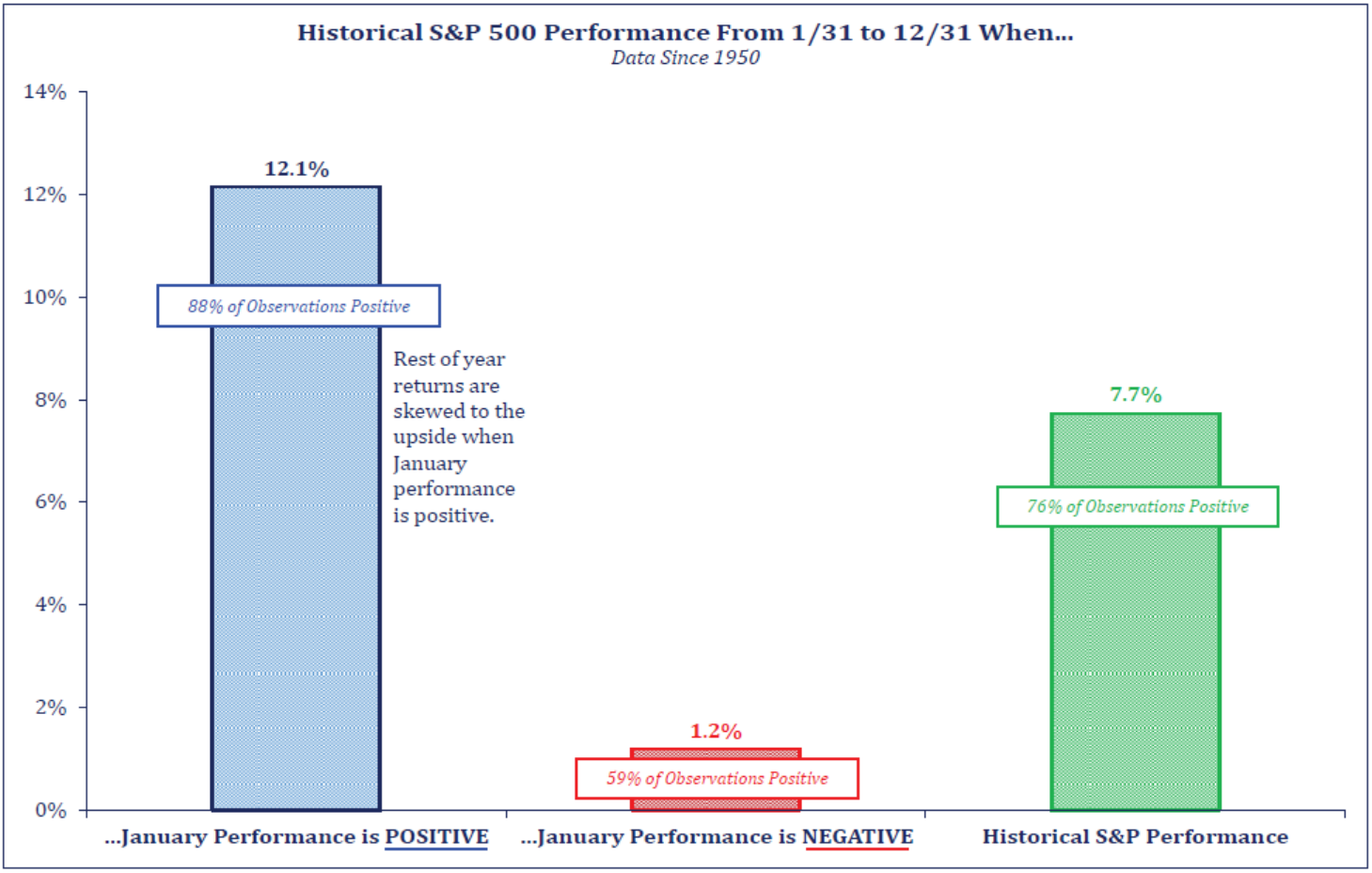
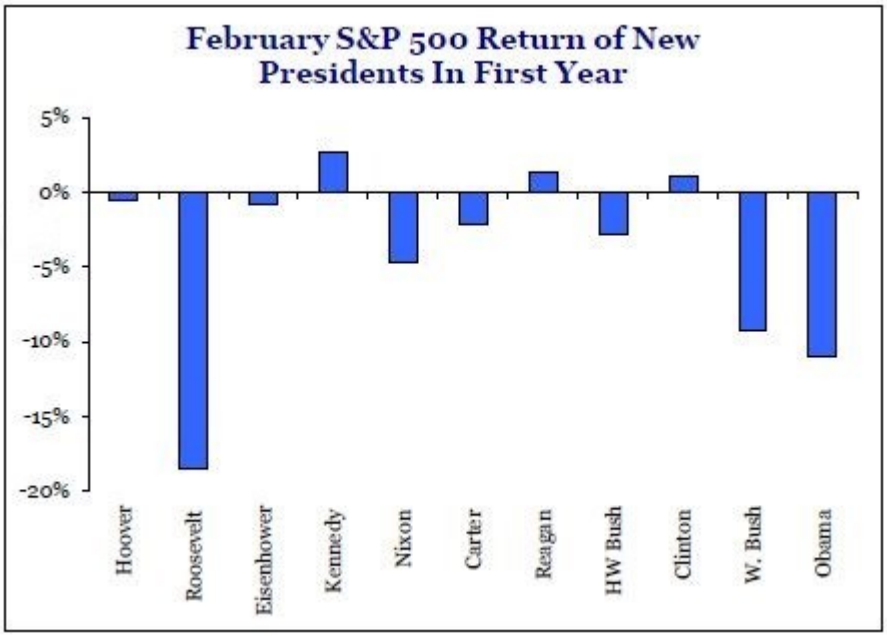
POSITIVE JANUARY TYPICALLY BODES WELL FOR REST OF YEAR





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