Rochester Financial Services

Fee-Only® Financial Management Services

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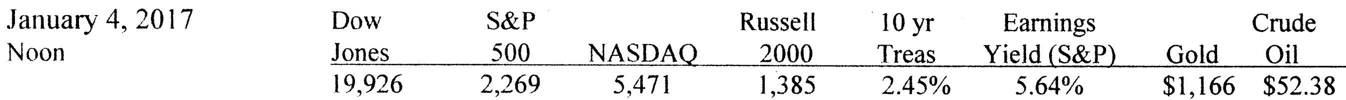
Principal



January 4, 2017 Noon	Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
	19,926	2,269	5,471	1,385	2.45%	5.64%	$1,166	$52.38

Investment Strategy Report

Stock Rally Extends Into New Year

The beginning of a new year always brings uncertainty to the markets. Will stocks reverse course as the new year begins or will they continue trending in the same direction. This new year brought added apprehension for 2 reasons. First, the thinking was that with the anticipation of lower tax rates in 2017, investors would hold off on any selling at the end of 2016, but instead, wait until this year to take profits. The second reason was that stocks for the past 2 years had fallen into a rut of starting off the new year with a dismal performance. 2016 was a particularly awful year as stocks got off to their worst start ever.

So here we are now, in the middle of the second trading day of the year, and thus far, we see no signs of any profit-taking or of a January swoon. In fact, stocks yesterday had their best day in 4 weeks, rising about 0.8%. The consensus opinion that I have been hearing on CNBC and from the analysts I read is that the new administration will be good for business and therefore good for stocks. The other trends that have been in place since the election have been a stronger dollar and rising interest rates. These latter trends have resulted in weakness in bonds (rising rates result in lower prices) and weaker emerging markets (stronger dollar hurts their foreign exchange).

This has led many investors to rebalance their portfolios to overweight stocks and underweight bonds. However, since peaking on Dec. 16th at 2.60%, the yield on the 10 year Treasury has since retreated and has now stabilized at the 2.45% level. The dollar, which had strengthened to about 1.03 to the Euro, has since backed off to about 1.05. Both of these have occurred as stocks have moved higher. So the jury is still out on whether substantially adding to US stock positions is the best strategy for 2017, especially since sentiment on US stocks has reached somewhat excessive levels, a cautionary sign in this contrarian business.

Many of you might be surprised to hear about investors increasing their exposure to stocks at a time when you might be a bit apprehensive about our new President-Elect. However, keep in mind that unless an economic slowdown is expected with a possible recession on the horizon, there really isn't a good reason to avoid stocks. Forecasts for US economic growth are factoring in lower corporate taxes, reduced government regulation, and the possible repatriation of overseas profits and have therefore been ratcheted higher for 2017. The possibility of a recession seems to have fallen dramatically over the last few months. Stocks can very easily have another 10% year.

The question of fixed income investing is, as in the recent past, a little more difficult, despite the recent stabilization of rates. I have heard forecasts that predict the yield on the 10 year Treasury will rise to 4%, including comments today by renowned analyst Byron Wien of Blackstone. While this will present definite headwinds for traditional bonds, it will not justify a strategy of transferring all our bond holdings into stocks. Bonds will always play an important part in reducing portfolio risk, balancing the risks of stocks and providing income. Instead, my strategy has been to balance the bonds within the fixed income portfolio – adding higher yielding and multi-sector bonds to reduce interest rate risk and boost income. This worked out well for us last year and should continue to work well in 2017.

The question of international investing continues to be one of uncertainty, as the US has been and continues to be the place to be. Last year appeared to be the year that emerging markets came back, as their performance for the first 10 months of the year significantly outpaced that of US stocks. However, since the election and the strengthening of the dollar, emerging market stocks have done poorly. My position is that unless I see a compelling reason to begin adding these stocks, I will not take on that added risk for our portfolios. *Jeff Feldman*

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