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FINANCIAL FORUM

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Market Commentary

Happy New Year! Or as the saying goes, "Out with the old and in with the new." For investors, however, I'm sure they would prefer, "Out with the old and in with more of the old." After all, who wouldn't want the stock market rally that ushered out 2016 to continue? After the surprising Republican sweep in the November U.S. elections, stocks rallied into yearend based on the ideas that new tax and spending policies, along with less government regulation, will usher in a 1980's-like-era of economic growth and prosperity. So although President-elect Trump hasn't even stepped foot into the Oval Office, stocks are already selling at stretched valuations (~18 times this year's projected earnings), while bond yields, the dollar, and oil have all shot higher, which will put pressure on those earnings. For 2017, the bottom line is this: Will we see "reflation" (accelerating growth and inflation) or "stagflation" (little-to-no-growth and inflation)? While only time will give us the answer to this question, I have listed below items we are monitoring which should give us an indication of what's coming.

Reflation: For stocks to continue rallying, we should see the following:

1. Personal and business tax rates get slashed, giving consumers more disposable income and corporations more profits (less taxes paid goes right to the bottom line).
2. Corporations are allowed to pay a one-time, reduced tax to repatriate potentially trillions in offshore cash. These monies could be used for investment in new plants, equipment, and/or technology or fund future dividends, stock buybacks, or mergers.
3. Infrastructure spending increases significantly, providing a strong fiscal stimulus.
4. Government regulation is decreased, making it easier for businesses to operate more profitably.
5. Global central banks remain accommodating, and
6. No negative global/macro event occurs. (i.e. protectionist policies or Brexit fallout, etc.).

Under this scenario, growth is ignited, and this acceleration in growth overpowers the headwinds of higher interest rates, a stronger dollar, and rising inflation.

Stagflation: The script for stagflation would go something like this:

1. Implementation of Trump's policies hit multiple speedbumps/delays or the implementation is watered down versus expectations.
2. Growth remains "ok" but doesn't create the intense acceleration that was intended. Therefore, the mild uptick in growth is not enough to offset higher interest rates, the stronger dollar and inflation, and earnings do not increase and stocks remain expensive.
3. Inflation continues to slowly build, forcing central banks to raise interest rates more quickly than anticipated, and/or
4. A global/macro event, like tariffs or a Hard Brexit occurs, rattling investors' confidence.

Bottom line: We will be monitoring this situation very closely to help you navigate through what we expect will be a challenging environment in 2017. The trillion dollar question is whether investors have become too optimistic and are ignoring risks.

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Wealth Management – Is a Potential Roth Conversion Opportunity Looming?

As I was researching this month's newsletter, I came across the following:

1. The U.S. federal debt will be slightly north of $20 trillion, or 120% of GDP, before President Obama leaves office this month. (It was *only* $10 trillion eight years ago.)
2. Total local and state government debt tallies another $3 trillion.
3. Total U.S. debt, including private and business debt, is $67 trillion, or almost 400% of GDP.
4. In the U.S. today, we have approximately 95 million people not in the labor force, 2 million prison inmates, 43 million receiving food stamps, 57 million Medicare enrollees, 73 million Medicaid recipients, and 31 million still without health insurance.
5. The above numbers do not include the estimated $100 trillion of unfunded liabilities at the local, state, and federal levels, which are going to have to be paid for out of current revenues at some point.
6. President-Elect Trump plans on combining tax cuts with large spending programs, which I suspect will only increase the deficit/debt problems.

I bring these points to your attention for two reasons. First, from an economic standpoint, unproductive debt is a constraining factor on growth. The more we increase our debt, the more difficult it will be to grow our way out of our debt problem. To prove this, all we have to do is look at Japan and Europe – two places with larger debt ratios and lower growth rates than ours. This could have a chilling long-term effect on corporate profits down the road, which would be a drag on stock prices. Secondly, I believe there is a good chance that because of our debt problems, we will also follow Europe and Japan and raise taxes in the future. If President-Elect Trump succeeds in lowering our tax rates, then over the next four years, it may be beneficial to convert traditional IRAs and 401(k) plans to Roth IRAs and 401(k)s, providing you have outside funds to cover the taxes owed at conversion. This may be one of those times where future tax rates will be higher than current rates, thus making a Roth conversion potentially beneficial. Next month, we will discuss in more detail the factors you should consider when deciding if a Roth conversion is right for you.

Weekly Thought – Time and Money

Most people take no care of their money till they come nearly to the end of it, and others do just the same with their time." …Johann Wolfgang Von Goethe

Here's to making the most of your time and money.

Dan

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P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you know of anyone who would like to be added to this list or who might benefit from our services, please pass along our name. We are always looking for opportunities to meet and help great people like you.