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K&S, LLC Financial Fitness Winter Newsletter January 2017 "A New Beginning"

This Fall was one of the most controversial Presidential elections in decades. We have a pro-business administration coming into office in January. This may be good news for investors. We may see a reduction in corporate and personal income taxes as well as an increase in spending on defense and infrastructure projects. As a result, we believe that there may be an increase in economic growth over the next few years and that the U.S. stock market is going to slowly move higher in 2017. Over the past month the stock market rallied by around ten percent. However, the rally has been uneven. Some sectors that are economically sensitive, such as banks, defense and construction industry related companies spiked higher, while higher dividend paying stocks that are interest sensitive, such as REITs and utility stocks moved lower. As the dust settles over the next few months, it would not surprise us if there was a partial reversal in some of these stock price movements. We continue to encourage investors to be globally diversified, keep your costs low, generate dividends and allocate/balance your assets within your comfort level.

The Case for Global Diversification –

From January 2007 to April 2016, the S&P 500 Index returned 78% while foreign stocks (MSCI World ex USA Index) returned only 7%. During a nearly six year period commencing in January 2002, foreign stocks trounced U.S. stocks by more than 11 percentage points annualized. U.S. and foreign stocks often move in different cycles that can begin and end unpredictably. Both common sense and research dictate that investors should hedge bets and hold a global portfolio. Doing so may provide you with more consistent returns and less volatility over the long run.

In the December 2016 edition Money magazine there was an article titled **"Your 20 Best Money Moves for 2017."** Here are some of the excerpts from the article:

For ordinary Americans, 2017 is likely to feel like the best year economically since the Great Recession.

The recovery is finally expected to trickle down to you in the form of an improved job market, higher wages, and growing spending power. There are things we've been talking about since 2012 or 2013.

And, despite the advanced age of this bull, your improving fortunes just may keep U.S. stocks chugging along too, as consumers represent 70% of the U.S. economy.

Still, with economic growth expected to remain sluggish at 2.2% - and with all the unknowns surrounding the new Donald Trump presidency – you'll need smart strategies to turn a decent year into a great one financially.

Trump's win raises uncertainties and risks, economists say, especially over trade policies. Still, tailwinds that are forming at the intersection of Wall Street and Main Street should help stocks make some decent progress. Expect another year like 2016, with mid-single-digit gains.

Earning for S&P 500 companies are expected to surge 12% in 2017, after being flat this year. Helping drive that: consumers with more dollars in their pockets.

Household spending has been meh, to use a technical term. But that should perk up along with pay. Average hourly wages could grow 3% to 3.5% in 2017. That could grow 3.5% to 4% should Trump's promised infrastructure spending produce jobs. The more you push job growth, the more you push wage growth.

YOUR BEST MOVES

⟐ Pick sailboats over motorboats … Investors in recent years favored shares of companies that don't require a strong economy to excel. They include technology shares that benefit from consumer spending, as well as retailers such as Home Depot and Lowe's because they are relatively cheap. Tech shares in the S&P 500, for instance, are trading at an 8% discount to their historical average price/earnings ratio, while the broad market is trading at a 10% premium. Though equities are expected to rise for a ninth straight year, strategists and portfolio managers warn investors not to get overly optimistic.

Rather than boosting your exposure to equities, you might add a small dose of high-yielding junk bonds. Junk bonds are highly correlated with equities but offer some cushion. In 2008 junk bonds suffered only 70% of the losses of the broad equity market. Yet over the past 15 years, junk bonds have generated an average annual gain of 7%, which is nearly identical to the return for the U.S. stock market.

THE FED STICKS TO "LOW AND SLOW" ON RATES

The economy isn't the only thing picking up steam. Inflation is expected to rise too, with consumer prices forecast to grow 2.3%, nearly doubled this year's pace, according to the Blue-Chip Economic Indicators survey. With higher inflation typically come higher interest rates.

Before the election, most economists expected two quarter-point rate hikes by the Federal Reserve in 2017. While Trump's election could speed up or slow the pace that is still a reasonable expectation. That means the Fed's short-term rate target should stay close to 1%, (allowing consumers to feel comfortable) spending.

YOUR BEST MOVES

⟐ Favor income stocks that can also grow. Some income investors frustrated by low bond yields have shifted into dividend-paying equities. But when rates do rise, people are likely to turn back to bonds, which means classic high-dividend payers such as utility stocks are a risk. Indeed, as yields on 10-year Treasuries have jumped more than half a percentage point since July, utility stocks have already lost 6% of the value.

Our advice would be shift into funds that balance decent yield with dividend growth.

⟐ Favor muni bonds. While bond prices move in the opposite direction of market interest rates, some forms of debt are less rate-sensitive than others. One such choice: tax advantaged municipal bonds. (10 year A rated yielding 2.2% on average)

An uptick in economic activity and wages translates to higher tax receipts for the cities, counties, and states that issue muni bonds. Moreover these bonds are starting off with higher yields than Treasuries, which allows them to weather rising rates better.

President-elect Trump is promising $500 billion plus in infrastructure spending and with his party controlling both houses of Congress, the likelihood that Washington, embarks on a new round of stimulus spending is rising. Spath of Sierra Investment management notes that any push for a national infrastructure spending is likely to create "huge increases in demand" for munis, which fund such projects.

EMERGING MARKETS STAY STRONG

Stocks in developing economies are likely to have another good year in 2017, after rising more than 17% so far in 2016. Over the past decade, the emerging markets have returned a mere 2.5% a year on average, even including this year's advance. The turnaround has come as economic growth in the developing world finally picks up after a long cold spell.

The recovery isn't uniform, however. China, the biggest economy in the emerging markets, continues to slow down, with GDP growth expected to fall to 6.2% next year, from 6.6% in 2016 and 7.3% in 2014. Economies that are reaccelerating can be found in Eastern Europe, Mexico, Indonesia, and the Philippines.

You can thank the bounce in commodity prices, as many emerging economies are still tied to the mining and production of raw materials such as crude oil. Since the end of January, oil prices have jumped from around $26 a barrel to about $45. Prices aren't expected to rise as aggressively in 2017, but they are forecast to be stable.

- Replenish your emerging-markets stake … If you haven't rebalanced your equities in a while, do it now. A 10% weighting in emerging-markets stocks five years ago is down closer to 5% now. Be careful, though. Because economists don't expect a new bull market in commodities to take off, you may want to avoid funds with big bets on commodity-reliant companies.

- …But go light on China. For years China drove economic growth in the developing world. But the country is now an emerging market in name only, mired by an aging population and a shrinking workforce.

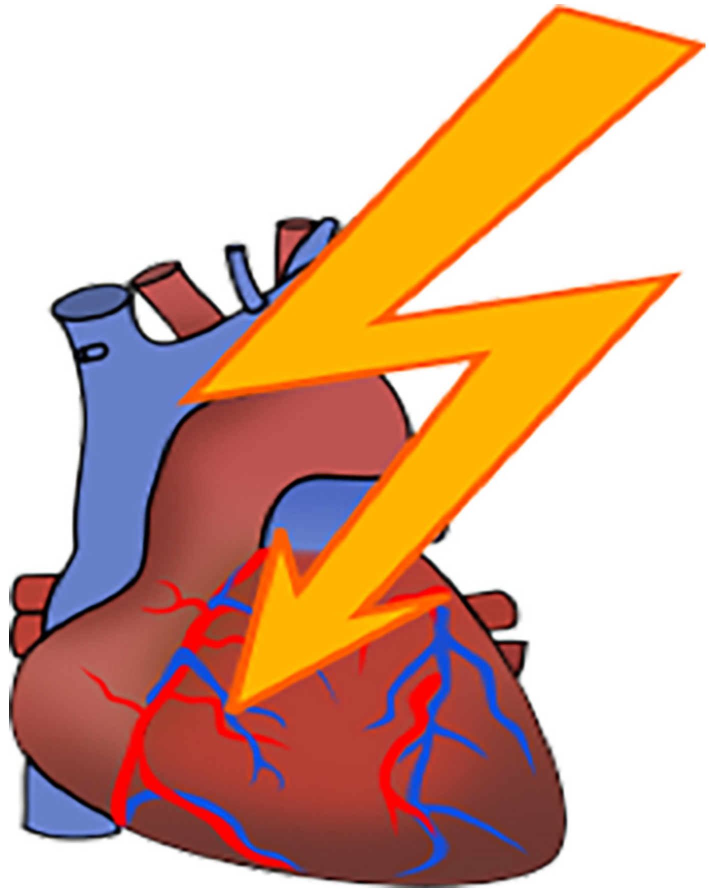
Here is commentary from CIBC Wood Gundy's "Monthly World Markets Report":

Charting Trends

Not only have the elections affected U.S. interest rates but the U.S. Federal Reserve (Fed) also hiked the Fed funds rate in December by .25%. The 10-year U.S. Treasury yields have already begun their move higher and have risen from 1.85% to 2.35% since the elections. The exposed capital-intensive and defensive sectors such as utilities and telecom have begun to feel pressure as investors start rotating out of these vulnerable sectors and repositioning their portfolios for a cyclical upturn. If we enter a sustained environment of rising yields, tighter Fed policy, and a stronger U.S. and global economy, these sectors should continue to underperform. If history is any indicator, should U.S. rates continue to rise steadily, as anticipated by CIBC Economics, then the cyclical sectors – technology, energy, consumer discretionary, industrials & materials – should fare far better than defensive sectors – consumer staples, telecom, health care & utilities.

Over the last 15 years when the U.S. 10-year Treasury yields have increased, small-cap stocks have tended to outperform large-cap stocks. This is mostly due to the fact that interest rates typically rise during periods when the economy is doing well or at the very least is expected to do well. Investors then tend to become more risk-tolerant and this results in a riskier stance towards equities and hence a larger allocation to small-cap equities. If U.S. growth stagnates, bringing bond yields lower, investors are likely to take a more defensive posture and this should favour large-cap stocks. However, investors who believe that the U.S. economic data will continue to improve, that the fiscal policies of the new administration will support U.S. growth, and that the U.S. dollar strength will continue should maintain exposure to or add smaller-cap U.S. stocks to their portfolios.

Health & Nutrition – Top Health Habits for Your Heart – Kathleen Doheny published an article on heart health on January 9, 2015. You can dramatically lower your chances of heart attack or disease by following healthy lifestyle habits. Here are the six habits that mattered: don't smoke, have a normal body mass index (BMI), get moderate to vigorous exercise at least 2.5 hours a week, watch 7 hours of television weekly, drink one or less alcoholic beverages daily, and eat a healthy diet of fruits and vegetables, whole grains, fish or omega-3 fatty acids as well as limit sugary drinks, processed and red meats, trans fats and sodium. Women who followed all six healthy habits cut their chance of a heart attack by 92% and lowered their chance of getting another risk factor, high blood pressure, by 66%.



We hope that you and your family are having a good winter season and look forward to talking to you soon.

Sincerely,

Andy Krosnowski Melissa Scott Paine

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