Investment Commentary

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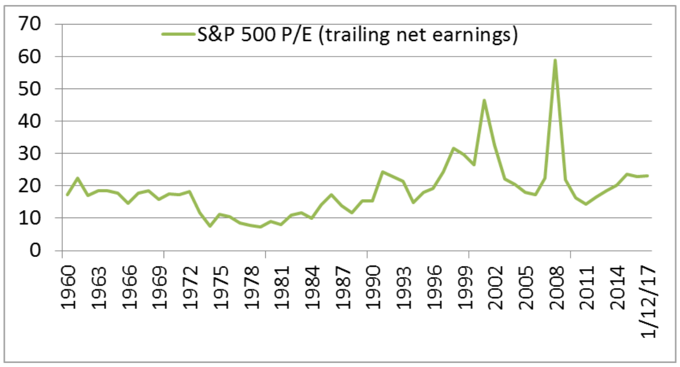
Market valuation is full:

The stock market continues to be fully valued based on metrics like price-to-earnings and similar measures. Since a fully valued market is basically another way of saying stock prices are high, perhaps too high, we need to consider the risks of a market pullback. Fortunately, a fully valued market becomes a larger risk when economic and businesses growth slows – or is at risk of slowing.



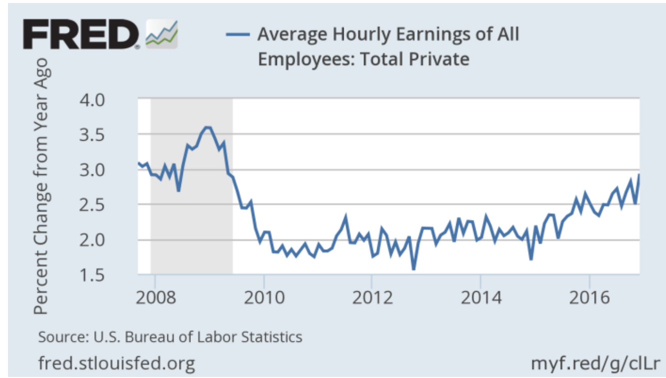
However, the economy and businesses are poised to grow:

In our view, the economy and businesses seem to be in fine shape. Consumer, business, and government spending appear to be positioned to support economic growth. Spending growth bodes well for earnings of businesses.

Consider some of the specifics:

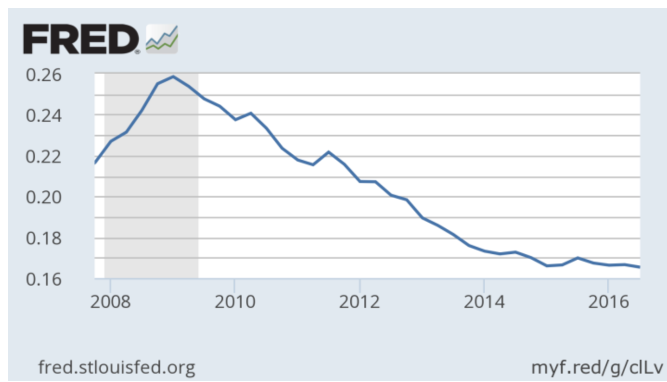
Consumers are gainfully employed –

Wages are rising -



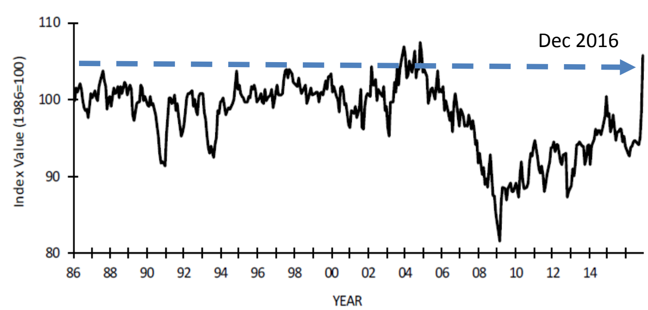
And households have much less debt than a few years ago –

(Household Liabilities as a percent of Net Worth)



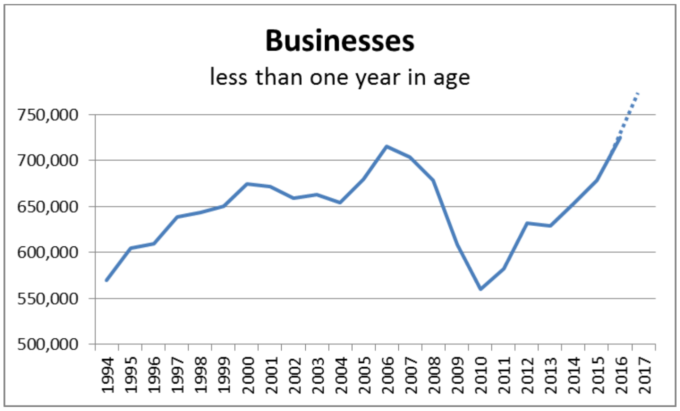
Further, a notable pick-up in confidence has occurred since the November election. Optimism surveys for small businesses, for example, have spiked to levels seen only once in the past thirty years.

NFIB's Small Business Optimism Index



Source: NFIB.

This sort of optimism is supportive of business spending and new business formations. For example, a pickup in optimism in 2004 among small businesses (previous chart) preceded a pickup in new business formation – as indicated in the next chart.



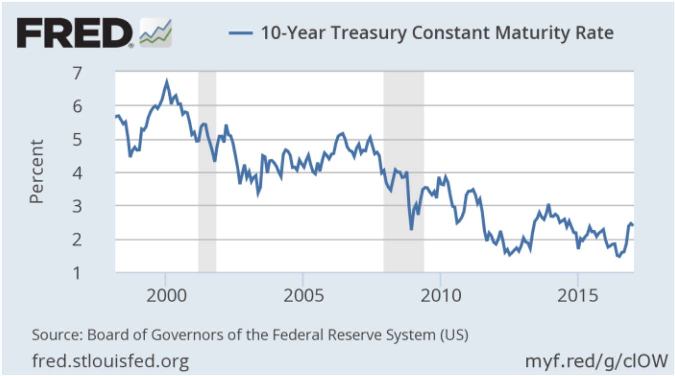
Finally, potential infrastructure and military spending plans are supportive of overall economic growth.

The bottom-line is the most important pieces of the economic puzzle are all positioned for continued, if not accelerated growth. Since major market pullbacks (ones that take several months or years to recover) rarely occur outside of recessions, we are comfortable with the market's valuation. Further, prices in the stock market will likely rise in 2017 especially if we see an economic or earnings growth surprise to the upside.

Interested rates are positioned to climb over the next several years:

Given our view on the economy, we believe the recent uptick in interest rates are here to stay. Further, we expect rates to continue their upward climb – in fits and starts – as economic growth picks up. Despite coming off a 35 year general downtrend, interest rates will rise when enough investors demand higher interest payments to ensure the value of their investments keep up with inflation (or the threat thereof).

The counter-arguments of rising interest rates are reasonable. Namely, 1) since U.S. rates are higher than global rates, foreign buyers of U.S. bonds will keep rates low and 2) high levels of debt around the globe puts a ceiling on global growth.



On balance, we are sanguine on the U.S. economy and tend to favor the notion that rates are poised to rise from current levels over the next several years.

However, given the counter-arguments, the pace of interest rate increases will likely be quite tolerable.

Investors should maintain their long-term strategic allocations:

The net result of a fully valued stock market, an accelerating economy, and a manageable pick-up in rates leaves us with the view that investors will do best by adhering to their long-term asset allocations. Long-term allocations are typically the result of individual circumstances, goals, and risk tolerances – and less focused on shorter-term tactical shifts. On the other hand, we continue to see plenty of individual investment opportunities with the potential of generating handsome risk-adjusted returns.

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