CURBSTONE
FINANCIAL
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From the Curb
Letter to Clients
Quarter Ending December 31, 2016

2016 will be remembered as a year full of surprises. Few predicted the sell-off that occurred in the first six weeks of the year, which brought the S&P 500 into correction territory. That correction was followed by a strong positive reversal. During the year, the “have nots” became the “haves”, as we saw a rotation out of growth stocks into value stocks. During the election cycle, the Republicans hit a trifecta, taking control of the Executive office, the Senate and the House. And, finally, the biggest surprise of all, the major domestic stock indices realized double-digit returns with the S&P 500 finishing up 11.96%, almost 2% above the 90 year average annual rate of return of 10.1%. The environment throughout the year provided investors moments of great anxiety, head scratching, and mixed emotions.

Well before the November elections, stock prices began to level off, as corporate earnings bottomed in the first quarter and turned positive in the third quarter. The “have nots” became the “haves” as money rotated out of growth-oriented issues into more cyclical areas like energy, industrials and materials, as fundamentals improved. In 2016, the top three performing sectors were energy, telecommunications and financial services. In fact, 7 sectors of the S&P 500 performed better than the average (11.96%) leaving consumer discretionary, consumer staples, real estate and healthcare, the previous year’s leaders, lagging.

Since the election, we are witnessing a rise in business, consumer and investor confidence, reflecting a more business friendly environment promised by the new administration. Proposed policies focused on fiscal stimulus, coming at a time when the Federal Reserve is taking steps to increase interest rates, are being welcomed by investors. Resolutions relative to tax reform, infrastructure investment and regulatory overhaul should positively impact the economy; and the prospect of Washington working again, after a decade of stagnation, has led to a sense of optimism.

As we look ahead, we see 2017 as a transition year. The Federal Reserve anticipates three interest rate hikes in the coming year. Although this brings a close to years of “cheap” money, it helps those living on fixed incomes, as interest-bearing accounts will begin to pay investors a positive return on their deposits. This renewed sense of optimism may endure, provided that campaign promises are, in fact, converted to pro-growth strategies. The offset to this sense of optimism is the realization that protective policies isolating the United States from the rest of the world, anti-trade

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actions, and tariffs could negate gains of the pro-growth agenda. Major policy change does not come quickly in Washington, so even on an accelerated basis, the effect of change may not be felt until 2018.

We expect increased volatility this year. We all recognize that the year will not be characterized by "politics as usual". First, investors will be challenged by a president who loves to "tweet" and think out loud...both unusual activities for a head of state. We believe markets will react first and ask questions later. The biggest challenge will be trying to determine if policy will follow "form" and actually impact fundamentals. Secondly, valuations for many stocks have moved beyond fair value and investors will need to see improved earnings in order to sustain these higher prices. In addition, inflation and/or a strengthening U.S. dollar could cause bouts of indigestion, causing stock prices to retreat.

We are cautious optimists. And, for that reason, we remain committed to managing well-diversified portfolios that we will rebalance throughout the year, ensuring that your objectives are being reflected in the asset allocation for your portfolio. We are long-term investors and believe that competitive returns are generated over long-periods of time. Increased volatility will likely create anxiety again this year, but we believe that you will be well-served by remaining disciplined in your approach.

We wish you a great start to 2017. Enclosed for your review are your year-end 2016 reports. Please let us know if you have any questions, comments or concerns.
We encourage an open dialog and appreciate the opportunity to serve as your investment adviser.