Investment Strategy Update

ASCENTIAL WEALTH ADVISORS
AN INDEPENDENT FIRM

Market Report — Quarter 1 • 2017

Markets Rally Post Election

US markets closed 2016 in positive territory after experiencing one of the worst starts, followed by another brief but steep decline after the Brexit vote in June, and finally an unexpected rally after the election in November. US stocks posted double digit returns, with small caps at the top as the Russell 2000 Index returned 21.3%. Value stocks outpaced growth with financials, energy, and basic materials the top performing sectors, and health care standing out as the only sector to post negative returns.

International equities again lagged the US. Emerging markets were positive with the MSCI EM returning 10.7%, even after fears of restricted trade policy under the new US administration pared back gains. Developed international market returns were at the bottom of the pack due to ongoing concerns relating to uncertainties surrounding the European Union.

International equity underperformance and falling bond prices weighed on returns for diversified portfolios. Despite only one small rate increase by the Fed, interest rates rose significantly post-election, and the Barclay's Aggregate Bond Index fell 3%, over anticipation of inflationary pressure from the new presidential administration's policies. For the year, the 10 year US Treasury yield bottomed in July at 1.30% before rising to close the year at 2.45%. Expectations are for rates to continue rising in 2017.

Index	*2017*
S&P 500	+11.96
DJIA	+16.50
BC Ttl Bond	+2.65
EAFE (Int'l)	+1

Dow Jones Relative Risk Benchmarks

Conservative	+2.92
Moderate	+7.68
Aggressive	+11.15

2017 Outlook

FIXED INCOME/BONDS — We expect gradually increasing interest rates over time, but believe there is a natural cap on US rates due to the global low rate environment. With rates in other developed nations still significantly lower, there will be continued demand for US bonds which should provide enough pressure to keep rates from rising sharply. In this environment, we look to stay positioned with a mix of bonds that have less sensitivity to rising rates, but also capture some yield.

Our View — *Position for slowly rising interest rates with exposure to intermediate bonds to enhance portfolio yield.*

US EQUITIES — After the climb we have seen in US equity prices, valuations are slightly above their historical averages for many stocks. The key driver of further returns will likely be companies' ability to grow their earnings. Continued earnings growth will support higher prices for stocks, and US companies are expected to benefit from lower taxes and de-regulation that could promote a more efficient and profitable operating environment. We believe that US equities still carry opportunity for investors, but selection will be more critical at current valuations. Our preferred sectors are US banks, technology, and consumer cyclicals due to a relatively healthy economy and pro-growth policy set to take stage. After a rebound in oil prices and a corresponding rally in energy stocks, we are less excited about the future upside in energy and look to pull back our exposure.

Our View — *US banks, technology, and consumer discretionary represent opportunity.*

INTERNATIONAL EQUITIES — International equities have trailed US equities for a few years. Foreign stocks have been under pressure from sluggish economic growth and political uncertainties. Foreign central banks have been implementing monetary policy stimulus, and while it is taking time, this should re-ignite economic growth. International stocks are not as richly valued as US stocks, and carry opportunity for patient investors. Gains in emerging markets were eroded post-election as protectionist trade rhetoric took center stage. We believe that the fear of trade policies hampering emerging markets is already priced into these assets and that the reality will likely not be as bad as feared.

Our View — *Maintain exposure to developed and emerging markets with a slight bias for developed international.*

Only 30!

Did you know the Dow Jones Industrial Average is comprised of only 30 stocks? Yes, they represent some of the largest, most well know US companies, but it is still only 30 stocks in a universe of thousands. We often view the S&P 500 as a better representation of the US stock market due to its broader composition.

Dow Stocks (as of Dec. 30, 2016):

3M (MMM)
American Express (AMEX)
Apple (AAPL)
Boeing (BA)
Caterpillar (CAT)
Chevron (CVX)
Cisco (CSCO)
Coca Cola (KO)
Disney (DIS)
Dupont (DD)
Exxon (XOM)
General Electric (GE)
Goldman Sachs (GS)
Home Depot (HD)
IBM (IBM)
Intel (INTC)
Johnson & Johnson (JNJ)
JP Morgan (JPM)
McDonalds (MCD)
Merck (MRK)
Microsoft (MSFT)
Nike (NKE)
Pfizer (PFE)
Procter & Gamble (PG)
Travelers (TRV)
United Technologies (UTX)
United Health (UNH)
Verizon (VZ)
Visa (V)
Walmart (WMT)

Dow 20,000 doesn't mean much

The financial media has created a great deal of hype around the idea that the Dow Jones Industrial Average reaching the number 20,000. The reality is, the nominal level of any market index is relatively meaningless, as market indexes are perpetually reaching new "highs" between periods of normal market pullbacks. Stock prices go up over time, just like the prices on goods and services rise. What matters more than price is the valuation of the market index, which includes a look at how the prices relate to the earnings or assets of the companies whose stocks make up the index. When you buy a stock you are buying fractional ownership in a business. A business which produces goods and/or services to earn revenue. A business which has value in terms of its assets. So a company like Apple trading at a price of $115.82 per share, with a price to earnings ratio of 13.94 might be considered a bargain relative to say Nike trading at $50.83 per share but with a price earnings ratio of 22.41. There are other factors that come into play of course, such as growth outlook, the stage of the business in its lifecycle, and so on. Price in and of itself does not tell us much about an individual stock or a market index.

At the close of 2016, the Dow was at 19,762, and based on current earnings trading at 21.5 times earnings, but based on forward earnings estimates was at only 18.6 times earnings. The historical average price to earnings for the index has been around 15 times earnings, however there have been times where it has traded well above that such as in 1999 when it was trading at 44.2 times earnings. So what does Dow 20,000 mean? If history is any indicator, maybe not a lot. Despite normal market pullbacks, the index will likely trend higher over time, just as it has for the past 100 years.

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