SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Market Observations
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We can never know about the days to come but we think about them anyway.

Carly Simon, 1971

ANTICIPATION

Notable events of 2016 – elections, market changes, geopolitical shifts – now are past but they serve as precursors for what lies ahead. 2017 begins with high anticipation for economic and market outcomes. Some perspective can help with charting the investment course.

Perspective

Even before the U.S. presidential election, investor concern was growing over a bear market for stocks and a recession for the economy. Why this concern? Because neither event had occurred for some time and the current expansion and bull market each was showing its age. Table I provides details of all U.S. economic expansions in the last nine decades. At 90 months, the current expansion is well-above average but not the longest. The below average growth in this recovery suggests more growth could occur before a recession appears. Table II shows bull markets for the Dow Jones Industrial Average ("DJIA"). The duration of the current bull market also is above average but not the longest. The growth of the DJIA since the 2009 bottom is notable but modestly below average, suggesting stock prices can move higher still before any bear market materializes.

Market trends since the election reflect investor anticipation that potential new policies will be favorable for economic growth and stock prices. New political leadership appears to be setting an ambitious agenda for change: reduce regulation; reform immigration; improve terms of foreign trade; recast healthcare; increase spending, especially for infrastructure and defense; lower tax rates for both individuals and businesses. Policy changes in each area could impact growth favorably but the timing and terms of any changes remain uncertain. An adverse outcome in the form of higher inflation could arise if trade policy becomes too restrictive and if deficit spending pushes the Federal Reserve to less accommodative monetary policy (i.e., higher interest rates).

Prescription

Portfolio diversification ensures neither the highest nor the lowest investment returns. Its goal is to achieve a given level of return for a given level of risk, both of which are appropriate for achieving financial goals within desired time horizons and at acceptable levels of risk. Table III compares the annual returns from five asset classes over the past decade. It is clear that each asset class has had its relatively better year. We can never know with certainty about the year ahead, but possible outcomes need to be thought about anyway. Portfolio outcomes can be enhanced by diversifying to lower risk relative to return or to increase return relative to risk.

Table I

U.S. ECONOMIC EXPANSIONS

START	GROWTH	MONTHS
Nov 1927	114%	21
Mar 1933	188%	50
Jun 1938	270%	80
Oct 1945	134%	37
Oct 1949	145%	45
May 1954	124%	39
Apr 1958	115%	24
Feb 1961	191%	106
Nov 1970	136%	36
Mar 1975	173%	58
Jul 1980	114%	12
Nov 1982	94%	92
Mar 1991	174%	120
Nov 2001	136%	73
Jun 2009	132%	90
AVERAGE	149%	59

Table II

BULL U.S. STOCK MARKETS

START	RETURN	MONTHS
Mar 1926	307%	42
Jun 1932	528%	62
Mar 1938	320%	99
Oct 1946	906%	185
Jun 1962	198%	44
Sep 1966	137%	26
Jun 1970	163%	30
Sep 1974	183%	27
Feb 1978	162%	37
Feb 1982	414%	67
Nov 1987	848%	147
Sep 2002	206%	62
Feb 2009	351%	95
AVERAGE	363%	71

Table III

ASSET CLASS RETURNS

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
17.1%	5.2%	42.1%	19.0%	7.9%	17.4%	34.0%	12.1%	0.6%	13.0%
7.0%	1.8%	29.4%	17.9%	0.6%	16.1%	15.8%	6.0%	0.0%	8.8%
5.7%	-29.8%	24.7%	11.6%	0.1%	8.1%	0.7%	5.0%	-0.2%	5.0%
4.7%	-37.3%	5.9%	6.6%	-2.2%	4.2%	0.0%	0.0%	-5.2%	2.6%
3.2%	-45.2%	0.2%	0.1%	-13.3%	0.1%	-2.0%	-3.4%	-7.0%	0.3%

MONEY MARKET	BONDS	U.S. STOCKS	FOREIGN STOCKS	ALTERNATIVES