Cambridge ADVISORS inc.
INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE — DECEMBER 2016

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MARKET COMMENTARY

US stocks finished the year strong. The DJIA even flirted with the 20,000 milestone level. Large cap stocks in the S&P 500 were up 3.8% in the fourth quarter giving them a double-digit one-year return of 12.0%. Small cap stocks in the Russell 2000 were even stronger with an 8.8% return for the quarter and 21.3% return for the year. International stocks in the MSCI EAFE did not fare as well and had a slight loss of –0.7% in the quarter reducing their gain to only 1.0% for 2016. Emerging market stocks fell -4.6% in the quarter but still posted an impressive 8.6% gain for the year. Meanwhile, yields soared in the fourth quarter and the Barclays US Aggregate Bond Index lost –3.0% reducing its 2016 return to 2.7%.

Financial stocks had the best return in the quarter with a 19% gain. Even so, they are not the best performing industry on a one-year basis. That spot goes to the energy sector which has had a strong recovery since the beginning of the year and resulted in a 27.9% gain for the year. Value stocks easily outperformed growth stocks in 2016 as seen in the difference in returns between the DJIA and the NASDAQ.

Third quarter GDP growth has been revised to 3.5%, much higher than the 1.4% and 1.1% growth seen in the previous two quarters. The Federal Reserve had been projecting 1.8% for all of 2016. Fourth quarter growth is expected to be around the 2%.

Corporate profits also showed marked improvement in third quarter. Analysts had been expecting profits to be down again marking the sixth straight quarter of negative earnings growth. However, earnings actually showed growth of 4.3%. The growth is expected to continue next year and even be above 10%.

The bigger news of the quarter was the election and its aftermath. We're not sure if the bigger surprise was the result of the election or the stock rally that followed. Many of the analysts were expecting a Clinton win and had warned that if Trump won, stocks would likely fall because of the uncertainty surrounding his policies and what he would do (this uncertainty would have existed regardless of who the republican nominee would have been). Although the after hours market did fall significantly as it became more likely that Trump was going to win, by the time the markets opened the next morning, the fear was gone and stocks began to rise. Market technician Ralph Acampora was on CNBC that afternoon predicting "Dow 20,000" and many viewers and commentators thought he was overzealous but by year-end, they didn't think so anymore.

Part of the reason the market rallied was because analysts began to see how the policies Trump had talked about in his campaign could spur growth. Yes, there were concerns about the tariffs he had talked about and possible trade wars. But, these fears ebbed and the economic benefits that could be seen with a repatriation tax holiday, lower corporate taxes, and incentives for businesses to invest in themselves became more prominent. Analysts are already starting to revise economic growth projections higher.

The yield on the 10-year Treasury bond catapulted from 1.61% at the end of third quarter to 2.51% at the end of the year. This rapid rise resulted in giving bond portfolios a negative jolt in the short-term, something bond investors don't normally experience. High yield bonds seemed to be the only US bonds that had positive returns in the fourth quarter thereby rewarding their investors for the higher risk they accepted.

The Federal Reserve raised rates for only the second time in a decade in December. In doing so, they indicated that they anticipate additional increases in 2017 as well. Many analysts are forecasting two to three small rate hikes in the year.

Many analysts believe the odds of the US entering a recession in the next two years are very low. They also are discounting concerns about price earnings multiples that are higher than they have been for quite some time because they are still in line with long-term averages and GDP growth and corporate earnings are on an upward swing. Small cap stocks have typically done well in this this environment and may continue to outperform their larger counterparts. International markets are also being watched closely to see if their economies can find footing for their next growth period. History shows us that the S&P 500 cannot always be the top performer as it had been for several years. Small cap stocks rose above in 2016 and analysts are watching to see when international stocks will have their moment. Markets are not without risk, though. Uncertainty always accompanies a new President - even if it is ignored initially. Diversification will still be warranted and prudent.

2016 BENCHMARK RATES OF RETURN

INDEX	FOURTH QUARTER	YTD
S&P 500	3.8%	12.0%
DJIA	8.7%	16.5%
NASDAQ	1.3%	7.5%
Russell 2000	8.8%	21.3%
International	-0.7%	1.0%
Fixed Income	-3.0%	2.7%

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have.

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FINANCIAL PLANNING

Election Implications

The outcome of the election in November could have implications that affect most financial plans. The biggest, of course, being taxes. President-elect Trump campaigned on simplifying the tax code and cutting certain taxes. If he and Congress are able to pass tax reform, it may behoove people to talk with their financial, tax and estate planning advisors to position themselves to benefit.

Trump's tax plan involves reducing the number of personal income tax brackets from seven to three with the top rate being 33% rather than the current 39.6%. The lowest rate would be 12% and the middle rate would be 25%. Most people will see a reduction in their income taxes. You can calculate your expected difference at taxfoundation.org/blog/how-would-trump-and-Clinton-tax-plans-affect-your-taxes.

Long-term capital gains and dividends would also have three rates with the highest being 20%. Also, the additional 3.8% Obamacare tax on investment income could be repealed.

In addition, he would like to eliminate the Alternative Minimum Tax (AMT) that many fall under as well as the estate tax. The estate tax has been debated and influx almost all of this century. The amount that could be passed tax free to heirs had increased from $675,000 in 2000 to $5.45 million in 2016. Amounts above were subject to a 40% estate tax. Under Trumps plan, there would be no estate tax. However, the step-up in cost basis at death would also be eliminated. Beneficiaries would be subject to capital gains tax when inherited assets were sold on estates above $10 million.

Another key point was to make America more attractive for businesses by reducing the corporate tax rate to 15%. What do corporate tax rates have to do with individual financial planning? The corporate tax rate would apply to small corporations as well as the large corporations. Many small businesses who are organized as S-Corps, partnerships or sole proprietors would also now pay this rate on business income rather than it passing through to be taxed at their ordinary income rates. If they are in a tax bracket higher than 15%, this could be significant.

Part of the plan also involves the standard deduction, itemized deductions, personal exemptions and childcare. He proposes increasing the standard deduction from $12,600 for couples to $30,000. Taxpayers can still itemize their deductions if they are more than the $30,0000 but there will be a cap of $100,000 for singles and $200,000 for couples. Personal exemptions would be eliminated, and the cost of child care for children under 13 would be fully deductible.

These are all just possibilities of what could happen. Until Congress votes and changes are enacted, your financial plan should stay flexible and not be dependent on any one outcome.

QUESTION: *What is technical analysis?*

ANSWER: Technical analysis is more than just charting price movements over time, and is an important component of a well-researched investment opportunity. When used in conjuction with economic analysis, fundamental analysis and quantitative analysis, a fuller picture of investment potential is provided.

Fundamental analysis can tell such information about a company as its competitive position in the market place, its management's strengths, and the dividends paid. Quantitative analysis can provide information about the financial health of the company through ratios and complex calculations of value. Economic analysis provides information as far as what stage of growth the economy is in and give clues as to which types of investments should perform best at each stage. Adding technical analysis to the mix provides information about price, volume, and psychology that the others don't provide. The first three methods may show that a company is a good investment but if volume is low or psychology is negative, growth may not be realized. Using all four methods in making investment decision can identify good companies to invest in at the right time.

CAMBRIDGE ADVISORS NEWS

We appreciate the positive feedback we continue to receive regarding the new format of our reports. You'll notice that at year-end, you'll no longer receive a bound booklet. We felt that the information in that booklet was not as useful as it once had been to clients, especially now that Schwab tracks cost basis on their system and provides reports with that information. In an effort to make our reports more meaningful, we eliminated several reports and kept only the ones that had information we thought clients would want to see. For this report, we added performance information. We will continue to add new features over time to make the reports even more meaningful to you. We are also working on the client portal where you'll be able to access your account information and reports in a secure way and we are exploring ways to better use the financial planning software that is integrated into the new system.

2017 Retirement Contribution Limits

Retirement Plans	2016	2017
401k and 403b Plans	$18,000	$18,000
Catch up contributions*	$ 6,000	$ 6,000
IRAs		
Traditional or Roth IRA	$ 5,500	$ 5,500
Catch up contributions*	$ 1,000	$ 1,000
SIMPLE IRA	$12,500	$12,500
Catch up contributions*	$ 3,000	$ 3,000

*If you are age 50 or older, you can make additional catch up contributions

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