Cambridge ADVISORS inc.
INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE MARCH 2017

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MARKET COMMENTARY

US stocks continued to surge in the new year. The DJIA passed the 20,000 milestone and even passed the 21,000 level before retreating some. Large cap stocks in the S&P 500 are up 6.1% in the first quarter of 2017. Small cap stocks were not able to continue their 2016 momentum but are still up 2.5%. International stocks in the MSCI EAFE have been much stronger than years past and are up 7.3% so far this year. Emerging market stocks are up even more with a 11.1% gain. Meanwhile, longer-term yields retreated somewhat so the Barclays US Aggregate Bond Index had a 0.8% gain during the first quarter.

Technology is leading the pack as the only industry with double digit gains for the quarter. After stellar returns in 2016, energy is the only industry to have negative returns now that the new year has started. REITs have also struggled some but their returns have managed to stay positive. Although one of the bottom performers now, financial stocks are expected to perform well in 2017 as yields increase.

Fourth quarter GDP growth was revised higher to 2.1%. This brings full year 2016 growth to just over 2%. The Federal Reserve had been projecting 1.8% for all of 2016. Looking forward, analysts are projecting 2-2.5% GDP in 2017 and 2.5%-3% for 2018.

Corporate profits are also growing. Earnings for the S&P 500 grew 4.4% in the fourth quarter after five quarters of declining earnings growth. Revenues were up 4.7% First quarter earnings are expected to be up 6.6% on about the same growth in revenues according to Zacks. These earnings estimates have come down from the 10.4% that was expected at the start of the quarter. Over the last few years, though, earnings estimates have routinely been revised lower as the quarter progresses. However, current revisions are smaller in magnitude when compared to past quarters.

Economic growth and earnings growth have certainly played a part in growing consumer confidence. Credit must also be given to optimism surrounding the President's goals to scale back regulations and cut taxes. The Consumer Confidence Index surged after the election and reached a 16-year high in March on positive expectations for the labor market, personal income prospects, and the economy. Small business confidence is also at its highest levels in more than 10 years. Small businesses account for about half of the economic output so their optimism tends to lead to hiring and spending.

Growing confidence has been reflected in the stock rally seen since the election. The S&P 500 returns have been stronger than average in the months following an election. It seems that market prices already reflect the anticipated passage of the President's campaign platform surrounding tax reform and reduced regulation. If any of these issues stall or are unable to be completed, investors may become disappointed and revise their expectations downward. If the optimism leaves, the market could return to its pre-election levels.

Treasury yields had also surged after the election. The yield on the 10-year Treasury bond jumped from 1.61% at the end of third quarter to 2.51% at the end of the year. Since then, yields have paused and even retreated to end the quarter at 2.4%. Strategas Research expects that the 10-year Treasury yield will be 3.0% at the end of 2017. Afterwards, they expect the growth in yields to slow considerably and expect the 10-year Treasury to yield 3.1% at then end of 2018.

The Federal Reserve raised rates for the second quarter in a row. That increase is the first of two or three expected in 2017. Inflation for February also reported its biggest annual increase in five years which also supports the expectation for further interest rate hikes. Inflation is still below The Fed's 2% target but it is in the upper end of the range that Fed officials thought would be reached this year.

Many analysts cite that with the economy and earnings growing, it is unlikely that stocks would experience a significant downturn. They also point out that it is typical to have a 10% correction in a year and these could be buying opportunities for long-term investors. The positive bond returns for the quarter are due to yields falling but with yields expected to rise, bond returns could be flat or negative depending on how quickly they rise. We still believe that diversification is a prudent strategy.

2017 BENCHMARK RATES OF RETURN

INDEX	FIRST QUARTER	YTD
S&P 500	6.1%	6.1%
DJIA	5.2%	5.2%
NASDAQ	9.8%	9.8%
Russell 2000	2.5%	2.5%
International	7.3%	7.3%
Fixed Income	0.8%	0.8%

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

Tax Reform

With the repeal and replace of Obamacare not coming to a vote, Congress and the President are moving on to tax reform. This issue will also likely face some challenges in finding agreement and legislation passed.

We have not had tax reform since Reagan was president. The Tax Reform Act of 1986 simplified the income tax code, broadened the tax base and eliminated many tax shelters. Many analysts credit the tax reform as one of several catalysts of the bull market of the 90's.

Eliminating the $1 trillion of Affordable Care Act taxes and spending was an important part of overhauling the tax code. If Republicans do not have support of Democrats, they will need to use "budget reconciliation" to have legislation passed by a simple majority. Under this method, in order for changes to the tax code to be permanent, plans cannot add to the deficit over a 10-year period.

With the polarization in politics continuing, it's obvious that gaining agreement from Democrats will be difficult. However, Republicans also need to find agreement within themselves and with the President. The current House Republican proposal and what President Trump has advocated for already have some differences that need to be reconciled.

Both proposals want to see the corporate tax rate reduced from the current 35% but they differ on the rate—the House Republican proposal says 20% while Trump would like to see it reduced to 15%.

Corporations with overseas sales may have large cash balances of savings accumulating. Those monies have been taxed in the countries where it was earned. If corporations bring that money back to the States, it would be taxed again at current rates as high as 35%. Corporations are therefore hesitant to repatriate those earnings and be double-taxed. The House Republicans and President Trump would like to give corporations a "repatriation tax holiday" on foreign income that is repatriated (brought back into the US) where they would pay a much lower rate. The two differ on the rate and may have differences on how to treat future offshore earnings as the President has not addressed that aspect.

The House Republican plan also includes a "border adjustment tax" (BAT tax) which would tax imports 20%. House Speaker Paul Ryan estimates it would raise $1 trillion to make up for revenue lost from other tax cuts. President Trump has not dismissed the idea but also has not yet embraced it.

In the current political environment—disagreement between Democrats and Republicans, lack of unity within the Republican party itself, and low approval ratings for the President–rather than grand sweeping tax reform, we may end up with scaled back tax cuts instead.

CAMBRIDGE ADVISORS NEWS

We are happy to report that once again Cambridge Advisors was recognized as one of the ***"Top 8 Best Financial Advisors in Omaha"*** by AdvisoryHQ, a financial review and ranking news media platform. To generate a more reflective award ranking of the top advisors and investment managers, AdvisoryHQ went beyond just analyzing the size of an advisory firm. AdvisoryHQ developed a "Top-Down Advisor Selection Methodology" that is based on a wide range of filters including fiduciary duty, independence, transparency, level of customized service, history of innovation, fee structure, quality of services provided, team excellence, and wealth of experience.

AdvisoryHQ uses a 4-step selection methodology to identify, research, and generate its list of top ranking firms:

- **Step 1:** Using publicly available sources, AdvisoryHQ identifies a wide range of financial advisors, RIAs, financial planners, and wealth management firms providing services in a designated area.
- **Step 2:** The firm's review and selection team then applies initial methodology filters to narrow down the list of identified firms. These filters include each firm's fee structure, fiduciary duty classification, and level of independence.
- **Step 3:** After trimming down the initial list, AdvisoryHQ conducts a deep-dive assessment of the remaining advisors. The award criteria takes into account a range of factors, including experience level (broad level of expertise and extensive years of experience), transparency, level of customized services, and website quality. Open door policy, resource availability (number of "available" advisory professionals and supporting staff), and range of provided services are also assessed to build up a broad picture of what each firm has to offer, before the final selection process occurs.
- **Step 4:** Based on the results of AdvisoryHQ's assessment, the firm's research and selection team then finalizes the entities that make it into the respective top ranking lists, which are then published to the general public.

AdvisoryHQ listed the features below as key factors in their decision. We are pleased that these things they like about Cambridge are not new to the firm—they are core values that have been important to us since our inception in 1990.

- Registered Investment Advisor
- Process and Customized Plans
- Long-Term Relationships
- Designations and Ongoing Education
- Team Approach

We are honored to be included on their list again. The full report can be seen at http://www.advisoryhq.com/articles/best-financial-advisors-in-omaha-nebraska.