How's Your Memory?

1/1/2017 – S&P 500 2239, DJIA 19,763

It's that time of year again. Christmas is over, the children and grandchildren are returning to school, and clients want to know what to look for on the investing landscape in the New Year.

After a lackluster 2015 in the stock market, most investors are cheering their positive stock market returns as 2016 rolls into 2017. Most areas of the equity markets showed gains for the year. However, I imagine that an awful lot of investors have already forgotten how the year began. Those first 10 days of 2016 evidenced the worst start to a year **ever** for the Dow Jones Industrial Average (DJIA) – going back to 1897! And then by February 11th, the S&P 500 was *down 15%* from the highs of only a few months before. *Ouch!* To refresh your memory, China was having economic problems, oil prices were plummeting, and investors feared the Federal Reserve would raise interest rates too far too fast. Right on cue, the media went nuts, fear and despair gripped many investors, and I penned another of these letters entitled "*Who Are You Going to Listen To?*"

Fortunately, sanity prevailed, the markets turned around, and investors eventually celebrated as the year came to a close. Yes, there was a lot of stress, turmoil, and surprises on the world stage—all of which brought plenty of volatility to the markets, but in the end, it was a positive year for most equity investors. *Whew!*

Why bring that up now? I'll come back to that in a moment but before we bid farewell to 2016, let's review how the markets played out for the year. Some forecasts we got right, including what we believe is the most important allocation decision – stocks did widely outperform bonds and cash. We were also correct to have reduced exposure to international equities. What we missed was that Value outperformed Growth – and by a wide measure. We had tilted portfolios towards Growth, which had helped in recent years. Not so in 2016. Nonetheless, most diversified investors walked away from 2016 with profits – and that's always a good thing.

As for 2017, here are some of our current thoughts with the caveat that these are "etched in sand" and are subject to change:

- The US economy should avoid a recession
- The equity markets shift from being interest rate-driven to earnings-driven
- Stocks (S&P 500) gain 8-10%, far surpassing returns on bonds and cash
- Domestic equity is favored over international
- Value and Growth perform more closely with Value slightly favored

So why the reminder of the ugly days of early 2016? Because sooner or later we're going to have yet another selloff. So I want to begin this year as I do every year with two familiar "Herb-isms":

> *"Investors must always be prepared financially, mentally and emotionally – for a 10% correction at any time."*
>
> *"Abide by Herb's Three Rules: Own quality, be diversified, invest in patience."*

Happy New Year!

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