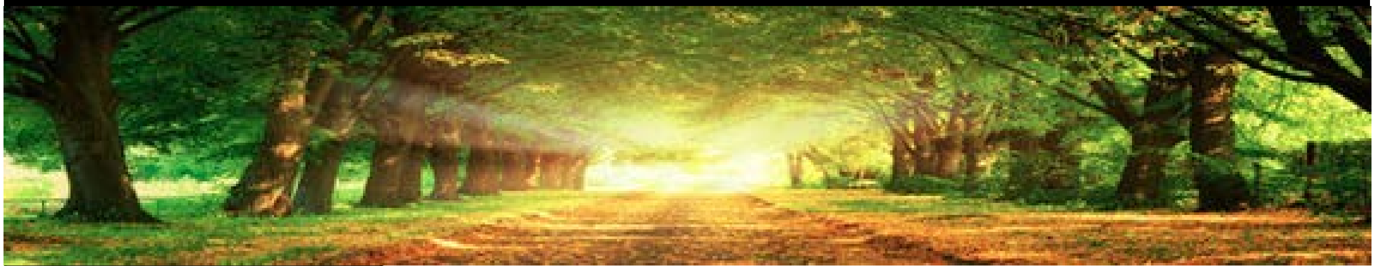
DECEMBER 27, 2016



Celestial WEALTH MANAGEMENT

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The "Trump Rally"

Many can't believe it, for sure many didn't expect it but the correlation to Mr. Trump as President-Elect and movements in the global financial markets is truly unbelievable. However, if you go back to about June, that is when most of the moves began. As you move through my final newsletter of 2016 I will provide a recap on each of the major asset moves via charts.

What is most interesting to me is that a Trump Presidency was actually being forecasted by the financial markets through the summer if current action is indeed correlated to Mr. Trump's win. You see all the current trends have been in place since late June/July and are just being amplified now. Is Mr. Trump's election the cause of these moves? I don't believe so. They were underway far before there was even a hint that he might win.

That being said, on the day he was elected, the S&P 500 low was 2,083.79 and we are now at 2,263 as of December 23rd. Nearly the entire yearly gain has come since election night. However, there has been MASSIVE dispersion on a sector basis with many stocks in the "right" sectors moving up multiples of 9%. Sectors like financials, industrial metals, energy and healthcare have had large upward moves while utilities, consumer staples, technology and biotech have moved flat to down.

The number one question you should ask yourself is the following? Will this dispersion continue? And…if so, what do you do? Investors are not used to correlations being low. For the past 8 years, generally all sectors have moved in tandem up and down. With this newfound dispersion, it is my belief that the next four years will be met with more volatility both up and down, and more dispersion between the winners and losers in the stock market. This is new for a lot of people or a return to more normal markets for many in my business. In my opinion this shift is being primarily driven by interest rate expectations. Interest rates have finally begun to rise because:

1. Trump is going to borrow a lot of money for rebuilding the military and infrastructure. This would increase the deficit causing the Treasury to issue even more debt.
2. Trump's policies are generally inflationary by nature and could be the match that ignites the inflationary animal spirits.
3. The cabinet pick of former banker, Mnuchin means he may be in favor of issuing as much debt in new long-term notes as possible while rates are low.

Is the Tide Turning?

As a country, we have just elected a businessman (with flaws) to the highest public office. His motivations are probably much different than President Obama's were. Is he the next Ronald Reagan? Probably not. Is he the next Jimmy Carter? I hope not as well. Let's start with the following:

President-Elect Trump has a large number of enthusiastic supporters as well as many who are fearful of what is to come. I think he will not deliver on all of the promises his supporters hope for. I also think he will not inflict the damage some fear as well. I think there are a number of things he may do that could unleash economic growth here in the U.S.

- He hates red-tape and what he deems overregulation. The reduction of regulations could unleash growth
- Tax simplification could help companies, entrepreneurs and individuals again unleashing growth
- He is against crony capitalism and the impression that the system is rigged against the little guy. If he sticks to this, the combination of tax simplification and a more fair playing field **could unleash entrepreneurialism**

But, if these positive aspects occur there could be a negative that I haven't heard anyone speak of. If red tape is removed, taxes become simpler and the path to growth seems achievable, the funds for expansion have to come from somewhere. **Reigniting the economy may be BAD for the stock market**. You heard me right. How can that be? If you start taking business risk and investing in growth, the funds may come out of assets like stocks, bonds and real estate. Stock buybacks and special dividends may go away in favor of longer term corporate growth projects. This may put pressure on stocks in the shorter term as the markets adjust to a new paradigm focused on business investment, growth, higher interest rates and less regulation.

Higher interest rates are generally negative for residential real estate prices, bad for utilities and good for banks and inflation-related assets. That is a huge oversimplification, but if things are turning, maybe keeping it simple is best.

In my opinion, many of the trends of the past 25 years or so may begin to reverse.

- **The disinflation and deflation from 1981 to the present may begin to reverse.**
- **The long slide in interest rates since 1981 might have reached its low in 2016 and may be slowly turning higher.**
- **Globalization of labor and economy may reverse to accentuate nationalism**
- **Ironically, because of these two points, median wages could begin to rise**
- **And if that occurs, the income and wealth inequality that has increased substantially may begin to reverse.**
- **Reduced red-tape and regulations and increased government efficiencies could provide a tailwind toward American businesses rather than a headwind**.
- **As opposed to market valuations expanding over the past 25 years to near all-time highs due to lower interest rates, I believe valuations will begin to contract with higher rates, which makes it imperative for earnings growth to improve for the U.S. stock market to advance.**

There has been a knee jerk reaction as their almost always is to a polarizing change. The analytical side of me says begin preparing portfolios for a new environment. Depending upon your individual investment objectives and other suitability factors, look into:

- Income producing assets with the ability to raise that income (dividends, rents, distributions, etc.)
- Raw materials and natural resources that generally benefit from inflation
- High quality companies with differentiated products with increasing revenue and attractive valuations
- Emerging Market debt and equity that generally performs well wither higher inflation
- Investment managers with high conviction ideas and strategies
- Nimble strategies with the potential to profit as volatility increases such as alternative investments

I believe investors should be wary of the following:

- Fixed Rate investments such as bonds
- Low quality companies with commoditized products
- Companies with high debt levels
- Securities tied to Market Cap weighted Indexes that may not perform well in the changing environment

Asset Class Trend Updates

As we wrap up 2016, I thought it would be beneficial to show the price action of various asset classes in what was a very volatile 2016. Within these charts you will see the very violent price action in January/February, market action around Brexit and the recent price action leading up to the election and afterwards. As I stated earlier, the current price action has been in effect a full 5 months before the election.

U.S. Dollar has strengthened significantly leading up to the election and then afterward.

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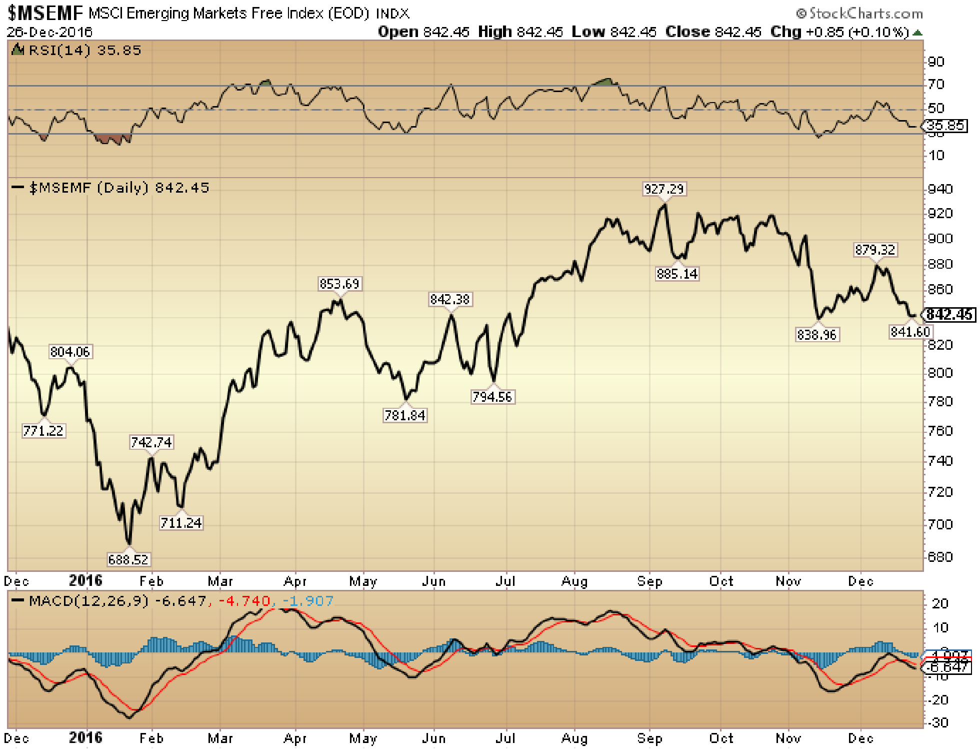
Emerging Market stocks have rallied significantly off their lows and may be benefitting from the uptick in inflation



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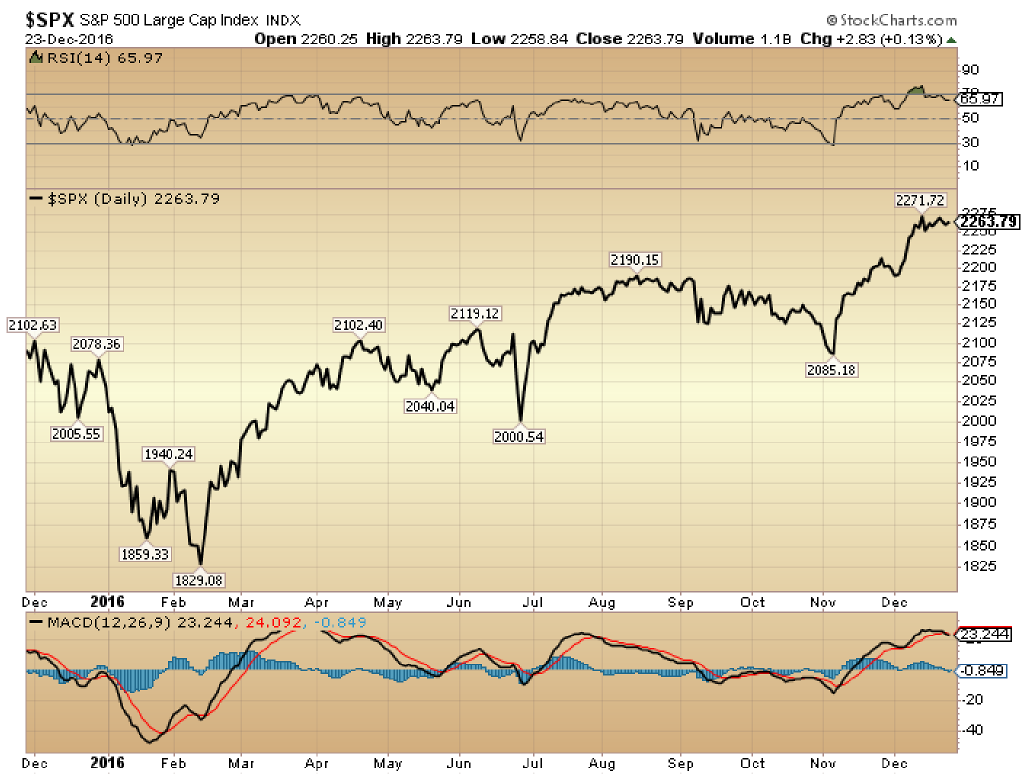
The S&P 500 began began its recent rally in June after Brexit and has continued through the election.



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Russell 2000 U.S. Small Stock Index rallied significantly, potentially signaling fears of protectionist policies.

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U.S. 10 Year Treasury Yield was moving higher (bonds moving lower) and accelerated after Mr. Trump's election.

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Gold began its correction in early August and has continued since Mr. Trump's election becoming extremely oversold.

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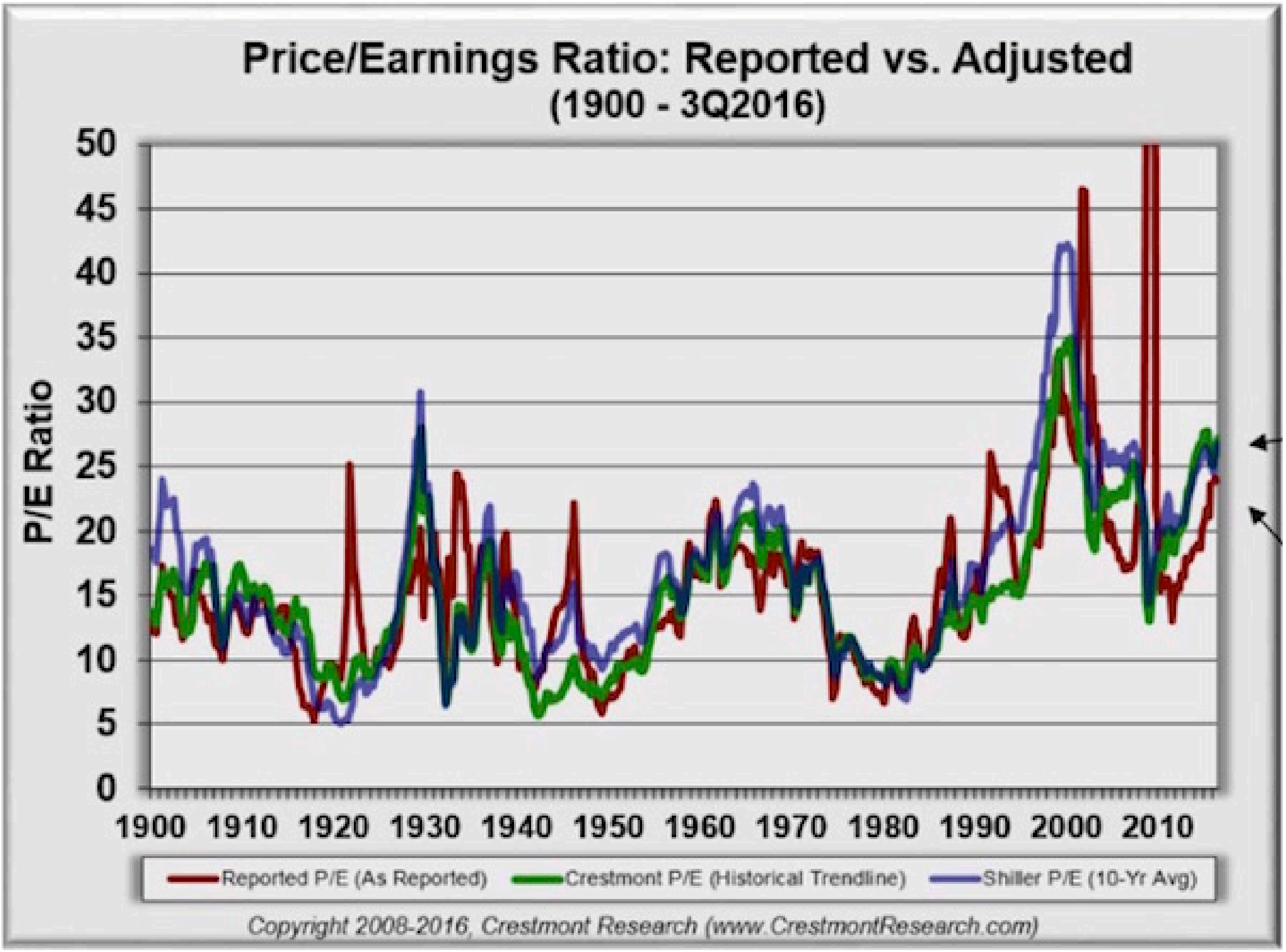
Valuation Update

I feel roughly twice a year is a good point to check in on valuation levels of various markets, both cheap and expensive. If you remember, from previous newsletters, valuations have almost no short-term predictive nature. However, over longer horizons of 5-10 years they have historically been pretty accurate in letting investors know whether an asset is currently overpriced or underpriced. For those investors concerned about buying low and selling high, valuation analysis may have incredible predictive value on future portfolio returns. This is why I am a firm believer on using valuation analysis to build long term portfolios. In my opinion, it makes sense to overweight assets that appear cheap or fairly valued and underweight assets that appear overvalued.

Here is a chart showing three different valuation metrics on the U.S. stock market from Ed Easterling, who does incredible valuation work at Crestmont Research. He runs a research service that is free to the public and is widely used and quoted in financial circles. You can check out his work at www.crestmontresearch.com.



As you can see from this chart. All three valuation metrics are significantly elevated compared to history. The only other corresponding periods as of this data are at the peak of the Roaring 20s and the Technology bubble around Y2K. This ratio spent most of the past century between 10 and 25. When it went below 10 those were depressed, cheap market levels. North of 25 ended up being overvalued manic buying tops. The problem with valuations as a timing indicator **is that they can stay over and undervalued for uncomfortably long periods.** With current U.S. valuations above 25 that doesn't mean a crash is coming. It does suggest, however, that we are not at the beginning of another long-term bull market.

However, as television personality Jim Cramer says, "There is always a bull market somewhere." If the U.S. is historically expensive, are there assets that are historically cheap? That answer is definitely yes. In order to become cheap, assets must have inflicted previous pain and losses on those holding the assets. That is what is needed to create the bargains.

In my opinion, two assets that may surprise investors to the upside over the coming 5 years are emerging market stocks and bonds. After a great run off the lows in 2016 it appears the worst is behind these assets. The common narrative is that the President-Elect would be bad for emerging markets because of his protectionist policies. However, that is a simplistic and superficial view of an asset class that represents roughly 50% of world GDP growth.

At the lows early this year, compared to an S&P 500 10 year average P/E of 25, emerging markets sported a P/E of 9! And high quality companies had a P/E even smaller of 5.5 according to Rob Arnott of Research Affiliates. Even after the large rally YTD, high quality emerging market stock valuations have only increased to 7 versus the S&P 500 which is now at 28! I believe, we are only in the early innings of a new bull market in these stocks for the following reasons.

- First, I doubt Trump is as tough on trade relations as his talk. He knows the value of international commerce and having quality trade partners. If he is not as tough as the narrative expects, that is a positive.
- Second, emerging markets typically do well historically, when U.S. based inflation is increasing and that seems to have begun. Trump may kick-start inflation even further.
- Third, Emerging markets have a demographic tailwind of a young population that generally is good for economic growth. The U.S. has an aging population that still has 7-10 years before its largest generation, millennials become a major economic driver.
- Fourth, emerging market stocks generally have cheap valuations and high dividend yields.
- Fifth, emerging market currencies have been in a 5 year decline versus the dollar. If the dollar's value peaks in the next year or two, the headwind could turn into a tailwind.

I think a potential surprise of 2017 is that the perception of Trump being bad for international companies and stocks ends up being wrong. I wonder if a second year of emerging market outperformance is in the cards.

I wanted to take a moment to thank all of my clients for the trust they place in me. I often spend the last few weeks of the year in reflection. I think about what worked and what didn't. What I would change and what I wouldn't. 2016 was a very volatile year in the financial markets and I would assume 2017 would be more of the same. I look forward to spending the next few weeks preparing for 2017. I will spend time with my wife, my two beautiful girls and friends. Treasure the time you have with your family and friends. You never know when it will be taken away from you. Live in the moment with an eye toward the future. Good luck in 2017! Here is a picture of me, my father, father-in law and a college buddy as we got ready for America's Game. Army beat Navy for the first time in 15 years. My father, a West Point grad, had an ear-to ear grin after the game beaming with pride. I am sure Navy will regroup and will be ready for revenge in 2017.

Investment Ideas

- **Rather than trying to "beat the market", focus on beating inflation and the rate on cash. Plan for safety and liquidity while seeking positive returns.**
- Equity valuations are very rich but masked due to the distortion of the Treasury curve. Volatility is returning to the markets and I think long/short managers are best positioned to capture this volatility by owning companies with strong businesses, barriers to entry, and good valuations and selling short weaker companies with high debt loads that have risen sharply with the broad market rally. I think this strategy of hedged equity may have the potential to produce attractive risk-adjusted returns if and when investors begin to question the valuations of companies. Stock investing involves risk including loss of principal. No strategy ensures success or protects against a loss. Long positions may decline as short positions rise, thereby accelerating potential losses to the investor.

- Monsoon country investments. Attempting to take advantage of demographic, educational and investment possibilities in the countries surrounding the old spice routes of the Indian Ocean. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

- In 2013, the Affordable Care Act began implementation. There will be many winners and losers in the healthcare industry as a result of the biggest change in the healthcare industry's history. With the largest portion of the U.S. population entering their golden years, healthcare needs will become even more important. Long/short Healthcare seems to be a very attractive way to invest in a sector with lots of potential and lots of potential pitfalls. Investing in a specific sector involves additional risk and will be subject to greater volatility than investing more broadly.

- A potential U.S. infrastructure upgrade cycle may be around the corner. Moving from our current grade of D+ to B would require an investment of $3.6 trillion by 2020.

- Supply problems remain high across the energy asset class. While there isn't a current shortage of energy on the planet, it is taking more and more energy and capital to discover, drill, transport and refine it. Long term Demand should continue to grow globally, particularly in China, India, and other developing countries.

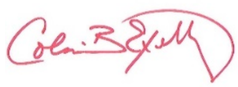
- Potential food shortages due to inclement weather and higher demand from the emerging Asian middle class could result in a boon to agricultural land and potash fertilizer companies. International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

- The rise of E-Commerce has coincided with an increased desire for efficient warehouse distribution real estate. As e-commerce moves toward even faster delivery, positioning of distribution becomes even more important.

- Precious metals mining companies have been extremely beaten down over the past four years. Mining is an industry that spans hundreds of years. Companies that mine for commodities are often highly cyclical, meaning they have sustained moves both up and down. When investing in the mining space it is important to be a contrarian. Ideally, you would want to accumulate miners when sentiment is poor around them and sell them when sentiment is positive. Historically this has been a good strategy.

  No strategy ensures success or protects against a loss.

Regards,



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