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In This Issue

and low temperature storage for the biomedical industry. If this sounds familiar, it should because we have owned this before. We like GTLS because it is a direct beneficiary of growth in LNG infrastructure needed to support greater US exports of natural gas. GTLS contracts with some of the world's largest energy companies. While they serve several different industries, Chart Industries trades similar to oil refineries, which enabled us to pick this company up on the cheap. They don't pay a dividend but has net no debt.

We also added America's greatest icon, **Walt Disney (DIS)** to the portfolio as a long-term anchor position. The stock was hit hard in 2016 falling over 10% from its all-time high and having the dubious honor of being only one of three Dow components in the red for the year. The stock price fell over concerns of losing subscribers at ESPN and rising sports programming costs. Although ESPN represents 35% of total revenue, it's Disney's content that brings real value and is a catalyst for rising earnings. On the horizon, the company has four Marvel movies, three animated features from Disney and Pixar and two Star Wars films. The company trades on the cheap side on a forward basis and has strong cash flow to support capital investment and debt. We believe Disney will move back to more normal growth rate over the next few years.

Taken For Granted

A Lesson in Futility

The adage "*On any given day*" could not be a more appropriate description for 2016. As a hard-core sports freak, last year will be remembered as the year three separate centuries old losing streaks came to an end. It started in early May when Leicester City F.C. (Football Club) won the English Premier Soccer League title, its first major championship of any kind in its 132-year history. In October, the Chicago Cubs exercised their demons by winning the World Series over the Cleveland Indians, breaking the 108-year "curse". In rugby, Ireland beat the mighty New Zealand All Blacks for the first time in 111-years. Breaking through psychological barriers can be difficult, but perseverance is the key.

Upsets were not limited to just sports as global politics were squarely in the cross hairs of a populist uprising. It all started across the pond with a surprising referendum vote enabling Britain to leave the European Union and ended with the shocking election of Donald J. Trump as the 45th President of the United States. While there were signs of global disenchantment from the rise in power of populist leaders in Europe, Latin America and Asia, elites in both the U.K. and the U.S. took their respective electorate for granted. However, "the people" had the last word as they sent a strong message against a system that seemed to be ignoring "*the little man*". The revolt crossed party lines as citizens were fed up with corruption, elitism and self-serving politicians. It will be interesting to see what changes and what reforms come out of this new political order. However, it is safe to say that regardless of what happens, it will be some time before politicians take the political will of the people lightly, again.

The Trump Effect

Presidents focus on agendas that reflect their experience, ideology and interest. Obama managed his Presidency based on progressive, left-leaning beliefs shaped and refined through his years as a community activist and one-term Senator. He spent most of his term influencing social issues at the expense of business, economic and foreign policy. Trump, on the other hand, comes to the White House with a wealth of business knowledge and little in the way of social and foreign policy experience. While he fancies himself as a master global negotiator capable of resolving complex negotiations, his expertise is limited to the boardroom, not the political arena. If words mean things, then Trump will likely spend much of his time supporting a pro-business agenda of lower taxes and easing regulation.

The Trump victory has had a positive impact on expectations for business as seen by the 8% pop in the Dow over the last seven weeks of the year and in December's economic indicators. The NFIB *(Small US Business Optimism Index)* jumped 19 points from November to December, its biggest bounce since 2009. Nonetheless, the main question is whether future economic growth can match current expectations. Much of the enthusiasm is drawn from parallels between the pro-business agenda of Trump and Reagan. However, one must consider that the economic environment that Reagan inherited was much more favorable for growth than what Trump will face. The table was set for the economy to run under Reagan as he benefited from a younger work force, prospects of falling rates to stimulate the economy, historically low corporate and consumer debt, market valuations and profit margins near record lows and a high national savings rate.

Trump does not have the benefit of any of these economic catalysts. Rather, he faces the prospects of rising rates, an aging population, high and rising corporate and consumer debt and market valuations and profit margins near cyclical highs. These headwinds could limit his ability to improve the growth trajectory of the economy.

Change doesn't happen overnight and it rarely goes smoothly. Inaugurating a new president is like incorporating a new company CEO. Remember, even with Reagan's success of sparking economic growth, the country had to endure a bear market and recession in '81-'82 before the expansion took hold. With that being said, this should not prompt investors to sell everything and flock to bonds. Timing is always uncertain. Therefore, investors should continue to be invested. Patience will be an important attribute as we wait to see how the economy reacts to Trump's policies. Setting reasonable expectations will also be important as achieving 80's type returns during Trump's pro-business administration might be a bit optimistic.

Nonetheless, persevering through the difficult times makes the gains all more rewarding. We will be watching the economy, the markets and Trump's tweets closely as he launches his agenda on the world. Happy New Year to all and may 2017 be healthy and profitable for you.

Market Review (End-of-Year)

Panic to Jubilation

Financial markets took investors on an emotional ride in 2016. One out of every two trading weeks resulted in stock gains or losses of more than 1%. It was an extremely volatile year, characterized by quick and extreme changes in market sentiment. It did not take long to kick things off as all three major indices (the Dow, S&P 500 and Nasdaq) fell sharply (6%) in the first week, the worst-ever five day start to a year. The losses kept mounting over concerns of slowing global growth in China, plummeting yuan, and possible recession in the U.S. By the middle of February, the Nasdaq had dropped a whopping 15%, and the Dow and S&P 500 were both lower by more than 10%. It's no coincidence that oil also hit a low of $26 in February on the weak global economic outlook.

The Markets stabilized and started to bounce back after President's Day. By the end of the first quarter, the Dow and the S&P 500 were back in the black. Investors pushed stocks in-and-out of positive territory throughout much of the spring and early summer leading up to the late June Brexit vote. After a brief panic (2 trading days) to contemplate the ramifications of Britain leaving the European Union (EU), the markets shrugged off any concern and moved higher for the rest of the summer as fear over a US recession abated. In fact, the Dow, S&P 500 and Nasdaq all closed at record highs on August 11th, the first time that has occurred since 1999. That feat was replicated seven additional times in 2016.

The election season proved volatile as the markets were only slightly positive for the year, going into the election. The rest, as they say is history. Investor sentiment changed quickly with the unexpected Trump victory and the equity market rolled to finish 2016 slightly off their all-time highs. The total return for the indices were 16.5% for the Dow, 12% for the S&P 500 and 7.5% for the Nasdaq. Within the Dow, two stocks, Goldman Sachs and Caterpillar accounted for almost 50% of the total index annual return. The S&P 500's best performing sectors were Energy +24% and Financials +20%. Healthcare -4%, was the biggest drag as concern over price caps and regulation weighed on the sector.

Expectations of an improving economy, Trump's pro-growth platform and rising interest rates helped ignite the dollar to its highest level in 13 years. The dollar move helped value stocks outpace growth stocks. However, the level of outperformance increased as market-cap declined. This makes sense as small-cap stocks don't usually have international exposure and currency related issues.

After several years of favorable fundamentals, bond investors felt the backlash of volatility as the rate of the 10y-Treasury bond fell throughout the first half of the year before rebounding in the fourth quarter. The benchmark Treasury bond bottomed out in early July at 1.4% after starting the year at 2.3%. However, in the fourth quarter the 10y-Treasury yield jumped 85 basis points to finish the year at 2.5%. As rates rise, bond prices fall which could cause some shock and concern when investors open their year-end statements. Nonetheless, individual bond holders should focus on income generation and take comfort in knowing that as long as the bond issuer does not slip into insolvency, they will receive their full principal value at maturity, regardless of how high rates rise (or prices fall) in the interim.

The Equity Portfolio

The Trump rally continued to roll throughout year-end as investors piled into the momentum trade without much regard to the likelihood of his policies being implemented. Therefore, investors must contemplate how much of the market run-up accurately reflects the value of future congressional victories. Factoring the extent to which higher capital costs and potential growth will impact stock prices are uncertain. We believe that the adage *"buy on the rumor and sell on the news"* applies this time around as investors continue to gobble up stocks until the inauguration and will sell once Trump takes the Oval Office. By then, the excitement will be over and reality will set in. Actions will speak louder than words as actual achievements will become market catalysts and the time between policy acceptance and implementation will become a headwind. We don't believe the markets have currently priced this or other stumbling blocks into the value equation. I know, I'm being a bit cynical, but what could possibly go wrong when you are dealing with politics and the government?

Cycles and Stock Pickers

Over the last several years, I have been less than bullish on the equity markets due to the underlying economic fundamentals supported by the Fed and Obama administration. The financial crisis and subsequent low growth, low interest rate environment prevented the economy from operating normally. Typically, the economy moves in a wave like fashion; from growth to recession and back again based upon real growth, inflation and corresponding monetary policy (raising or lowering interest rates). With extended periods of near zero interest rates, non-existent inflation and only moderate growth, the financial markets have become highly correlated with most asset classes moving up and down together. Since 2008, correlations among stock sectors have averaged 82%, considerably higher than the norm of 50%. The greater the percentage, the more stocks move together. Lowering the benefits of diversification. Corporate bond prices, which typically move in an opposite direction to stock, also jumped higher as the Federal Reserve initiated and engaged in years of Quantitative Easing policies. This created a "risk on" environment where investors (starved for income or yield) moved out of bonds and into more risky equities to try to generate extra return. This homogeneous environment made it difficult for active managers to outperform because all assets classes acted alike and the markets rewarded risk taking. Similarly, with the onslaught of Exchange Traded Funds (ETF's), investors could easily buy a basket of stocks representing a specific index rather than having to rely on individual stock picking.

On November 8, a real economic shift took place with Trump's victory. Suddenly, there was hope that interest rates would normalize (the 10y-Treasury yield jumped to a two-year high) and an economic expansion would provide an environment where cycle investing could once again become in vogue. This environment creates opportunities for experienced portfolio managers who know how to navigate such conditions and can anticipate changes in the business cycle. Strategic allocations and stock picking will be rewarded while general market exposure could underperform. Remember, the financial markets have yet to go through a significant bear market since the end of the financial crisis. Therefore, ETF investors have yet to feel the negative effects of market returns.

If our premise is correct, it is a good idea to have a general idea where we are in the cycle. Some stock sectors do better at the beginning of a recovery (Financial and Industrial) while others do better toward the end (Utilities and Consumer Staples). Unfortunately, there is no clear consensus as some prominent economists believe we are in the latter part of the cycle due solely on the length of this bull market. Others believe that we could be on the brink of a strong multi-year expansion as corporate earnings could emerge from a five-quarter recession and the high probability of a large fiscal stimulus package passing congress.

We believe the economy is at an inflection point. Based on Trump's pro-business agenda, growth could finally accelerate to more normal levels for a typical recovery. Financial, Industrial and Technology sectors usually lead markets at the beginning of a new cycle. We really like certain segments of the Financial sector as it has underperformed the S&P 500 since the financial crisis. Despite its recent run-up, valuations are still compelling in consumer finance, money center and regional banks. Furthermore, we don't believe the economy can continue to gain strength without a pick-up in lending.

We also like segments of the Technology sector as lower proposed corporate taxation and a potential repatriation tax holiday could encourage capital spending and investment, triggering organic revenue growth or merger & acquisition (M&A) activity. Specifically, we are looking for those firms supporting and/or supplying Alphabet, Apple, Amazon and Facebook, as they push forward on the AI (Artificial Intelligence) frontier.

Although it is not early cycle, we also like Healthcare due to its underperformance in 2016 and attractive valuations. Sure, it's under Congress' microscope for pricing, but we think lawmakers will be preoccupied with tax policy changes, Supreme Court Justice nominations and pro-growth policies rather than focusing on drug pricing.

Additions and Subtractions

This quarter we were net users of cash as we engaged in a pairs trade where we sold our long-term position in **Verizon (VZ)** and bought **AT&T (T)** due to their improving profitability, cash flow, operations and business outlook. T has a broader product offering which will be enhanced by the potential acquisition of Time Warner Inc's (TWX) vast premium content including the Turner properties, HBO and Warner Brothers TV and film studios. T should leverage the acquisition to enhance their leadership in mobile broadband video distribution via pricing and bundled packages. In November, T initiated its live streaming service under DirecTV NOW which does not require a contract, hardware or credit check. Going forward, the company's mobile entertainment business should continue to drive cash flow and add to earnings and support its 4.5% dividend.

We added **Chart Industries (GTLS),** to the portfolio as a long-term position based on its diversified business of manufacturing equipment to support the energy and chemical business, distribution and storage related to LNG (Liquefied Natural Gas) terminals and cryogenics, vacuum insulation