INVEST FOR A LIFETIME NOT THE NEXT YEAR

January 2017

A positive end to the year for stocks in 2016 may have helped investors forget the roller coaster ride we all took to get here. That is often the case as it is rare for the market to move in a straight line up or down over any 12-month period. The U.S. market, as measured by the S&P 500 Index, began the year by declining 10% through February 11th, as fears of rising interest rates, falling oil prices and poor economic news from China raised concerns of a worldwide economic downturn.

As these fears proved unfounded, the early pessimism gave way to optimism and stocks began to rise in lock step with the recovery in oil prices. Oil, which reached a 13 year low of $26.21 per barrel in February, nearly doubled to $50 per barrel by spring. The S&P 500 Index didn't have such a sharp rise but did show an increase of nearly 20% between mid-February and June. The June 23rd Brexit vote, in which the United Kingdom voted to leave the European Union, sent equity markets down some 5% over the next few days, but the decline was quickly reversed. The market enjoyed a summer and early autumn of surprisingly low volatility.

As the election loomed, the pollsters and the popular press all but guaranteed the election of Hillary Clinton as President. It appeared the markets were comfortable with that likely outcome, and pundits warned that a surprise Trump victory would send stock markets reeling. Indeed, during the wee hours of the morning following election day, when it became obvious that Donald Trump, not Hillary Clinton, would be the next President of the U.S., equity futures cratered some 8%. With a victory speech containing a few conciliatory words and delivered while most Americans were asleep, Mr. Trump eased the fears of many. The market, proving yet again it is indeed anything but rational in the short run, saw futures recover all the 8% loss even before stocks opened for trading that morning. U.S. stocks went on to post several days of advances and in December the Dow Jones Industrials flirted with the 20,000 level for the first time. As the year closed, the Dow Industrials, the S&P 500 Index, and the NASDAQ Index all traded close to their all-time highs.

For 2016, the S&P 500 Index appreciated 9.5% and with dividends provided a total return of 12.0%. The energy, basic materials, and financial sectors performed the best, while the health care sector was the only sector to experience a yearly decline.

- Volatility is normal and don't let it derail you;
- Staying invested matters, through good and bad times;
- Diversification works and is paramount for any long-term portfolio.

As we begin 2017, we look forward to continuing to help our clients with their financial plans, and manage their investment portfolios to meet their long-term financial goals. We will continue to hold core equity portfolios comprised of the stocks of individual companies – seeking good companies with growing earnings and strong financial positions trading at reasonable valuations. With foreign stocks trading at valuations considerably lower than U.S. stocks, our client portfolios will generally hold significant exposure to foreign markets, either through individual company stocks or through pooled funds. We will seek to understand the cash flow requirements of our clients, and ensure such cash flow needs are met through expected income and as needed by holding money market cash or secure, short-term investments. Let us ensure your investments are well-positioned for the long-term, with adequate liquidity so that you can be less concerned with the short-term gyrations and all the negative news that will undoubtedly ensue.

We so thank you for the trust and confidence you have placed in Knox & Downing Advisors and we wish you a healthy and happy 2017.

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Smaller U.S. company stocks did better, with the Russell 2000 Index of small cap stocks returning 21.6%. In the foreign stock markets, the FTSE Emerging and Developed market indices returned 11.6% and 2.9%, respectively. The yield on the ten-year U.S. Treasury note began the year at 2.2%, declined to less than 1.4% following the Brexit vote, and then rose to end at 2.5%, near its high yield of the year, but still way below its long-term average.

As investment advisors, we are often asked how upcoming events - the turmoil in the world, the latest piece of bad news, Brexit votes, elections, and so on - will affect the stock market. These questions become more numerous and pressing when important events close to home like a Presidential election take center stage. As we opined in our October 2016 newsletter, we felt a great sense of relief that the rancorous Presidential campaign would soon come to an end. However, as far as what the lasting effects the election would have on the stock market, the question on everyone's mind, we really did not know. Indeed, Warren Buffet stated in April of 2016 that shareholders of Berkshire Hathaway, the company for which he directs investments, would do fine no matter which candidate was elected. After the election, in an interview on CNN, Buffet stated that "the stock market will be higher 10, 20, 30 years from now. It would have been with Hillary, and it will be with Trump".

It is difficult to do, but as investors we need to forget about the short-term gyrations of the stock market. Watch or listen to financial news programs for entertainment or information but don't base your investment decisions on what you see or hear there. We believe it is important to focus on an investor's time horizon, usually a lifetime or longer, and not on the next few days ahead. It's also important to focus on the things that you can control. Create a sound financial and investment plan that reflects your time horizon, your cash flow needs, and your risk tolerance.

This autumn, J.P. Morgan Asset Management published a marketing brochure that was titled "Think in Decades, Not Days". With due credit to JPM, we list below their seven principles to help build a strong portfolio for the long-term:

- Plan on living a long time;
- Cash isn't always king (but always have sufficient cash reserves);
- Harness the power of dividends and compound investing;
- Avoid emotional biases by creating and sticking to a sound financial plan;