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PINNACLE QUARTERLY

Hangovers & Roadmaps

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8 Things to Do in 2017
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8 Things to Do in 2017

Now that we've started the new year, this is a great time to take a fresh look at your financial picture and update things that may be stale or outdated. To help you do that, here are eight ways to improve your financial health in 2017.

Retirement

Review your 401k contribution. Will you turn 50 in 2017? If so, you are now eligible to make "catch-up" contributions to your plan. Are your contributions properly allocated for current market conditions? Do you have an old retirement plan that you can rollover?

Cash Flow

Audit your auto-debits and recurring charges. Review how much you are paying for those services that you no longer use. Should you terminate any of these?

Emergency

Create an emergency fund. Do you have three to six months of expenses in reserves? Are you saving money in an HSA plan that can be invested and then used for your healthcare purposes?

Debt Management

Reduce your debt to cut expenses. Can you transfer some of your debt to a lower rate so you can reduce your monthly payment?

Safety

Create stronger passwords for your financial accounts. Don't rely on the same passwords for you Starbucks account and your bank account. Do you have your passwords stored in a safe place where someone can access them in case of an emergency?

Social Security

Start learning about how Social Security works and ask your financial advisor about your options and which may be best for you. Visit the Social Security website to become familiar with its resources.

Insurance

Review your insurance coverages. Is the amount of coverage appropriate? Is this coverage still necessary? Should you raise your deductible to reduce your premium?

Age 70½

If you turned 70½ in 2016 and have not yet taken your required minimum distribution, please contact your Wealth Manager as you have until April 1 to withdraw the appropriate funds. The consequences of not withdrawing at least your required minimum distribution is a penalty equivalent to 50% of the amount that should have been withdrawn.

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MARKET REVIEW

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2016 began with a thud and ended with a bang. After one of the worst-ever starts to a year, U.S. stocks managed to rebound and ultimately finish the year with solid gains. Much of the rise came in the final few weeks of the year, following the surprising results of the U.S. presidential election. Indeed, there has been an abrupt change in market sentiment, and asset prices have largely taken their cues from a recalibration of economic expectations in the wake of the surprising Trump victory and Republican sweep of Congress.

While policy specifics under the incoming administration are still being fleshed out, markets aren't waiting around for the details. There have been sharp moves in certain areas of the market since the election, and we believe these moves are sending signals that are influencing asset allocation in a world where the political landscape has shifted dramatically. Below are some of our initial thoughts on how the election may impact the investment landscape in 2017.

A Roadmap Developing?

From a pure investment standpoint, the recent election seems to be creating a roadmap for macro developments and portfolio positioning under a Trump administration. The basic narrative is one of stronger growth, higher inflation, and less regulation.

Economic growth is expected to pick up through fiscal stimulus. From a big picture perspective, the idea that a sizable fiscal package could be enacted at this point in the business cycle is a big deal and comes at a time when markets were beginning to wonder if the monetary authorities were running out of bullets. In terms of the fiscal initiatives expected, perhaps the biggest change will come through tax cuts and possibly tax reform that would benefit both consumers and businesses. Some type of infrastructure spending also looks like a good possibility over the coming year, which should also support growth.

Higher growth, tighter immigration policy, and possible protectionist policies should all be inflationary. For many years, the global backdrop has been highly disinflationary, but that dynamic may be changing, and the recent election may be the catalyst that unlocks this transition. If so, this could mark a significant shift in the bond market towards higher interest rates, after more than three decades of declining rates.

Heavy regulation has long been cited as a significant headwind by large and small businesses in the current cycle. The incoming administration seemingly favors less regulation, which should produce a more business friendly environment and has the potential to boost confidence in those who control business investment.

Translation to the Portfolio

Using these broad principles as a starting point, the next step is to assess what these developments might mean for portfolio positioning. From our perspective, these are some of the likely winners and losers assuming the backdrop just described comes to be.

Winners

Stocks jumped following the election, and in general they should continue to benefit from a more pro-business environment that helps corporate profits grow faster. However, there's been a large discrepancy in performance between the various sectors of the market, and that's likely to continue, too. Specifically, the Financial sector appears poised to outperform due to positive factors like a steeper yield curve and the prospect of less regulation. In addition, mid cap and small cap companies may outperform multinational large caps due to less foreign exposure in the event that tariffs or other trade impediments are enacted, and they may disproportionately benefit if corporate tax policy is reformed.

The U.S. dollar appears poised to continue rallying, with ramifications throughout the portfolio. Within equities, that would suggest favoring domestically oriented sectors and industries over globally exposed areas, and overweighting domestic equities at the expense of international equities (since a stronger dollar erodes the total returns of U.S. investors due to currency losses). Another option is to hedge the currency exposure in certain international markets.

Within fixed income, the winners are likely to be positions that are less sensitive to higher interest rates, including inflation-protected bonds, credit-sensitive sectors such as floating rate debt, and fixed income alternatives.

Losers

Traditional bonds stand to be one of the primary losers if interest rates begin to increase due to better growth and hotter inflation. In this scenario, we would likely reduce exposure to the most rate sensitive bonds like Treasuries and municipals. We wouldn't be keen to abandon them completely since they can still play an important role in a diversified portfolio, especially during periodic outbreaks of volatility in the equity market. Nevertheless, there's plenty of room to meaningfully reduce exposure relative to current positioning.

In addition, there are several sectors of the equity market that are very rate sensitive (such as Utilities and REITs) that would be likely candidates to underweight. If the dollar continues to appreciate, then international equities may suffer due to weaker currencies. And emerging markets could also come under renewed pressure from a stronger dollar after enjoying a rebound in 2016.

The Risk of a Hangover

While the roadmap of how to position over an intermediate timeframe appears to be coming into focus, the timing of fully transitioning the portfolio for a changing environment is more complicated. Quite simply, the market has been partying since November 9th, and we think it might be susceptible to a hangover as we enter the first quarter of 2017.

There are several reasons why the market might be due for a pause or a pullback soon. For starters, the moves since the election appear to be getting a little ahead of themselves. As mentioned earlier, investors are still lacking important details about future policies. It could very well be that the market is set up for some disappointment relative to current expectations when final agreements are reached. For example, the presumed size of a tax cut could be reduced in order to move it successfully through Congress.

There's also a question of timing, with plenty of pundits anticipating that the benefits of any fiscal stimulus will be felt more fully in 2018 rather than in 2017.

In addition, the moves that have occurred in interest rates, the dollar, and inflation expectations may result in some degree of financial tightening that actually causes growth to cool off after accelerating in the second half of last year. There's also the question of how the Federal Reserve will react to all of this. They have consistently pledged to proceed gradually in normalizing interest rates from very low levels, but if they begin to see signs that the economy is heating up, they may feel compelled to increase their pace of rate hikes, causing growth to choke off.

How to Position Now?

The investment team has been spending a considerable amount of time weighing the impact of the election for financial markets. There are several changes to the portfolios that we anticipate making based on longer-term roadmap we believe has emerged as a result of the election outcome. However, there are also some shorter-term risks to consider based on recent outsized moves in the markets. Therefore, the timing of the transition comes down to a matter of tactics.

After plenty of deliberation, we feel that the first quarter could present a more attractive opportunity to fully implement the changes that we'd like to make if some of the recent moves partially reverse themselves. We executed a few trades recently in order to begin the process and plan to remain patient and use any upcoming pullbacks to complete the process. While we don't anticipate making a significant change in overall risk considering the age of the business cycle and elevated valuations, we think there's plenty of room to make shifts within both our equity and fixed income holdings to take advantage of a changing environment.

Pinnacle's Three Dynamic Strategies

PRIME SERIES

Pinnacle's Prime Series offers investors an array of actively managed portfolios that are globally diversified and designed to provide market-like returns with less risk. Our Prime Series is comprised of five distinct options that include conservative portfolios that prioritize stability and income, moderate portfolios seeking a balance of stability and growth, and growth portfolios designed for appreciation and growth.

The Prime Series portfolios are managed by our experienced investment team to pursue value anywhere in the world—in any asset class—and evaluate opportunities using both qualitative judgment and quantitative tools. Our over-arching strategy is based on long-term economic themes where we build our portfolios in line with the strengths and weaknesses in the market. Our investment team evaluates the qualitative and quantitative data and adjusts our portfolios accordingly. These portfolios have been managed by our investment team since 2002 through all market cycles and have a GIPS verified track-record. The Prime Series should appeal to clients who want an active, tactical management strategy that blends the best of qualitative judgment and quantitative tools.

MARKET SERIES

Pinnacle's Market Series provides an investor with a globally diversified portfolio that is primarily managed with strategic asset allocation and complimented with tactical management in a smaller portion of the portfolio. The strategic holdings are low cost and efficient, and the satellite portion provides a way for the portfolio to increase return potential when markets are cheap, and dampen risk when markets are expensive or volatility increases.

The series offers three portfolios to investors: Conservative, Moderate, and Appreciation. The strategic allocation comprises 70% of the portfolio and is diversified across twelve asset classes that are systematically rebalanced to retain targeted allocations. The tactical allocation comprises 30% of the portfolio and consists of U.S. stocks and fixed income securities. The tactical satellite includes the flexibility to move between stocks, bonds, or cash, and rotates between them depending on market valuations and technical conditions. By combining both strategic and tactical strategies, the Market Series offers the benefits of both passive and active management.

QUANTITATIVE SERIES

The Pinnacle Quantitative Portfolio provides investors with an actively managed portfolio that uses a 'Core and Satellite' approach to combine tactical asset management and quantitative analysis. The Core strategy invests approximately 60% of the portfolio in our Dynamic Moderate Growth model, which strikes a balanced approach between capital appreciation and income. The Satellite strategy comprises about 40% of the portfolio and uses sophisticated quantitative analysis that leverages value and momentum data as it rotates equity sectors, bonds, and cash to balance growth and risk.

Our proprietary quantitative model evaluates current market conditions based on a set of valuation and technical indicators, and rotates the allocation between ten U.S. equity sectors and bonds or cash. This portfolio will appeal to clients who are looking for a heavily rules-based approach to investing and are willing to make aggressive allocation changes depending on market conditions.

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