Shorepoint
Capital Partners LLC

Identifying Opportunity.
Navigating Risk.

Newsletter – January 2017

MARKET TRENDS 12/31/2016

US Stock Markets	Q4	YTD
S&P 500 Index	3.8%	11.96%
S&P MidCap 400 Index	7.4%	20.7%
Russell 2000 Index	8.8%	21.3%
Int'l Stock Markets		
EAFE Index	-0.7%	1.0%
Emerging Mkts Index	-4.2%	11.2%
Fixed Income		
Barclays Intermediate Gov't/Credit Bond Index	-2.1%	2.1%
Barclays Capital Muni Bond 3 Year Index	-1.1%	0.1%
Commodities		
SPDR Gold Shares (NAV)	-12.4%	8.7%
Goldman Sachs Commodities	5.8%	11.4%
Real Estate		
Dow Jones US REIT Index	-3.1%	7.6%
Yields	**12/31/2016**	**12/31/2015**
6 Mo. US T-Bill	0.6%	0.5%
10 Yr UST	2.5%	2.3%

Sources: Total Returns from WSJ Market Data Group, Standard & Poor's, Barclays

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When The Unexpected Happens!

The fourth quarter was marked by a truly historic U.S. Presidential election that concluded with one of the most unexpected results in history. The majority of pollsters hypothesized that Hillary Clinton would defeat Donald Trump handily. In fact she did beat him in the popular vote, winning by over 2.5 million votes. However, in the all-important electoral college, Trump won convincingly by sweeping not only southern states such as N.C. and FL, but also by delivering in the depressed rust-belt - winning PA, MI, OH, and WI.

The point of this update and discussion is not political. We have all likely had more than enough of that corrosive diet from the 24 hour breaking news buffet, social media memes and diatribes, comedic skits and impersonations, as well as the estranging meals and parties with friends and relatives over the holidays. Instead, we will focus here on the investment and philosophical implications of this historic moment and describe what to us appears to be a classic case of contrarianism, a favorite theme of ours, writ large.

No One Knows!

Pollsters as a whole were incredibly and consistently wrong about this election. The overwhelming, pervasive inaccuracy of the pollsters raises two key points. First, we have been reminded how *unscientific* polling is by the amount of inference and extrapolation applied to data. Second, the widespread failure of pollsters and reporters to predict the results of this election accurately points to the danger of *group thinking;* as the grandfather of Contrarianism, Humphrey B. Neill, wrote, "When everyone thinks alike, everyone is likely to be wrong."

What Can We Learn?

Well, it's healthy to be skeptical, to question the experts, and to linger for a while in the differentiating between what is a *probability* and what is a *possibility*. Whether it's your investment advisor, C.P.A., weather anchor, your kid's teacher or your primary care doctor, we are all relying on probabilities and past data to project future outcomes. And day to day in any career, as the famed value investor, Jeremy Grantham has written, it is less risky to your livelihood if you are slightly wrong, but close to consensus, rather than wildly and individually wrong and out there on the margins. Self-preservation biases us to clump together.

If you have a predisposition to diabetes, your doctor tells you to exercise and adjust your diet, but the doctor doesn't spend all of his or her time only on diabetes prevention. After all, there are many other organs that need to be considered and myriad outcomes to explore. Over time we all seem

predisposed to hook into the *probabilities* of a result which exacerbates our neglect of what could happen, the *possibilities*.

In the end, we should understand that the effects of "group think" can color inferences and exaggerate what is *expected* while putting the *unexpected* under lower lights, despite the real possibility that the outlier result could really happen. The scary conclusion behind this analysis is that we are reminded again of something uncomfortable and timeless, that we are ultimately responsible for ourselves and that the world is unpredictable.

The blizzard of 1978 stranded school buses and motorists. People from Los Angeles lost money betting on the Rams ("the greatest show on turf") over our beloved Patriots led by a young Tom Brady. The specific ravages of the 2007-2009 financial crisis were mostly unexpected. Against all odds, Trump won.

So Financially, What Should We Do? Less Generally!

We would point out that the prediction game, while fun and endlessly alluring, receives too much time and emphasis. Just turn on CNBC for market forecasts, sports radio to hear Super Bowl predictions, or news stations with weather forecasts every 7 minutes. As a culture or a people, we are obsessed with guessing what the future will look like.

Although it registers deep in our humanity as considerably less sexy, why don't we exalt the power of counterpunching? It's a much more important skill to be able to take a hit and to react to changes and to be flexible. And we aren't espousing massive, knee jerk changes. For example, the widely held belief before the election was that a Trump win would instantly sink the markets. That was actually true but only *very briefly*, in the aftermarket hours in the overnight and early morning hours where trading can be wildly volatile and pricing erratic. By the time Trump had declared victory and the markets opened for normal trading, the decline was muted and a slow but long and powerful upside move occurred. Those that sold on the Trump win left serious gains on the table.

This may sound critical of professionals, but it's really not meant to be. What service does an economist really provide clients if he or she dwells on the possibility for a 2007-2009 market calamity which is a ***five*** standard deviation once in *70 year event*? It's much more likely the market will be up or down 10% in a given year so why not prepare for that?

Doing less is often more - if a good base of diversification is in place. As a long term investor, it's better to know thyself and to express it to your advisors and to have your posture reflected in your investment allocation. With that in place, more value is placed on careful, small changes instead of overhauls, which, to us are symptoms of the initial due diligence having been subpar. Know yourself, your clients and invest accordingly - with patience and restraint because that approach is undervalued compared to "big" market calls.

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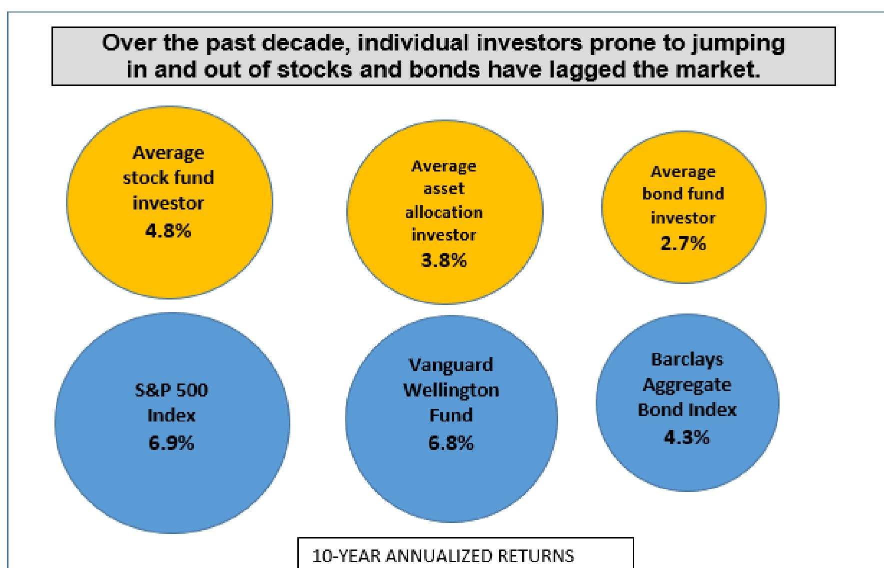
For the professional, a focus on the long term probabilities over possibilities can make one look foolish in the short term.

We need to realize that the improbable can happen. But looking foolish, not guessing at the future, and being a reactive counterpuncher (taking the Muhammad Ali "rope a dope approach") can still make you serious money over the long haul and prevent you from losing it - as the contrary outcome of this election illustrated in the short term just a couple of months ago.



Notes: *Average asset allocation investor holds stock, bonds, and cash. As of Nov. 30 2016* **Source:** *Morningstar*

Conclusion

The recent political/market events has led to two important observations:

- ***No one really knows what events are going to occur. AND,***
- ***No one knows what the financial markets reaction will be.***

So, what is it that we do know? The domestic economy is chugging along, although at a low level, with low inflation, improving housing starts, strong car sales, and attractive energy prices. As for the consumer, job growth and wage gains are robust, household debt service levels are historically low, and the University of Michigan's Index of Consumer Sentiment is the highest since January 2004. The surge in the domestic consumer optimism is likely a result of Trump's proposed policies, such as boosting domestic employment, cutting tax rates, raising infrastructure spending that will lead to stronger job and wage growth. The higher optimism could provide tailwinds to consumer spending and investments. For corporations, the likelihood of lower tax rates, the possible repatriation of trillions in cash held overseas, added infrastructure and consumer spending will increase earnings. The NFIB Small Business Optimism Index is at an 11 year high and we believe that mid and small caps could benefit significantly from a lower corporate tax rate.

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Obviously, there are several known and unknown risks that we must monitor and make adjustments for if prudent in the long term. The Federal Reserve will continue hiking short-term interest rates but this will be a result of an improving economy and rates still remain low by historical averages. The negative impact of the strong U.S. dollar may lessen earnings growth for companies. On the political front, the specter of a President using tweets, starting trade wars, etc. is unsettling to say the least. However, as we stated in our last newsletter, "*….major policy changes still require a coordination between the Administration and Congress. …, there is usually little to do as investors because there are too many variables to consider and frankly the long term timeframe we follow tends to wash away the significance of short term politics, even for the ultimate job in the country, if not the world."*

Although we are close to all-time highs on some domestic equity markets, the move up has been very narrow. As you can see by the following chart, since the election, financials, telecom, energy and industrial have been the major beneficiaries while healthcare, consumer staples, and technology have lagged. Also, international developed market equities continue to lag and emerging markets were down over 4% in fourth quarter. Bonds were especially weak especially U.S. Treasuries, high quality corporates and municipal bonds.

S&P 500 Sector	Election - 12/31/16	2016
Financials	12.22%	22.80%
Telecom Services	11.93%	23.49%
Energy	7.35%	27.36%
Industrials	4.96%	18.86%
Real Estate	4.39%	3.39%
S&P 500 Index	**3.82%**	**11.96%**
Materials	3.66%	16.69%
Consumer Discretionary	3.65%	6.03%
Utilities	3.57%	16.29%
Info Technology	1.47%	13.85%
Consumer Staples	0.16%	5.38%
Health Care	-2.12%	-2.69%

Source: Tamarac

Where does that lead us? As contrarians, we have added to dividend paying stocks especially the beaten down and vilified healthcare sector. We are also positive on technology, mid and small cap stocks and international equities. As for bonds, we continue to have a diversified allocation and think much of the anticipated interest rate hikes are factored into municipals, leverage loan funds, etc. Although a stock market correction (10% pullback) is not out of the question, we will use it, and normal day to day market volatility, to upgrade portfolios into higher quality companies that are attractively valued, with solid balance sheets and that are strong cash flow generators.

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