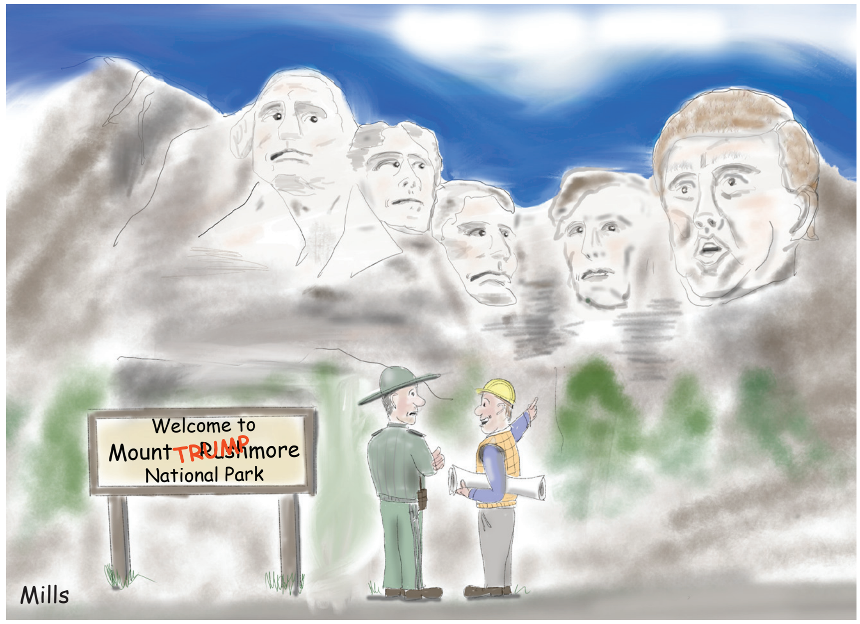
COUNTER POINT

The Quarterly Commentary of Jurika, Mills & Keifer LLC



"It was his top priority in making our infrastructure great again"

FIRST QUARTER:
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Summary:

- A Trump presidency, combined with other changes in the world creates a greater range of potential outcomes, both positive and negative.
- In near term, investors may be counting too many Trump chickens before they are hatched. Over longer term, some Trump policies should be positive for U.S. economy, but will also result in higher deficits.
- In a more fragmented world of winners and "losers," we like the U.S. more and rest of world less.
- Within U.S., we continue to like areas of higher growth like technology and biotechnology.
- With stocks and bonds expensive, we remain cautious but continue to balance investments targeted at areas of long-term growth with a core of defensive and alternative strategies, and a foundational base of bonds and cash.

The Future looks different…

The beginning of the year is usually marked with a host of predictions for what the new year will bring. Given how wrong most of the predictions for 2016 turned out to be, we are going to spare you any attempt to do so for 2017.

2016 was a humbling year for pollsters and market prognosticators, underscoring the perils of trying to predict the future and trying to second guess the stock market.

The year started out in a sour mood, with concerns about a global recession causing stocks, commodities and corporate bonds to fall sharply through the middle of February. Several market pundits proclaimed: "sell everything!"

And then the clouds parted and the sun came out and suddenly, things didn't look quite so bad. Markets bounced back strongly through the Spring, right up until the "Brexit" vote surprised the world. Financial markets immediately sold-off. Again, the pundits cautioned dark times ahead and advised investors to sell everything and hide under a rock.

But the world didn't end, the sun rose again the next day and the financial markets bounced back surprisingly quickly, before leveling off in the Fall, ahead of the U.S. election.

Like the Brexit vote, the outcome of the U.S. election seemed to be a foregone conclusion: Mrs. Clinton would win, and that would be fine for the markets and economy. After all, markets like stability and predictability, and Clinton was, if nothing else, predictable. Conversely, if Trump won, the experts were quite certain that markets would crash.

And they were right. For a very short while. Trump pulled off a startling upset, and the markets plunged, overnight, before rebounding sharply the following day. The US stock market finished the day over 1% higher and went on to add another 5% by year-end.

In fact, although it was a bumpy year for most asset classes, almost all asset classes ended the year higher than where they started, and many,

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significantly so. If you had been fortunate enough to spend the year on a tropical island without cable news, you would have likely done fine from an investment standpoint and spared yourself a lot of anxiety along the way.

So instead of making predictions, we thought it would be good to start the year by focusing on some valuable lessons learned in 2016 as well as over our many years of investing. We also thought it would be good to make a few observations on the significance of the Brexit vote, the Trump victory and other changes afoot on the geopolitical stage, as they have direct relevance to how we currently see the world and are structuring our clients' portfolios.

Lessons Learned:

Many years ago, we wrote a piece called ***"The Future Looks Different"*** in which we made several points that are as relevant today as ever.

The main point of the piece is that the future tends to unfold differently than we expect, and that our expectations about the future are very much informed by how we feel and about the present and recent past.

As humans, and investors, we tend to be linear-thinking creatures. We typically forecast the future by looking in the rearview mirror and extrapolating current trends forward, in a straight line, often to an irrational extreme. As a result, we often miss seeing the inevitable curves in the road that lie ahead until they are upon us.

In March of 2008, as oil price rose above $100 a barrel, industry analysts predicted that it could rise as high as $200. It peaked around $140 in June and by December it was selling at $30. Last year, as oil prices fell below $50 for the first time, some industry analysts thought it could fall below $20. “Sell all your energy stocks” they cried, “Oil may never see $40 again.” Today oil trades at over $53.00 a barrel.

Back in 1999, as stock prices moved ever higher, investors embraced the narrative that there was a “new economy” of “clicks and eyeballs” and that traditional valuation metrics, not to mention the laws of physics, no longer applied. The higher the market rose, the more investors embraced this *new* thinking. This practice worked until March of 2000 and when the laws of common sense and gravity were suddenly rediscovered. Like Wile E. Coyote, investors looked down and realized there was nothing holding up stock valuations but thin air. Stocks promptly tumbled back to Earth.

A corollary to the problem of linear thinking and extrapolation is that even if we correctly identify a trend or outcome, we may reach the wrong conclusion about the subsequent result of that outcome. Most people who correctly predicted that Brexit would happen or that Trump would win, also predicted that markets would subsequently fall. The widely expected outcome produced a completely opposite and unexpected result. After a brief sell-off, markets rose.

Another corollary to this problem is that we oversimplify. We think, “if A happens, then B will happen,” but fail to realize that if B happens, C and D might also happen, both of which will cancel out B. The world is a multidimensional puzzle and the chain of cause and effect is not always linear. A good example is in August 2011 when the debt rating on U.S. Treasury Bonds was downgraded by Moody’s. Common sense would dictate that if a bond is downgraded, investors will sell it and its price should fall. But in this case, after a brief sell-off, investors ending up *buying* Treasuries, despite the downgrade, causing prices to rise.

Sometimes we fail to expect the unexpected. It is rarely the thing that everybody is worried about that tends to get you, but the surprise from left field that nobody saw coming. Few people anticipated the horror of the 9-11 attacks nor their aftermath.

Few people saw the credit crisis until it was already upon us. They were having too much fun making money to notice the warning signs.

The course of human and economic development is punctuated by events from "left field." You could go back over decades of market history and find countless examples of surprises – some good *(the internet and the collapse of the Soviet Union)*, some bad *(September 11th, and the credit crisis)* - that immediately forced a material change in our assumptions about the future. Although these events are difficult to anticipate, they are often significant and one should always anticipate that they will occur.

And finally, we fail to realize that just as things can go wrong, they also can go right. Problems typically beget solutions, especially when a lot of people have an interest in solving them. The credit crisis was a scary time, but investors had already priced a lot of negatives and very few positives into asset prices. Stock prices therefore reflected almost everything that could go wrong, and very little that could go right.

Although it is easier to sound smart by being a pessimist and pointing out all the reasons why things are bad, it is a far better investment strategy to be an optimist. We don't know a lot of wealthy pessimists or market timers. We do know a lot of wealthy optimists. It is human nature to want to move forward and to make things better and this is why economies tend to grow over time. Although market strategists may like to argue that the economic glass is half empty, consumers and businesses don't waste time on empty exercises. They just go out and get more water.

This is why it doesn't make sense to try to time the stock market. It is too unpredictable in the short term.

It is, however, wonderfully predictable over the long-term. Just as economies have a strong tendency to grow, markets have a strong tendency to rise over time. It therefore makes sense to invest with a long-term strategy that allows you to capitalize on this growth while tolerating the inevitable turbulence that one encounters along the way.

This is also why it is important to diversify your portfolio among asset classes and investments, even if counter to how you may look at the world today. The chances are high that your perspective about the world, economy and markets will evolve and change over time. The future tends to unfold differently than conventional expectation.

Current Outlook: The Natives are Restless

These lessons provide a good filter for looking at the world today, most notably in the wake of the U.S. presidential election. They serve as a reminder not to get too invested in any one set of expectations or outcomes.

As we wrote on November 9th, there are a number of areas where we will likely see policy changes. Some of these should be positive for economic growth, some could be negative, and some are complete unknowns.

Among the positives are tax reform, regulatory reform and fiscal spending. Among the negatives are inflation, trade policy, immigration policy, environmental policy, and foreign policy. Among the unknowns are healthcare and Trump himself. He is the ultimate wild card and it remains to be seen whether he will be effective or, in his own words, "a disaster."

Tax Reform: Under President Trump, corporate and individual taxes are likely to decrease. There should also be a "tax holiday" to allow companies with large cash hordes overseas to repatriate them into the United States. Tax reform, especially corporate tax reform, would be a positive for the U.S. economy and markets, and this should be a top priority for the new administration as it results in an immediate benefit to companies and consumers.

Regulatory Reform: We also expect to see a meaningful reduction in the amount of regulations, primarily on businesses. Fewer regulations should help to foster economic growth, especially among smaller companies, but can also lead to some bad behavior among companies.

Fiscal Spending: There is broad consensus among Republicans and Democrats that U.S. infrastructure is in desperate need of repair and renewal, and there has been talk about setting up a large infrastructure spending bill towards this end. But not everyone feels this way, including a block of staunch fiscal conservatives within the Republican Party who want to see deficits shrink rather than expand. We think something will get passed, but well short of the trillion dollar figure that some have thrown around. It will take several years for any of the projects to become "shovel ready" and for dollars to actually flow into the economy.

Trade: It seems clear that trade policy under Trump is likely to be more restrictive than the status quo. This tendency parallels similar tendencies towards protectionism elsewhere in the world. This is a mixed blessing. Many U.S. companies are multinational and do business all over the world. Moreover, as consumers, we benefit from inexpensive imports from other nations. A move towards greater protectionism will likely slow overall economic growth, increase prices and do little to create new jobs in the U.S. Our expectation is that Trump will be less protectionist in practice than his rhetoric suggests.

Healthcare: Trump and Republicans have spoken repeatedly about repealing the Affordable Care Act on day one. This is more easily said than done, given the significant consequences of having no alternative plan to fall back upon. In the near-term, we expect healthcare will be a volatile space in which to invest, but a very attractive area for long-term investment.

Immigration: Contrary to political rhetoric and conventional wisdom, the U.S. actually needs immigration, especially of skilled workers, to offset a gradually declining labor force. The stated Trump immigration policy is a negative for economic growth.

Inflation: With increased fiscal spending, tighter immigration and trade barriers, we would expect any increase in economic growth to result in higher inflation, especially in wages.

Thoughts about the World:

We wanted to conclude by making a few points about larger trends that we see playing out in the world, particularly with respect to globalization, demographics and technology. They merit a larger discussion in another Commentary but are worth noting briefly now.

Since World War II, and in particular over the last 20-30 years, globalization has been a powerful force binding countries closer and closer together through immigration, trade and multilateral agreements. The fall of the Soviet Union and the formation of the European Union and common currency were major milestones in this process. Much of this globalization had an American stamp on it and, as Ian Bremmer of the Eurasia Group argues, for decades, *Globalization* and *Americanization* were largely synonymous. But not any longer.

Recently, the direction and character of globalization has changed. Global economies are continuing to grow, but the U.S. is in retrenchment as a hegemonic global leader. The European Union is cracking at the seams as countries try to assert their national priorities over the collective whole. There has been a rise in populism and nationalism around the developed world, and a growing antipathy towards immigration. The natives are restless and the politicians are nervous. Other than Angela Merkel, much of the leadership of the major G10 Countries will be completely new next year. Meanwhile China is continuing to invest and exert its influence around the world. ***We seem to be entering a period where it is every country for itself.***

The United States is particularly well positioned to survive, if not thrive in this type of environment given that we are economically strong, militarily powerful and not overly reliant on other countries for trade. We are almost self-sufficient from a standpoint of food and energy and other natural resources. Other countries and regions are less well suited to thrive in a more fragmented global economy.

Demographics are also creating large new economic and political currents. The populations of the developed world are aging, and as they retire, there are fewer workers to support them and provide for their healthcare and welfare.

Finally, technology is reshaping the landscape of industry after industry, producing many wonderful new products and capabilities, but also displacing workers, trades or even entire industries.

These factors are important for at least two reasons. First, because they are likely to endure, especially under a Trump administration. Second, because they suggest a more fragmented and challenging global economic environment marked less by a rising tide that lifts all boats, but by a world of winners and losers.

Current Investment Strategy:

In the wake of Trump's win, and the prospect of a more favorable environment for economic growth and the stock market, investors have plowed back into stocks, especially in the U.S.

This makes sense, but as we noted above, investors should be careful about maintaining a grounded and balanced perspective.

Currently, investors seem more focused on what can go right more than what can go wrong and are likely counting their Trump chickens prematurely.

Not everything that Trump and the Republicans have promised will happen right away, if at all, and not everything will turn out as expected. Under normal conditions, the political process remains messy and cumbersome and the chain of cause and effect is rife with hazards and unintended consequences.

Under Trump, there is a greater range of outcomes, both positive and negative for the global economy and markets. We certainly expect more volatility.

In a more fragmented world of winners and losers, we like the U.S. more than the rest of the world, despite higher valuations. It is stronger and better positioned and less vulnerable to geopolitical risks. We have therefore trimmed non-U.S. positions in favor of greater U.S. stock exposure.

Within the U.S., we continue to emphasize areas of higher long-term growth such as technology and biotechnology. These sectors have underperformed since the election but offer the most compelling combination of valuation and potential appreciation.

Overall both bonds and stocks look expensive, especially longer maturity government bonds that are vulnerable to rising interest rates. We have therefore increased exposure to the defensive equity and alternative strategies that can endure and even capitalize on market turbulence and price disparities.

As always, we focus and invest for the long-term, balancing diversified investments focused on areas of long-term growth and innovation with more defensive equity, alternative and bond strategies to mitigate volatility and risk.

We thank you for your ongoing interest and welcome your questions and comments.

Jurika, Mills & Keifer, LLC
January, 2017

Jurika, Mills & Keifer is a private wealth management firm serving a select group of individuals and families.

Our firm is built on a core set of values and investment principles that have been central to our identity and success for over 30 years.

Our objective is to preserve and build the purchasing power of our clients' capital over time through forward-looking investment management and smart financial planning and counsel.

Our offices are in San Francisco, California. We welcome your inquiries.

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