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QtrNotes

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Financial Planning Alerts for 2017:

Maximum annual contribution levels for profit-sharing and retirement plans will increase to $54,000, or $60,000 if you are over 50. IRA and 401(k) contribution limits do not change.

The new limit for the estate tax will be $5.49 million, with the likelihood that the tax may be greatly revised or repealed. We are cautioning clients against doing any aggressive estate tax planning until there is more clarity about future policy.

Quotes:

Ask five economists and you'll get five different answers – six, if one went to Harvard.

Edgar Fiedler, economist

People don't realize that we cannot forecast the future.

Alan Greenspan

2016: A Year of Surprises

The year 2016 began with the worst stock market month on record: after a year of mediocre returns in 2015 and the first interest rate hike in years, the S&P fell by over 11% in the first 28 trading days of the new year, hitting bottom on February 11th. Corporate earnings were weak, China's economy was slowing, energy prices had cratered, and investors feared a potential recession.

Despite lack of confidence and fear of the unknown, equity markets across the world climbed fitfully back from the early rout and all looked well – until the middle of June. Britain stunned the world with its vote to leave the European Union, and global financial markets panicked in the day that followed. The resulting sell-off was swift and intense – and lasted barely two full days, before markets rebounded to previous levels.

On the evening of November 8th, the world witnessed a major upset as Donald Trump surprised nearly every pollster. Asian markets tanked first on the news, then European, and US markets started the next day deep in the red. But by noon the same day, some calm had set in: markets recovered and have rallied nicely since.

In other notable events of 2016, the US dollar climbed to new heights against many foreign currencies; corruption charges resulted in a presidential impeachment in South Korea and a resignation in Brazil; nearly 50 years of war ended as Colombia paved a pathway to peace with the FARC guerillas; an American President visited Cuba for the first time in 88 years; and Fidel Castro died, an event that resonates especially deeply in Florida.

2016 was full of surprises, and will go down in history as a rise in populist and nationalistic politics. But despite massive turmoil along the way, investors who were able to block out the noise and headlines enjoyed positive returns in almost every asset class this year.

Index	*12/31/2016*	*YTD*
Dow Industrials	**19,762.60**	**13.4%**
S&P 500 Index	**2,238.83**	**9.5%**
Russell 2000	**1,357.13**	**19.5%**
MSCI EAFE	**1,684.00**	**-1.9%**
Global Bond Index	**451.35**	**2.1%**
10-Year Treasury yld	**2.45%**	

Looking Ahead

With the inauguration only three weeks away, we're witnessing the transition to a Trump presidency with much fanfare and many tweets. We can only speculate on future economic policy. But with past presidencies, policy as implemented has inevitably proved to be much tamer than the campaign rhetoric.

Here are some of the most probable early initiatives: corporate tax rates are likely to fall from 35% to the mid-20% range. Owners of LLCs and S Corporations expect to see a partial benefit on their pass-through income. Personal income tax brackets will likely be consolidated, with the top marginal rate dropping from 39.6% to 35%. High earners expect an end to the 3.8% surcharge tax on unearned income. More money in consumers' pockets should support higher consumer spending, while corporate profits will benefit from higher sales and lower taxes. We've seen an uptick in consumer confidence and increased expectations for corporate earnings.

Lower taxes might seem like a panacea for growth, but it's not that simple. Government spending accounts for over 20% of US GDP: if the government collects fewer tax dollars, it won't be able to afford to continue spending at the same rate without increasing the deficit. To pay for tax cuts, the administration hopes to rely on faster economic growth, as well as cuts to "non-essential" government programs. The extent to which growth may accelerate, or the degree to

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FIRESTONE CAPITAL MANAGEMENT

Safety in Numbers: Dark Clouds

Google Drive, iCloud, OneDrive, etc.: even as hard drives get bigger, we're urged to skip it all and store everything on commercial servers accessed through the internet: the Cloud.

But is it safe?

The short answer is, inevitably, "No." The more useful answer is, "What do you mean by 'safe'?"

Is the information you're storing sensitive? (A photo of your cat versus your driver's license.)

Is it your only copy? (Imagine if the last photo of a loved one was saved to the cloud – and nowhere else.)

Will it be a problem if it is copied, re-used by strangers, manipulated, distributed? (A photo of your cat versus one of your child.)

Who has your data? Some firms have fairly good reputations for keeping files secure; some of those reputations are well-earned. The biggest firms have more resources to keep things secure, but they're also the biggest targets for hackers.

Is it encrypted? Is your account locked with a password – a good, strong, unique one?

Cloud storage can be invaluable, as long as it's approached with care.

The Year Ahead

(cont'd from page 1)

which government programs will be cut, remains to be seen. Deficits are likely to increase, and inflation as well. In our base case, we anticipate inflation-adjusted real economic growth will near 3% in the year ahead.

After eight years of holding rates at near zero, the Federal Reserve has finally started to raise interest rates, a development that we expect to accelerate in the coming year following on the other proposed policy changes.

The other large policy mandate is to bring back manufacturing jobs to the US. Reactions range from excitement about a manufacturing renaissance to fears of trade wars. The reality is likely to fall somewhere in between: we expect to see some tough talk on trade, which could lead to a combination of import tariffs and tax incentives for domestic production. The good news is that some jobs may be preserved and wages may increase. The bad news is that inflation will likely increase as imports and labor costs go up. The US economy is part of an interconnected global supply chain, and that won't change. Countries such as China and Mexico will remain major trading partners with the US.

The president-elect has proposed a trillion-dollar package to repair our aging infrastructure. We expect the conservative Congress will balk at the cost and deliver a smaller deal. Whatever is announced will help job creation, promote wage growth, and boost demand for commodities and services. This is good news for companies around the world.

We are cautious in our positioning. Certain policies appear likely to boost stock prices, and some could cause markets to pause or retreat. We can speculate, but we don't know what will transpire or how markets will react. History teaches us that the best course of action, calculated risk-taking within a diversified portfolio, leads to long-term gains.

The economic future is always uncertain; without a crystal ball, we look at valuation measures to help us see where the markets may be headed. Where are valuations today?

The Dow and the S&P 500 are at record highs, but a better measure is the price an investor is willing to pay for a company's immediate future income, known as the price-to-earnings or P/E ratio. The S&P 500's P/E ratio based on next year's projected earnings, is 17, only slightly higher than the 25-year historical average of 15.9. This suggests that, relative to future growth expectations, the market is reasonably priced.

But the P/E ratio is only one of several different ways to measure the market. The Schiller P/E ratio, which is based on 10-year earnings, currently stands at 28.1, which is 68.3% higher than the historical average. Historically, none of these measures have been consistently useful gauges for market timing: we repeat, none of them.

By most measures, the markets are somewhat above average valuations today. Because of this, we have tempered our long-term return outlook for stocks to mid to high single digits, as opposed to the double-digit forecasts touted by some economists.

We'll never have all the information we want, because we invest in and for an essentially unknowable future. The markets are performing well at present, and confidence is improving; for now, we should take that at face value. We don't see signs of euphoria yet, and argue that investors should continue to take the long view.

A New Look for the Firestone Portal

Many of our clients are already using the Firestone client portal, accessible through our website at firestonecapital.com. Working with our software partners, we have refined and greatly improved the online experience for Firestone clients wishing to stay on top of their financial picture.

The new user interface allows you to monitor your account performance and transaction activity, share and store documents, review market action, and even create a picture of your overall net worth. We look forward to working with you to make sure you get the most from your new portal.

As a security measure, portals are subject to deactivation if you have not logged in within the last year. If you need to reactivate your portal or want to establish new access, please let us know.