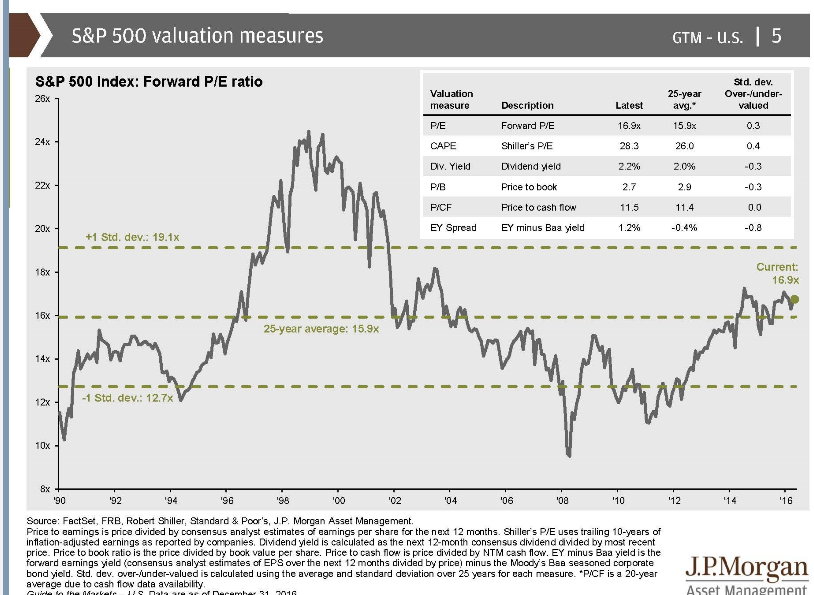
MEDALLION WEALTH MANAGEMENT

Where Trust is Earned

YEAR END QUARTER COMMENTARY — DECEMBER 31, 2016

2016 was nothing, if not unpredictable. We opened the year with one of the most negative six weeks on record. Through February 11 the S&P 500 was down ten percent, the Barclay's US Long-term Treasury Index was up ten percent and the price of West Texas Intermediate crude was at a ten year low. Recession concerns were running high and in their 2015 year-end forecast the Federal Reserve had indicated they expected to raise interest rates four times in 2016. On February 12 it was revealed that JP Morgan CEO, Jamie Dimon had purchase $27 million of his company's stock. Market psychology changed almost overnight and it became apparent that with all the global turmoil, the Feb was unlikely to be as aggressive in raising rates as the December forecast indicated. Stock prices suffered their second significant correction with the shocking Brexit vote on June 23 when the UK voted to leave the European Union. In two days the S&P 500 dropped 5.3%, the British pound hit a 31-year low and the yield on the 10-year US Treasury fell to its lowest level since 1962. US stocks, however quickly recovered as it became clear that it would take several years to implement the changes necessary to exit the EU and the significant decline in the Pound made the UK economy more resilient and globally competitive. Finally, we held the biggest political surprise for last. If the Brexit vote wasn't enough of a blow to the credibility of the pundits and pollsters, the presidential election victory of Donald Trump on November 8 caught the US and global political world completely flat-footed. The markets, on the other hand, not so much. Although the Dow Jones Industrial Index futures were down as much as 800 points overnight, by the time the markets opened at 9:30 AM November 9, it had recovered most of the pre-market loss and moved into positive territory by lunch-time. We now refer to the market action since the election as the "Trump Rally". The S&P 500 is up 4.6% from Election Day to year-end and the yield on the 10-year T-Note has almost doubled from the Brexit low, in anticipation of more robust economic growth. Timing is everything. Although Trump gets a lot of the credit, the fact is that some of the change in trend had begun before November 8. Market leadership had shifted from bond proxies to more cyclical Value oriented stocks and the S&P 500 Financial index had moved to a near five-year high by December.

S & P 500 Index



Equity Valuations are not yet extreme.

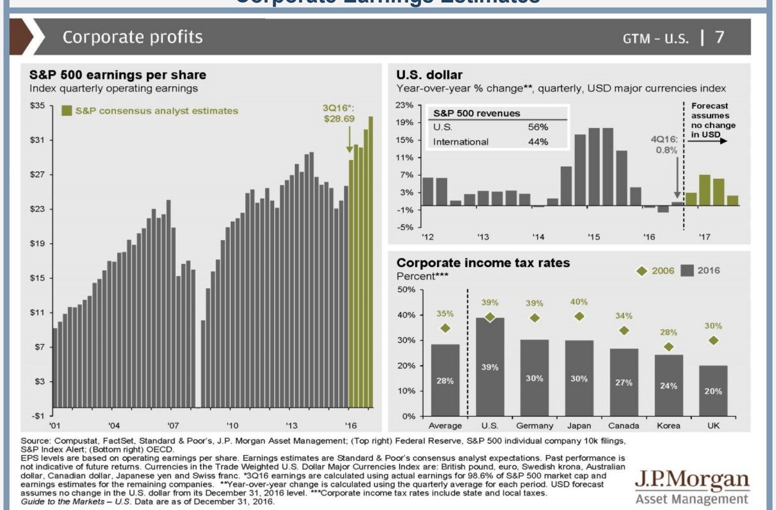
In a pure play world, US stock indexes generated handsome returns in 2016. The large-cap, blue chip Dow Jones Industrial Index returned 13.42 percent and on a total return basis, the S&P 500 returned 11.96%. Technology suffered slightly with the tech-heavy NASDAQ returning 7.50% and developed international returned just 1.50 percent for the year, according to the Morgan Stanley; Europe, Australia and Far East Index. Bonds had one of their least positive years with the Barclays Aggregate Index returning 2.65% and the T-Bond Index returning 1.33 percent. Things were relatively more disparate when looking at just the fourth quarter. The DJIA returned 7.9 percent for the quarter and developed international did nearly as well at a positive 7.07 percent. Technology continued to lag behind the more value driven sectors as the NASDAQ generated a somewhat meager 1.34 percent and the strong dollar hurt Emerging Market returns to the tune of a negative (1.44) percent. Fixed income suffered through one of their worst quarters in many decades. The Barclays Agg had a negative (2.98) percent for the quarter and the T-Bond Index had a negative (11.67) percent. Dissecting US equity returns, there was considerable dispersion between Growth versus Value and Large versus Small for the full year and the quarter. According to the S&P Indexes for the year Large Growth returned 6.89% versus 17.40% for Large Value and Small Growth 22.16% versus Small Value at 31.32%. For the quarter, again we saw significant differences with Large Growth at 0.48% and Large Value at 7.35%. Small Growth lagged Value at 9.66% against 12.60 for Value. Drilling down, we see that value benefitted from the returns of energy and financial stocks with annual returns of 23.65% and 18.64%, respectively. Sector performance detractors for the year were Healthcare and the bond proxies Consumer Staples and Discretionary with a negative (4.36%) and positive returns of 2.58% and 4.32%, respectively. Quarterly returns yielded similar type results; Financials up 20.48%, Energy up 6.56% and Healthcare negative (4.42%), Staples down (2.7%) and Real Estate down (5.27%).

2605 Nicholson Road, Suite 2103
Sewickley, PA 15143
724-934-8600

As we begin the new quarter, new-year and new administration we thought we would share some of our expectations for a possible agenda for the Trump Administration and their ramifications. We believe one of the first actions a President Trump will take will be to reverse many of the executive orders imposed by his predecessor. This looks to be the proverbial low hanging fruit. They were put in place without Congressional action and they can be repealed without Congressional action. And Trump spoke of doing this many times on the campaign trail. In the energy sector alone, there is as much as $48B of stalled energy projects due to climate change rules. The Keystone and Dakota Access pipelines represent about $13.8B in private capital spending that could be released almost immediately. While not all are executive orders, they can be reversed with 51 votes in the Senate. Hilary Clinton spoke of a $50B infrastructure spending initiative financed by taxpayers. Almost all of the energy infrastructure spending is private capital that is truly “shovel ready.”

Two other issues likely to have high priorities and are likely to be pursued concurrently are tax reform and repeal and replacement of the Affordable Care Act (ACA). Both, especially the ACA were high profile issues during the campaign and the proposed cabinet secretary appointment has very specific credentials for his department. Representative Tom Price is Trump’s pick for Secretary of Health and Human Services. He spent 20 years as an orthopedist in Atlanta, is chairman of the House Budget Committee, is a leading critic of the Affordable Care Act and has been the architect of several Republican proposals to replace the ACA. He is also a good friend of Vice President-elect Mike Pence and House Speaker Paul Ryan. Tax reform is an issue that could move one of two ways. There is talk about reducing corporate tax rates in the first 100 days of the administration. Tax rate reduction is relatively quick and easy process. However, many Republicans in Congress have been talking about tax reform, which is something very different. True tax reform has only been accomplished once in the past 100 years and is very time consuming. If the Republicans use budget reconciliation to make changes to the code, they have to be budget neutral or positive or any changes will expire in five years. Hardly worth the work without the revenue. One possible solution mentioned has been the concept of border adjustability. Under this process imports are taxed and exports are exempt from tax. It is estimated that this could raise an additional $1 trillion in revenue, as well as using dynamic scoring in the budget. This is the process of using assumed economic growth from proposed changes and the concomitant taxes derived from that activity. As much as an overhaul of the tax code might be welcome, it remains to be seen if there is the political will and staying power to get it accomplished. It is interesting that companies with less international exposure and small cap stocks have been outperforming the broader equity market.

Corporate Earnings Estimates



Accelerating earnings growth can support valuations.

Also, look for news on trade and a Supreme Court nomination. The US is likely to withdraw from the Trans-Pacific Partnership and pursue a policy of bi-lateral negotiations with individual countries across the region. We would expect a renegotiation of NAFTA and additional pressure on China to support their currency. Any Supreme Court nominee still requires a 60 vote majority in the Senate so some Democratic votes will be necessary. After the snubbing of President Obama’s nominee, Merrick Garland, the Democratic leadership is very anxious to stake a position against almost anyone the Trump administration proposes. It will be interesting to see just how much political capital a President Trump is willing to use in this fight.