The Investment Counsel Company
Investment Management Consultants

Quarterly Insights January 2017

The Investment Counsel Company's Quarterly Insights is intended to provide our perspective on current economic conditions in order to help those we care about improve as successful investors.

There was no shortage of drama within financial markets during last year. The Standard and Poor's 500 Index produced its worst start to a year on record, falling 10% by early February. Concerns about China's deteriorating rate of economic growth, the collapse of oil prices, and an increasing probability of a global recession indicated by negative foreign interest rates, quickly resulted in high investor anxiety. The broad U.S. stock market surprised most investors by shaking off these and other geopolitical shocks in 2016.

Clearly, the media and investors alike were not prepared for Britain's departure from the European Union (Brexit), a Trump presidential victory, or the financial markets' reaction to such events. Some believe that the best lesson from last year was that establishing a contrarian view, by avoiding investor consensus and the media, can lead to outsized profits. We agree with Wall Street Journal columnist, and writer of "The Intelligent Investor" column, Jason Zweig's views. He writes, "If all you learned from the stunning surprises in 2016 is that the unexpected will happen, you haven't learned nearly enough."

The year's most significant moves in financial markets contradicted conventional wisdom. Zweig states, "This past year showed how tightly most of us cling to our preconceived notions, how fiercely we resist evidence that we might be wrong and how adept we are at deceiving ourselves into thinking we were right." Many investors strengthened their conviction of a Hillary Clinton win with every media sound bite. And how many investors were convinced that a Trump win would automatically result in financial market chaos? Yet the S&P 500 rallied more than 5% after his election. "Investors often wall themselves off from new information that could threaten their views", he explains. "That is why to be a good investor you have to be right much of the time, but to be a great investor, you have to recognize how often you may be wrong."

While U.S. equity markets advanced instantly in response to the U.S. presidential election, other unforeseen consequences included the equally rapid rise of our nation's currency to an all-time high against the Euro and interest rates nearly doubling for the U.S. Ten-Year Treasury Note. These two related factors resulted in bonds giving back earlier gains, which offset the strong stock returns for those with diversified portfolios. Similarly, foreign financial markets also gave back some gains earned earlier in the year due to weakening currencies relative to the stronger U.S. Dollar.

The U.S. stock market has already responded to anticipated friendlier business policies such as deregulation, tax cuts, infrastructure spending, relaxing constraints in national defense budget spending and other promises under the new President. Undoubtedly, the overriding question for 2017 is whether, and to what degree, those elevated expectations will be met? Should reality prove disappointing, the market could be vulnerable later in the year. The S&P 500 Index is now trading at 19 times last year's earnings, a level clearly above the historical median but not unreasonably high in light of continued economic expansion given that improvement in corporate earnings can further support higher stock prices. Fortunately, stronger earnings in 2017 should be comparatively easier with energy companies no longer a drag since returning to profitability. Due to elevated stock valuations, it is reasonable to expect share prices may rise a bit slower than profits.

Economists feel the current improving economic momentum can be expected to carry forward into the second half of 2017 and into 2018. Wall Street is forecasting relatively strong earnings growth for S&P 500 companies in 2017. However, in recent years, such predictions have been continuously cut back. Therefore, a more conservative forecast for earnings growth and S&P 500 returns is to be expected. Additionally, there is sufficient evidence to remain constructive on emerging markets, with expectations to continue resuming their outperformance versus other global stock markets. Large and unprecedented Chinese investments and liquidity into Indonesia, Malaysia, Thailand, and Pakistan can be expected to offset many of the risks to the region. Known challenges include higher U.S. interest rates, a more protectionist stance on trade policy in core economies, especially the U.S., and the global growth risk if a worst-case scenario for Brexit materializes.

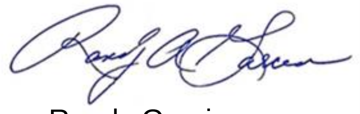
Many economic forecasters are looking for the U.S. Federal Reserve to raise interest rates three or more times in 2017. The more conservative outlook is for two 0.25% hikes this year. Since interest rates have already increased quickly in the U.S., there is a decent likelihood that they will remain in the current range for the near-term. Furthermore, differences in economic and monetary policies between other countries and the U.S. should continue to influence relative bond market performance in 2017. Evidence indicates sluggish global economies may constrain upward pressure on U.S. rising interest rates.

A realistic forecast is for 2017 to be a decent year for stocks and modest yet profitable for bonds. Headwinds to the growth outlook include trade protectionism, stronger U.S. dollar, higher interest rates, and possible deterioration in the global geopolitical and economic climate. While it is important to establish and support an investment view, prudent and profitable portfolio construction requires vigilant attention to addressing financial market knowns and unknowns in order to construct an effectively diversified portfolio.

We appreciate the opportunity to express these views and sincerely hope that you find value in this perspective. Every team member of The Investment Counsel Company remains steadfast in our firm's commitment to providing our maximum effort in striving toward the absolute finest experience to our valued clients.

On behalf of our staff, we wish that the New Year brings health, happiness, and continued prosperity to you and your family.

Sincerely,



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Chief Executive Officer

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