



2017

Market Forecast

United States

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U.S. Market: Large Cap (DOW/S&P 500®)

The U.S. market is segmented many different ways. It is segmented by capitalization, sectors and industry groups. In the first three sections of this report we will be examining the market according to capitalization: Large, Mid and Small. The Large Cap market has traditionally been represented by the Dow Industrials and the S&P500®. The Dow is the most common and most used when discussing the market.

There are many advocates that prefer one of the representative benchmarks over the other but, in the end, after exhaustive statistical comparisons,

the 10 year average. This will place the Dow at 7.14% return. There is a high range of 23232 and a low of 20115.

If the high range is reached the market will return 12.5% and if the low side of the forecast is reached the return will essentially be flat.

The same level of returns are expected in the S&P500 index but, the numbers are different because the benchmark starts from a different base. In Figure 2 we have shown the index fund known as an iShare that carries the ticker (IVV). This is a security that every investor can buy just like a stock security.

The return expected is nearly the same as for the

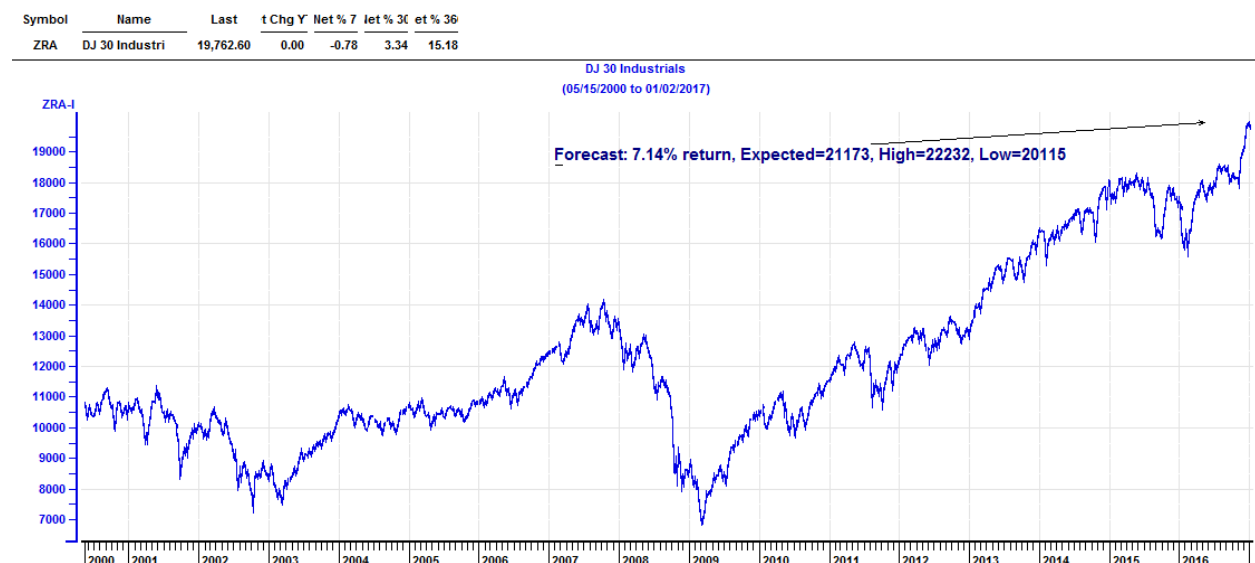


Figure 1: Forecast for Dow Industrials Index 2017

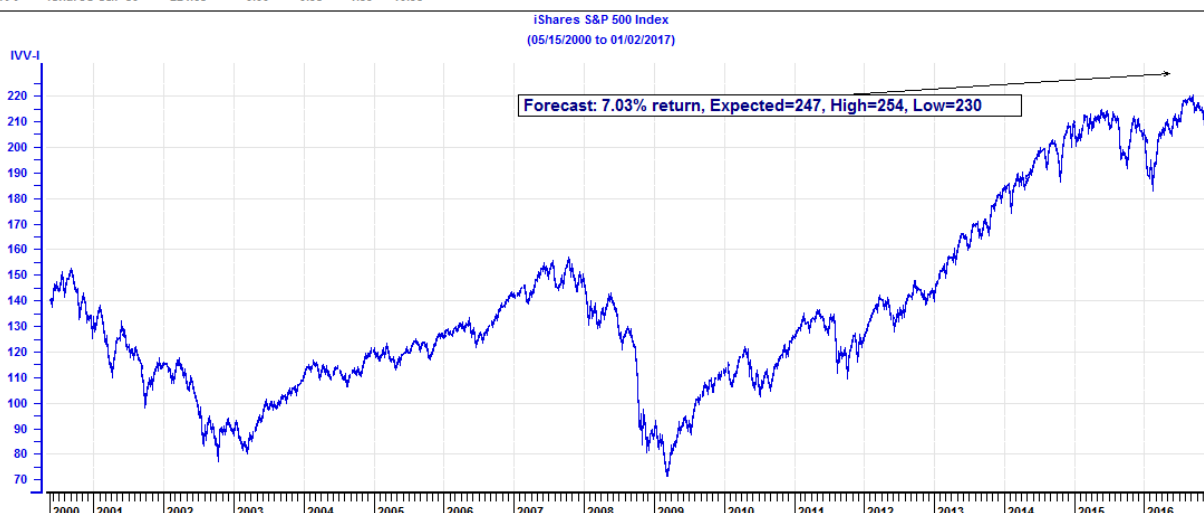
there is very little difference between the two when it comes to measuring the market over time. In our Economic Forecast 2017 we provide detail on our expectations and given our view the Dow should perform just slightly lower than

Dow at 7.03%. The high expectation is at 254 representing a 12.4% return and the low side is expected at 230, representing a 1.8% return in the market.

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Symbol	Name	Last	t Chg Y	Net % 7	let % 30	et % 36
IVV	iShares S&P 50	224.65	0.00	-0.95	1.39	10.98

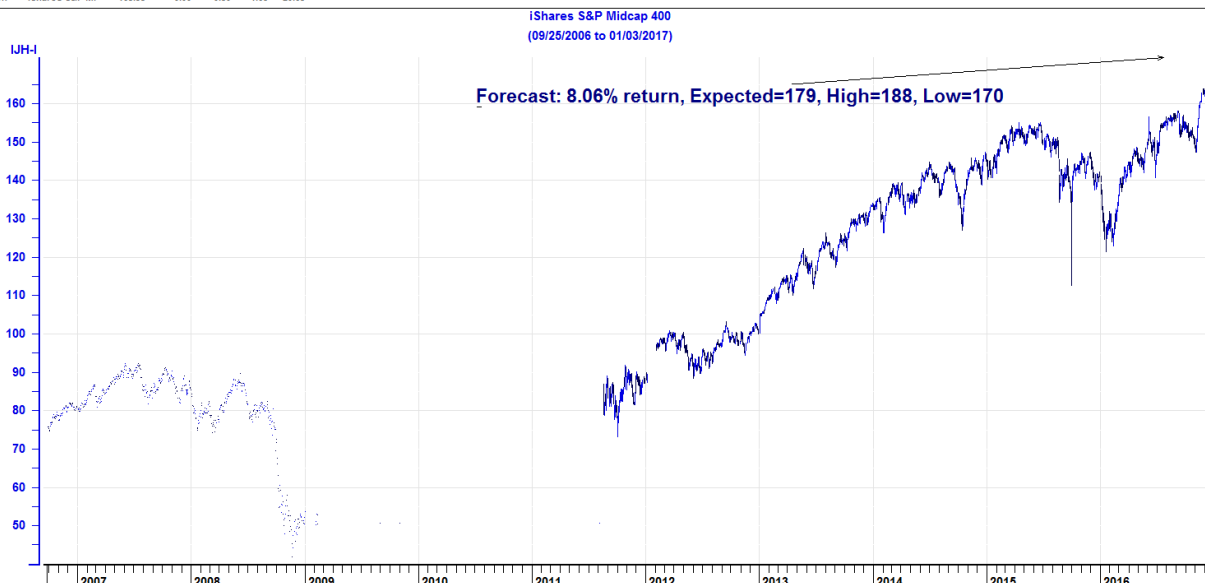


U.S. Market: Mid Cap (S&P 400®)

The Mid Cap index has not been around as long as the large Cap index (500) but is the most followed mid cap index in existence. To be considered for inclusion in the index a company must have a market capitalization of at least \$1.8 billion, but not more than \$5.9 billion at the time of inclusion.

The Mid Cap market overall is 11.5% above fair value with stocks in the Mid Cap Financials sector leading the way at 24% above fair value (124%FV). Mid Cap Utilities is also well above fair value at 122%FV, but has been much higher throughout 2016 as investors sought investment income.

Symbol	Name	Last	t Chg Y	Net % 7	let % 30	et % 36
IJH	iShares S&P Mi	165.35	0.00	-0.50	1.68	20.65





All of the Mid cap sectors are above 100%FV except Consumer Staples at 93%FV. The next most fairly valued sector is Telecommunication Services at 102%FV.

The Mid Cap part of the domestic market will perform a bit better than the large Cap area. We expect Mid Cap stocks to increase 8.06% for the year. This is a bit under their long-term average of 8.66% but, a respectable performance. Using the iShare index fund family IJH as a benchmark would place the security at 179 by year-end. The high side is at 188 and a lower side at 170 representing 13.3% and 2.7%, respectively.

U.S. Market: Small Cap (S&P 600®)

The Small Cap index picks up where the Mid Cap index leaves off and incorporates stocks that are no more than \$1.8 billion in market

capitalization when they are included, but at least \$400 million.

The category is overvalued at the current time by 13.2% with Small Cap Financials and Small Cap Materials being the highest above fair value. In fact, all of the Small Cap sectors are at, or above, fair value. Small Cap Materials has reached 125.8%FV along with Small Cap Financials; both are at exactly the same level of valuation.

On the lower side, Small Cap Health Care takes the lead at 99.9%FV followed up by Small Cap Consumer Discretion at 101.7%FV. It is not surprising that nearly the entire category is near or above 100%FV given the recent run to the upside.

Figure 4 shows the history of the index and our forecast. We expect the small cap category to take a pause and let earnings catch up to expectations. The category will experience a

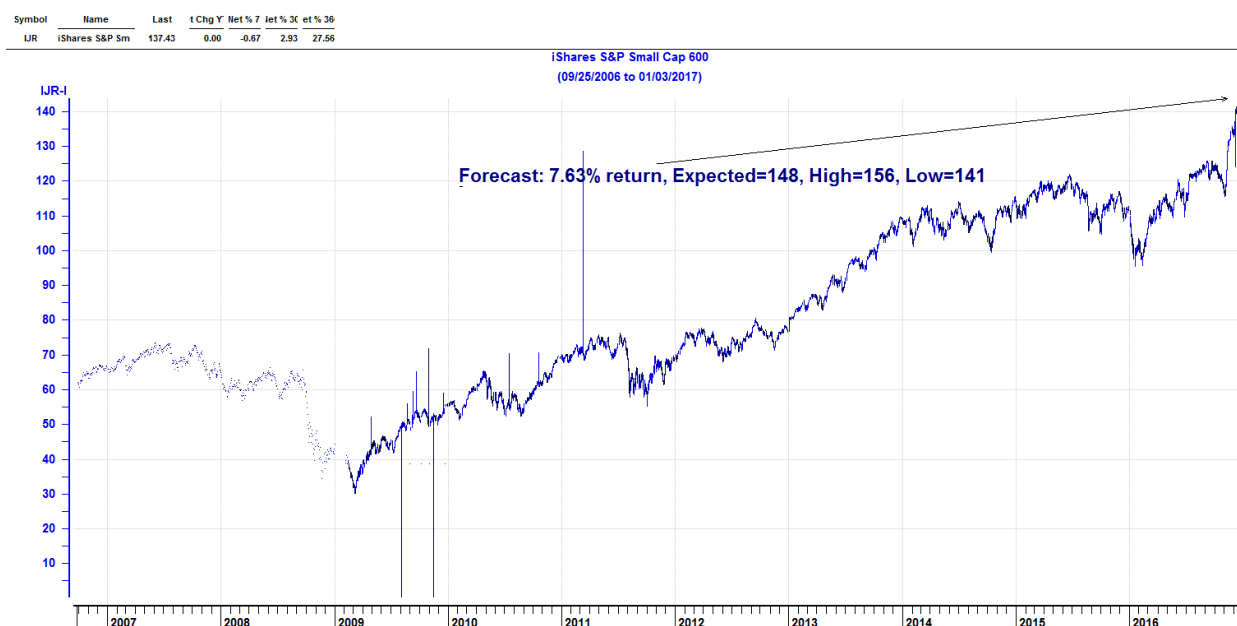


Figure 3: U.S. Small Cap Forecast using iShare IJR as a benchmark



good return at 7.63%, but it is the slowest of the three market capitalization categories.

Using the iShare IJR index we expect to see a value of 148 by year end with a high side of 156 which would represent a 13% return, and a low side of 141 representing a return of 2.3%.

U.S. Large Cap Sectors: Consumer Discretion (XLY)

The large cap market is further segmented into ten sectors. In the following sections of this forecast we will provide our expectations for each of the sectors. The first is Consumer Discretion (XLY) which is currently at

discretionary market index and is readily available to any investor.

We expect a 9.46% return from the sector which would represent a value of 90 in 2017. The high value is 94 representing a 14.4% return and the low side of our forecast is 85 which represents a 3.4% return.

U.S. Large Cap Sectors: Consumer Staples (XLP)

Consumer Staples (XLP) includes some well-known companies such as CVS the pharmacy/convenience store and Monster

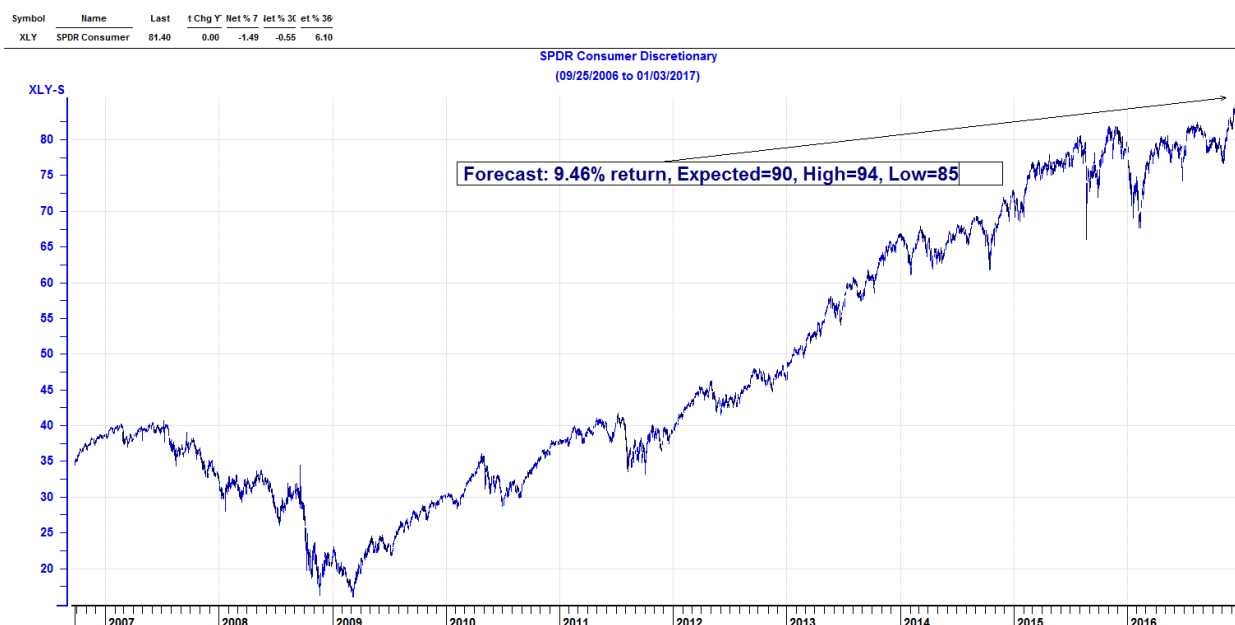


Figure 5: U.S. Consumer Discretionary Sector Forecast

102.5%FV. This is in a similar position as the market overall which is at 102.2%FV.

Figure 5 shows the history and forecast for the sector being represented by the SPDR XLY which is a security that mimics the consumer

Energy the energy drink supplier. The sector is at 102.5%FV just as the Consumer Discretionary sector in overall relative position.

However, we expect a slightly better return this year from the sector reaching a price of 57 which

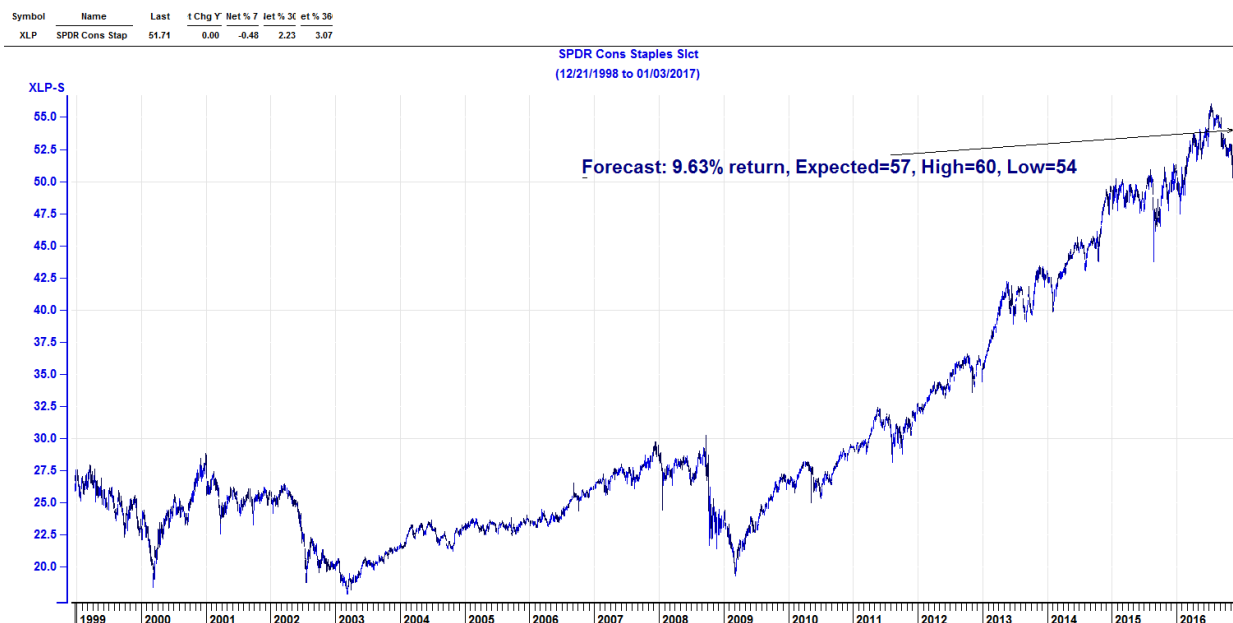


Figure 6: U.S. Consumer Staples Sector Forecast

represents a 9.63% return. Figure 6 shows the history of the sector and our forecast.

The high side of the sector could potentially reach 60 which would be a 16% return with a

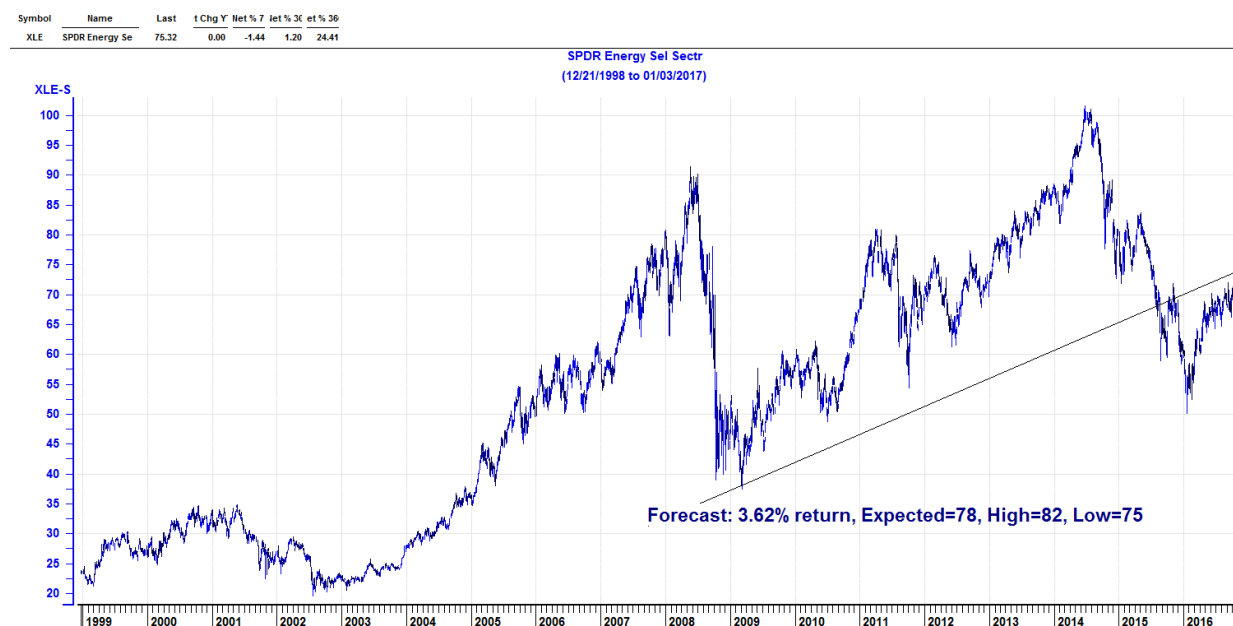


Figure 7: U.S. Energy Sector Forecast



low side potential of 54 representing a 4.4% return for 2017.

U.S. Large Cap Sectors: Energy (XLE)

During 2016 Energy received the widest variation of all sector forecasts throughout the investment world. Many investors expected disastrous outcomes due to bankruptcies, over-supply of oil, and high leverage amongst the newest exploratory companies. It was one of the most beat-up sectors at the beginning of the year only to turn out to be one of the best performing.

Energy has performed much to our expectations and we believe the current energy prices represent a good economic level for the sector as well. (For more information on the Energy sector please read our Economic Forecast 2017 and Energy Sector Report 2017.)

We expect the Energy sector to slow down over the next twelve months, but still post a positive return of 3.62%. The sector is at 112.3%FV which is in the middle of the upper regions of the fair value trading range (110-120%FV). The expected return should see the index (XLE) at a price level of 78 with a high side potential of 82 and a low potential of 75, just about where it is today. If the high side materializes the return will be 8.3% and the market basically stays flat on the low side.

U.S. Large Cap Sectors: Financials (XLF)

Financials have struggled all year mainly because of the sector's dominance by the banking industry. Banks have experienced great turmoil over the past decade that included extremely low interest rates, scandals and fines, higher government restrictions, and an unusual situation of constant reductions in total employed while experiencing shortages in

Symbol	Name	Last	1 Chg Y	Net % 7	Net % 30	Net % 50
XLF	SPDR Financial	23.25	0.00	-1.23	3.29	22.00

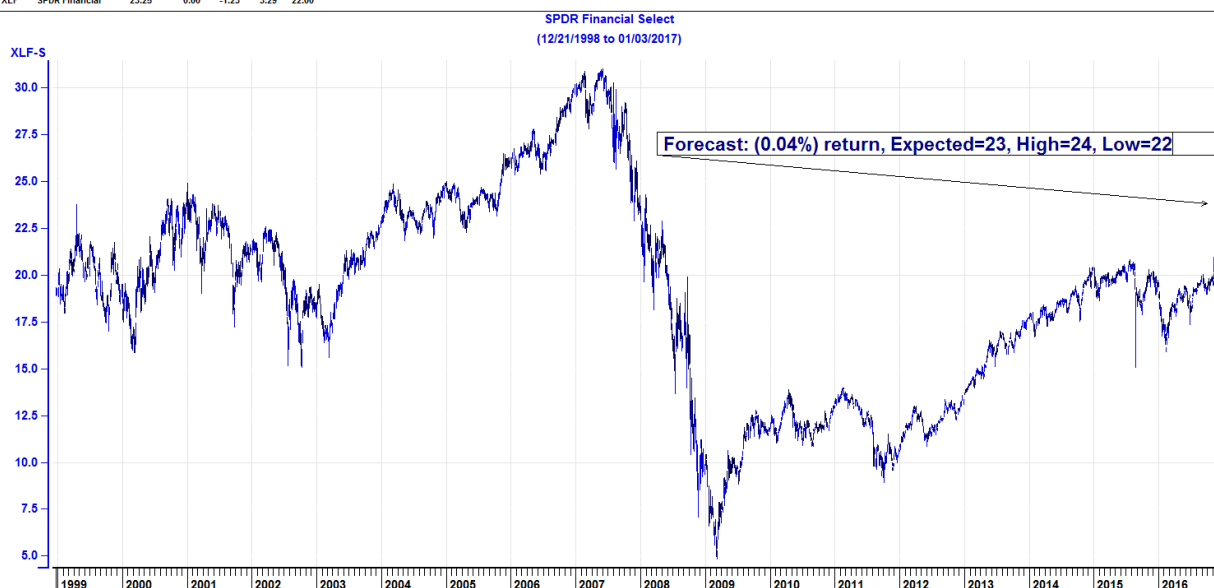


Figure 8: U.S. Financials Sector Forecast



management. Interest rates are just one of the many structural difficulties banks must face. Most of the banking industry has spent time consolidating and becoming assimilated into a common view.

We do not have high expectations for the Financials sector due to the many structural challenges facing the banking industry. There will most likely be an investor euphoric response to every increase in interest rates made by the Fed, but we think it is premature and overly optimistic.

We expect a flat to slightly negative return in Financials while the sector remains slightly above fair value at 107.7%FV. If investments are to be made in the sector we would recommend taking a closer look at the industry groups that compose the sector as an alternative.

U.S. Large Cap Sectors: Health Care (XLV)

Health Care has been the source of great expectations and great disappointment. The industry has been through so many versions of modernization and “reform” that it would be impossible to even guess where the market will end up in 2017. The turmoil is not over as the new administration has targeted the Affordable Care Act (ACA) for overhaul and possible replacement.

We expect the outcome will be some sort of redesign in an attempt to resolve some of the unaffordability part of the services, premium and provider expenses. In any case, we expect a sizable 10.3% return from the sector.

The return is a combination of a better environment for constituents of the sector and a current fair valuation of 91.9%FV which is the lowest of the ten sectors.

Symbol	Name	Last	1 Chg	Y Net %	7 Net %	30 Net %	et %	36
XLV	SPDR Health Care	68.94	0.00	0.00	0.28	-3.00		

SPDR Health Care Select Sector
(12/21/1998 to 01/03/2017)

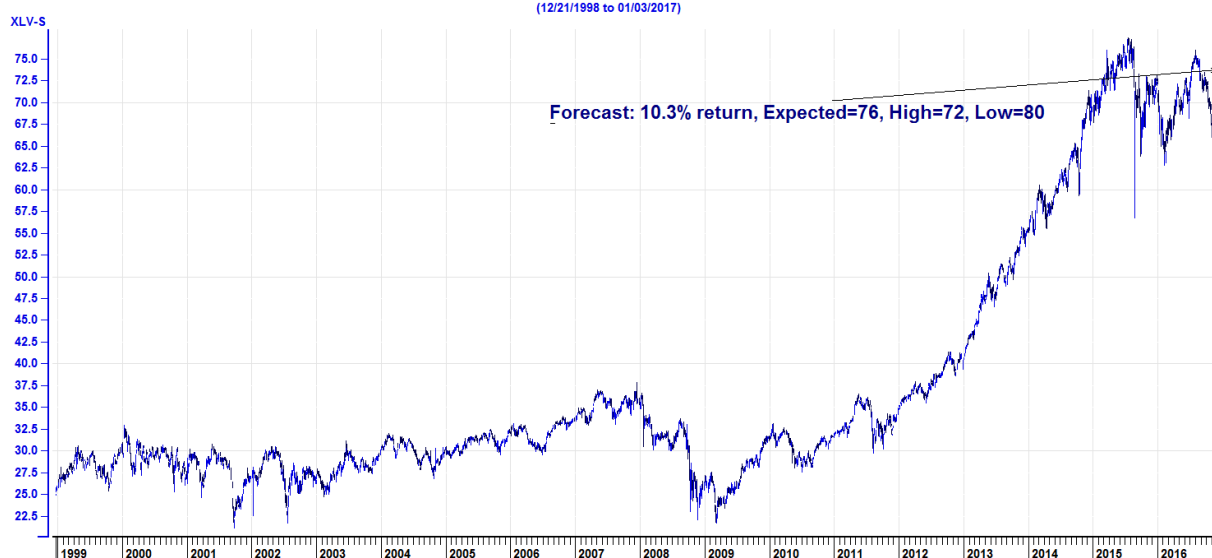


Figure 9: U.S. Health Care Sector Forecast



Symbol	Name	Last	t Chg	Y Net %	7 let %	30 let %	36 let %
XLI	SPDR Industri	62.22	0.00	-1.13	-0.30	18.65	

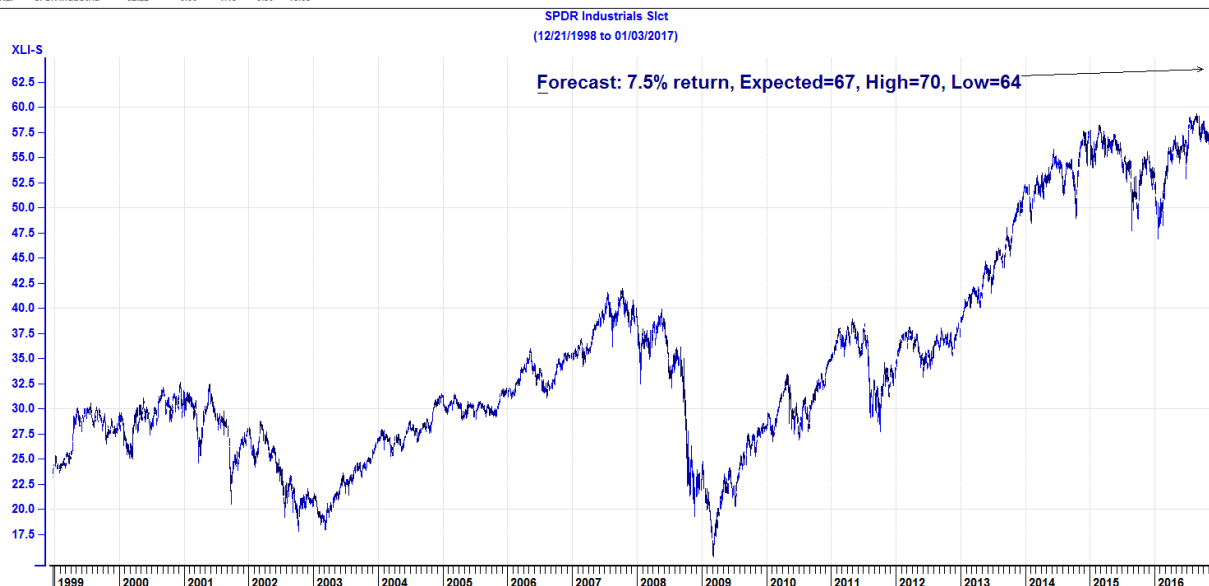


Figure 10: U.S. Industrials Sector Forecast

U.S. Large Cap Sectors: Industrials (XLI)

We expect a respectable performance in the Industrials sector gaining 7.5% next year. Examples of companies in this sector are: United Technologies, airlines and railroads of which all will play a part in an expanding economy.

The sector ended 2016 at just slightly above fair value at 109.8%FV so it is well within the normal fair value range (80-120%FV). If the higher end of our forecast is reached at 70 the sector will provide a 12.1% return.

While the potential expansion in domestic markets is a positive for this sector there is another influence that could slow the industrial companies – trade tariffs. We do not expect the tariff activity to be damaging, but there is the potential that investors could expect worse and sell away from this area of the market. This is why our forecast is a bit dampened for 2017.

U.S. Large Cap Sectors: Information Technology (XLK)

This sector is one of the most exciting because many new ideas, processes and efficiencies come from this area. The sector is currently at fair value, 100.4%FV and we expect to see a return of 8.95% in 2017. There are numerous new chip designs coming from manufacturers such as Intel's Kaby Lake and Optane. Companies that are embracing some of the new designs are creating future competitive barriers.

Enterprises today can take one of two paths when technology threatens to structurally change the marketplace. They can embrace the change and create an advantage, or become defensive and eventually leave the market. Unfortunately, there are more enterprises that become defensive and hope to win in the marketplace by whining about unfair advantage or unacceptable risks. The whiners just make it easier for the creative.

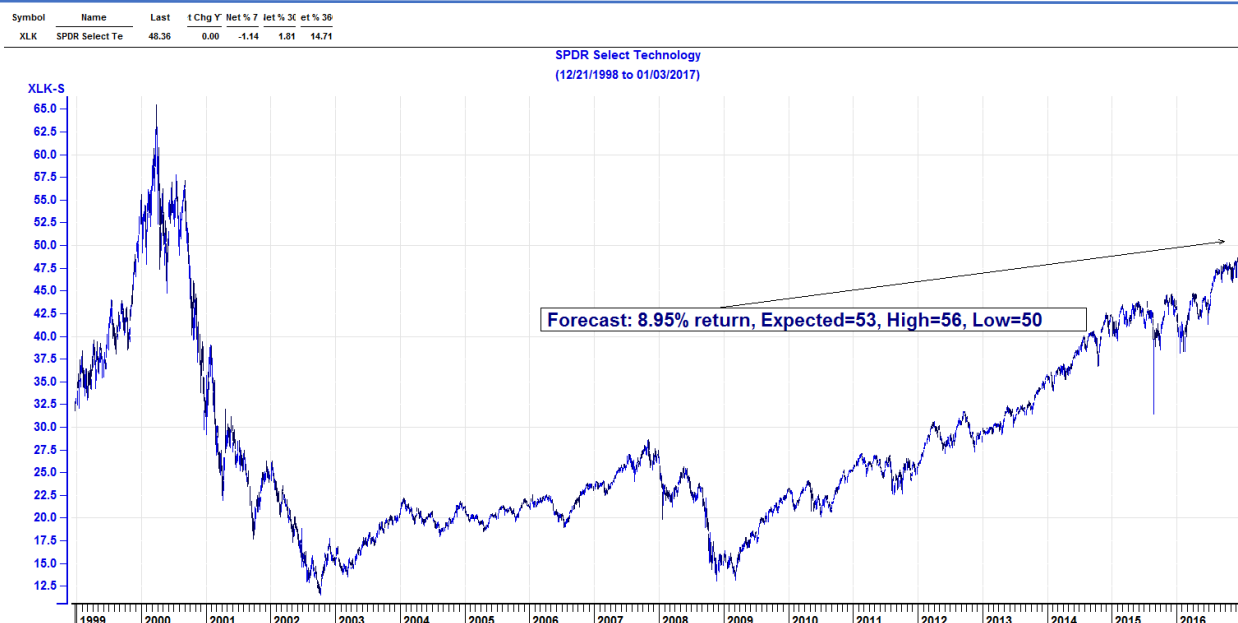


Figure 11: U.S. Information Technology Sector Forecast

We might be surprised to the upside by this sector, but there is strong global competition with minimal geographic barriers restricting the markets.

U.S. Large Cap Sectors: Materials (XLB)

Materials companies represent approximately 3% of the market. This includes companies such

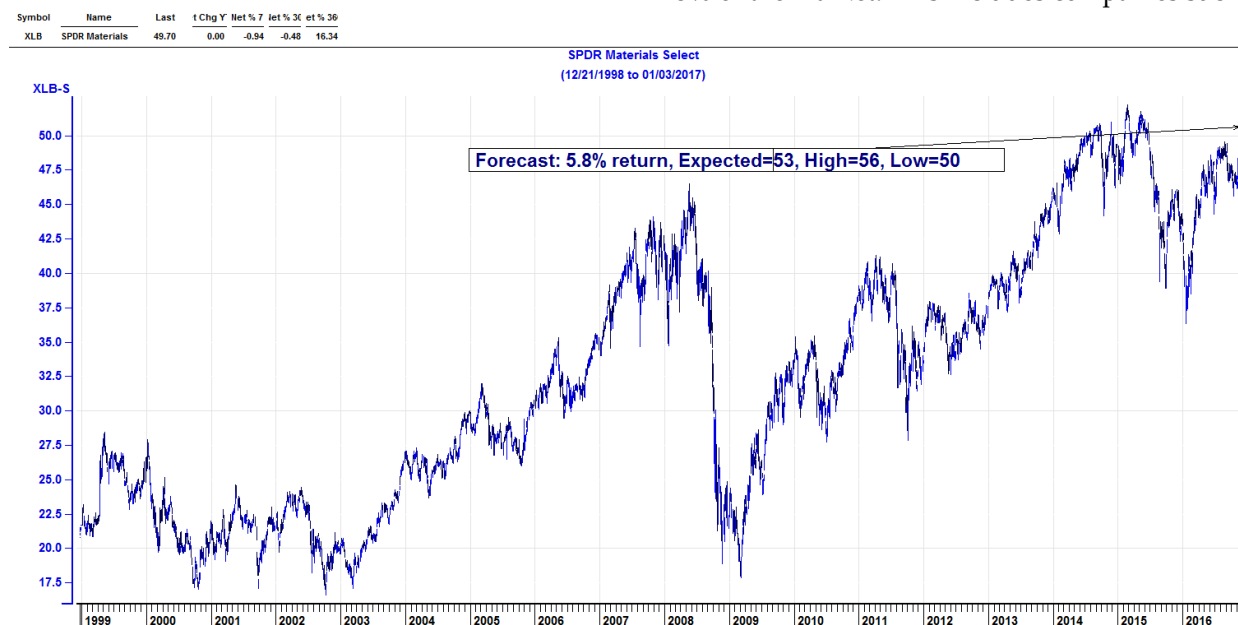


Figure 12: U.S. Materials Sector Forecast



as: CF Industries, Air Products and PPG. At the end of 2016 the sector reached a level of 105.1%FV. We expect a fairly good growth contribution for the Materials sector in range of 5.8%.

This sector received a boost over the past decade through reliable and reasonable dividend yields as investors sought higher yields from their investments. We believe this effort will continue to support the sector as it will take the Fed a

Symbol	Name	Last	t Chg	Y	Net % 7	Net % 30	et % 36
XTL	SPDR S&P Telec	69.34	0.00	-0.95	2.51	26.43	

SPDR S&P Telecom
(01/24/2011 to 01/03/2017)



Figure 13: U.S. Telecommunications Services Sector Forecast

U.S. Large Cap Sectors: Telecommunication Services (IYZ)

Telecommunications Services is dominated by AT&T and Verizon. It is interesting that after all the “deregulation” that took place under Judge Green while breaking up the Bell “monopoly” we now have two major phone companies and no longer have one of the most advanced research organizations in history, Bell Labs, and rate 10th instead of #1 in overall communications technical capability as a country. Now there’s a success story for government intervention in business, right.

while to reach more normal rates. We expect a 3.8% return from the sector. This should generate a value per share of 36 with a range of 38 on the high side to 34 on the pessimistic side.

U.S. Large Cap Sectors: Utilities (XLU)

The last sector in the group covers enterprises that are considered utilities such as power companies. This sector also has benefitted from investors seeking higher yields from securities as many treat these stocks as 30 year bonds. Valuation of the sector is reasonable at 110.3%FV. It was much higher earlier in 2016 and came close to reaching an overvalued position (130%FV).

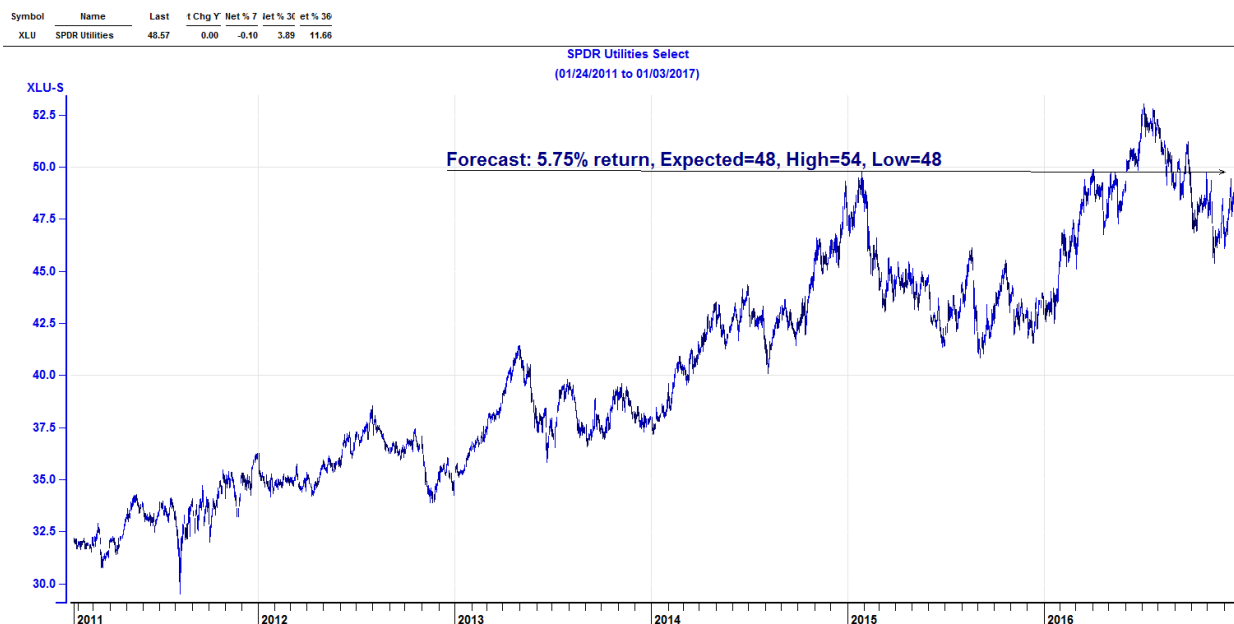


Figure 14: U.S. Utilities Sector Forecast

We expect to see a 5.75% return for the sector in 2017 reaching a value in XLU of 51. The optimistic view places the price at 54 and the less optimistic view places the sector at 48.

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