"To be a good investor, you have to be right much of the time. To be a great investor, you have to recognize how often you may be wrong."

—— Jason Zweig, The Wall Street Journal, December 2016

January 23rd, 2017

A Look Back

Although Wall Street saw its worst start to a year ever in 2016, with the S&P 500 losing as much as 11% by mid-February, the U.S. stock market bounced back and posted solid gains. Small-capitalization stocks, which had lagged the market in 2015, led the charge in a rally that gained further steam after Donald Trump's surprise victory in November. The S&P 500 returned slightly less than 12% (inclusive of dividends) for 2016. The two best-performing sectors were energy, which rose 24%, and financials, which gained 20%. Both had been among the worst performers of 2015.

This year's rally extended a bull market that has tripled the value of the Dow Jones Industrial Average (DJIA) from its financial crisis low of 6547. Even so, stocks brushed off several shocks in 2016, including a recession scare, worries about a slowdown in China, and tremors caused by the United Kingdom's vote to leave the European Union. The bulk of 2016's gains came during the second half of the year, when a rebound in corporate earnings, accelerating U.S. economic growth and stabilizing oil prices helped stoke investor enthusiasm for stocks.

The election of Donald Trump as the next president of the United States supercharged this rally as investors bet that the new administration would usher in business-friendly policies such as tax cuts, looser regulations, and fiscal stimulus. The DJIA gained 7.8% post election day through the end of the year and finished above 19,000 for the first time on November 22. However, a stall in the recent rally has raised questions about whether stocks will continue to surge into 2017 and propel the blue-chip index to 20,000, its next milestone. Should the rally survive to the Ides of March, it will have become the longest bull market in history.

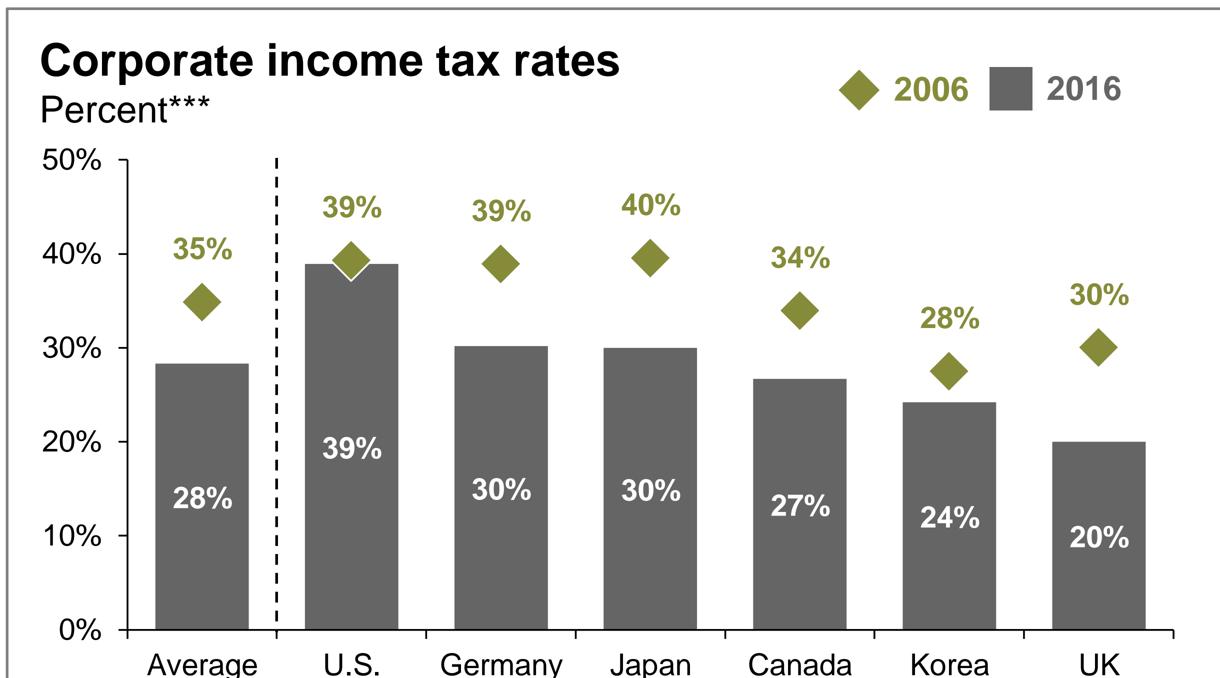
Performance

The majority of accounts managed by Boyar Asset Management lagged the S&P 500 for the first nine months of 2016. The three best-performing sectors within that index were energy, telecom, and utilities, to which we had minimal exposure.

It is not unusual for our accounts to lag the leading indices for extended periods. We tend to be sector and market capitalization agnostic and thus do not correlate well with the major indices. Rather, we aim to buy the least expensive businesses we can find, regardless of industry or size, believing that this will lead to superior results over a market cycle (making up for any periods of temporary underperformance). For example, our research concluded that both telecom and utilities were quite rich and that financials and certain health care stocks were selling at attractive valuations. The market clearly disagreed with our choices, since the former shined, while the latter lagged—yet this trend started to partially reverse course as financial shares advanced by more than 20% during the 4th quarter. This caused the vast majority of our accounts to perform quite well relative to the S&P 500 in the final quarter of the year, although our 4th quarter comeback was not enough to overcome the underperformance we experienced at the beginning of the year.

A Look Ahead: Are Lower Taxes and Less Regulation on the Horizon?

The Trump administration, in all likelihood, will be more business-friendly than the Obama administration was. Accordingly, we can expect lower tax rates for both individuals and corporations. As the following chart demonstrates, since 2006 the U.S. corporate tax rate has stayed at 39% even as the corporate tax rates in Germany, Japan, Canada, South Korea, and the United Kingdom have decreased from an average of 35% to an average of 28%. Any movement toward leveling the corporate taxation playing field, together with a potential tax holiday for overseas cash held by U.S. companies, should positively affect U.S. domiciled companies and potentially stimulate the economy further.



Source: J.P. Morgan Asset Management's Guide to the Markets

In the months leading up to the 2016 presidential election, the Trump campaign frequently highlighted regulatory reform as a necessary step to reinvigorating economic growth. Now, with the election past, the Trump administration appears determined to follow through on this issue. Although we do not yet know the exact form these regulatory changes will take, we believe that some initial conclusions can be drawn. Several areas of the market could be aided, we think, by a reduction of their regulatory burdens, with the financial services sector among the primary beneficiaries. For example, reform of Dodd–Frank regulations could diminish compliance-related costs, increase operational flexibility, and boost profits for financial institutions such as commercial banks and investment banks.

Higher Interest Rates?

A more vigorous economy translates into higher interest rates, so most economists are looking for a few rate hikes in 2017. Our bet is that we will get two increases. If you recall, The Federal Reserve predicted three rate hikes for 2016, and all we received was one. What's more, look for the dollar to continue being the global currency of choice. The pundits are calling for the euro to trade at parity with the dollar, we are almost there, so that would not surprise us. But we think the dollar's run is almost over. Our suggestion? Plan a European vacation: The Continent is on sale.

The dramatic rise in interest rates has been a tailwind propelling financial shares, which increased in value by ~25% during the 4th quarter. How much of this is reflected in the recent price increase is open for debate, but we think for long-term patient investors, despite the chance of a temporary pullback, there are many attractive opportunities remaining in this sector over the long term.

Here's one last thought about higher interest rates. If the 30-year bond bull market is over, then bond investors should take note: A 1% rise in rates translates into an ~18% decline in the value of a 30-year treasury bond. Perhaps your "safe" bonds might not be so safe after all?

Is the Bull Market in Equities Nearing an End?

This bull market is long in the tooth. However, as the following chart demonstrates, bull markets do not normally expire because of age; rather, they usually end because of overvaluation or when an exogenous event occurs. Our bet is that that as individual investors watch the value of their bond portfolios decline, they will unload their fixed-income holdings. Because they will have to find a home for their capital, the equity market might well be the primary beneficiary.

In the years since the financial crisis, individual investors have been reluctant to purchase stocks. Yet before bull markets end, they normally join the party. When this happens, unfortunately, "Mom and Pop" often enter the stock market towards its peak, and end up buying high and selling low.

Characteristics of bull and bear markets

	Bear markets			Macro environment				Bull markets		
Market Corrections	Market peak	Bear return*	Duration (months)*	Recession	Commodity spike	Aggressive Fed	Extreme valuations	Bull begin date	Bull return	Duration (months)
1 Crash of 1929 - Excessive leverage, irrational exuberance	Sep 1929	-86%	33	◆			◆	Jul 1926	152%	38
2 1937 Fed Tightening - Premature policy tightening	Mar 1937	-60%	63	◆		◆		Mar 1935	129%	24
3 Post WWII Crash - Post-war demobilization, recession fears	May 1946	-30%	37	◆			◆	Apr 1942	158%	50
4 Flash Crash of 1962 - Flash crash, Cuban Missile Crisis	Dec 1961	-28%	7				◆	Oct 1960	39%	14
5 Tech Crash of 1970 - Economic overheating, civil unrest	Nov 1968	-36%	18	◆	◆	◆		Oct 1962	103%	74
6 Stagflation - OPEC oil embargo	Jan 1973	-48%	21	◆	◆			May 1970	74%	32
7 Volcker Tightening - Whip Inflation Now	Nov 1980	-27%	21	◆	◆	◆		Mar 1978	62%	33
8 1987 Crash - Program trading, overheating markets	Aug 1987	-34%	3				◆	Aug 1982	229%	61
9 Tech Bubble - Extreme valuations, .com boom/bust	Mar 2000	-49%	31	◆			◆	Oct 1990	417%	115
10 Global Financial Crisis - Leverage/housing, Lehman collapse	Oct 2007	-57%	17	◆	◆	◆		Oct 2002	101%	61
Current Cycle								Mar 2009	231%	95
Averages	-	**-45%**	**25**					-	**154%**	**54**

Source: J.P. Morgan Asset Management's Guide to the Markets

With that in mind, we'll note that the American Association of Individual Investors sentiment survey revealed a gain in bullish sentiment among retail investors from ~24% on November 3 just prior to the election, to nearly 50%. According to Barron's, this was the biggest three-week surge in bullish sentiment in more than six years, and it drove the S&P 500 up nearly 6% in less than a month. During the first full week following the election, $25 billion flowed into U.S. equity ETFs, placing it among the best single weeks on record. From November 8 to December 15, U.S. equity ETFs experienced an astonishing $97.6 billion in inflows, totaling 150% of the amount that went into the category during the whole of 2015. Only time will tell whether retail investors have once again joined the party at precisely the wrong time.

The U.S. Presidential Election Cycle and Stock Market Returns

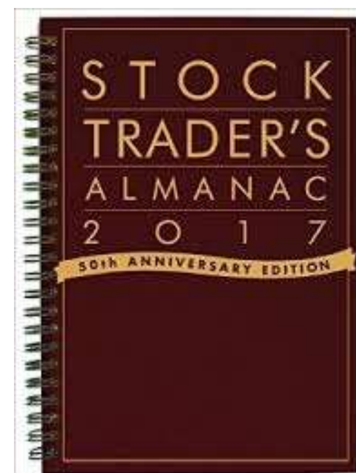
Because this year's presidential election was anything but ordinary, historical outcomes relating to stock market returns and past presidential elections must be viewed with a healthy degree of skepticism. That said, we'll note some historically relevant trends. Since 1949, the Dow Jones Industrial Average has increased by an average of 8.3%. However, under a Republican presidency that number decreases to 6.8%. It is worth noting that when Republicans have controlled both houses of Congress as well as the Oval Office, the average percentage change increases to 14.1%.

Investors should take note that the first year of a presidential election cycle has produced some abysmal events/stock market performance as noted by *The Stock Trader's Almanac* (from which the facts in this section have been sourced):

> *In the past 26 post-election years, three major wars began: World War I (1917), World War II (1941), and Vietnam (1965); four drastic bear markets started, in 1929, 1937, 1969, and 1973; 9/11, recession, and continuing bear markets in 2001 and 2009; less severe bear markets occurred or were in progress in 1913, 1917, 1921, 1941, 1949, 1953, 1957, 1977, and 1981. Only in 1925, 1985, 1989, 1993, 1997, and 2013 were Americans blessed with peace and prosperity.*

Even more disturbing is that since 1953, performance immediately after an election year has been dramatically better under Democratic presidential administrations (an average gain of 13.4%, for a cumulative

gain of 93.9%). Under Republican presidential administrations, the average performance for the first year of the presidency has been a loss of 1.2%, for a cumulative loss of 10.6%. If 1985 and 1989 are eliminated (both saw a gain of 27%), the results are dramatically worse.



Most worrying of all, **<u>since 1913, only one positive year has ensued after a Republican president took control of the White House</u>** (in 1921, after Harding's election, the DJIA increased by 12%). Under Eisenhower, the DJIA declined by 3.8%, and after Nixon's election, it lost 15.2%. Similarly, when Reagan took office, it dropped by 9.2%, and after George W. Bush was sworn in, it fell by 7.1%.

If history is any guide, 2017 will not be a pretty year. We are truly in uncharted territory, so hopefully past performance is not indicative of future returns in this case.

<u>Article Excerpts and Commentary</u>

In the following section, you'll find excerpts from and commentary on four articles we recently read that we think you'll find interesting.

<u>The Math of a Big Loss</u>

In the following article, which recently appeared in *Financial Advisor Magazine*, you'll read about the unique consequences caused by outsized market losses that occur shortly before or during retirement. Although we strongly disagree with the author's conclusion—that retirees should consider investing in uncorrelated assets (investments that *supposedly* rise or fall independent of the stock or bond market) or investing in long/short hedged strategies—we do believe that he makes several valid points about portfolio losses.

In our opinion, the best way to protect someone's nest egg in such a situation is to keep a substantial portion of that person's retirement account in cash (the actual percentage will vary depending on the individual's financial situation as well as his or her tolerance for risk). An investor who does so can take advantage of temporary market swoons by purchasing securities at bargain basement prices (rather than selling securities at depressed prices) and will have cash available to withdraw for living expenses. Although there is no perfect plan for dealing with this important issue, we believe that such an approach offers the best way to both preserve and grow a retirement account.

The numbers are in—and stark.

An individual decides to retire after a lifetime of hard work just as the market falls. An investment portfolio subject to market returns would therefore be negatively impacted, and the potential outsized effect could come as a shock. For example:

A loss of 10 percent requires an 11 percent gain to recover, which is quite manageable. However, as the loss grows, the size of the return needed to recover increases at a faster pace. Indeed, a 50 percent loss requires a 100 percent gain to recover and an 80 percent loss requires a 400 percent gain just to get back to even…

Call it the (bad) luck of the draw; the value of the portfolio decreases at the exact moment individuals begin withdrawing assets for day-to-day living expenses and other issues; assets that are then unavailable to participate in the rebound that is sure to follow.

Known as sequence-of-return risk, it can decimate even the best-laid retirement plans. The havoc caused is something from which the retiree will most likely never recover, diminishing the quality of life of which they've dreamed.

Too many investors fail to realize that it's not only about the loss of monetary resources, but also the loss of time in which to make them back. For young investors just starting out, its impact is negligible. Not so for their older counterparts, one reason sequence-of-return risk rises with time, and at its highest just before retirement.

Attempting to time the market by jumping in and out at what investors believe to be opportune moments usually only serves to inflict further damage, and impedes the ability to capitalize on the power of compounding interest. Research shows the age at which someone begins saving (earlier), as well for how long they save, is more beneficial than the actual amount invested; the average 25-year-old will have double the assets of one who begins saving at age 35 when they each eventually reach retirement age.

So aside from starting young, what can be done?

Alternative investment strategies are one answer; so-called non-correlated asset classes that rise and fall independently of stocks and bonds can mitigate losses and enhance returns in increasingly volatile investing environments driven by hyper-connected global markets.

Long/short equity, one particular hedged growth investment strategy, can limit volatility within the portfolio, stabilize the sequence-of-returns and narrow the possible outcomes to help investors and their advisors better plan….

Traditionally reserved for the "satellite" portion of the portfolio, its ability to participate in equity markets while managing downside risk is fueling an argument for long/short equity as a core position...

Hedged growth strategies such as long/short equity potentially turns the math of a big loss into an equation for a big gain, by lessening the amount of risk, and the time-horizon needed to recover, helping to ensure the individual doesn't run out of money before they run out of life.

Excerpt from an article written by Clifford Stanton that appeared in Financial Advisor Magazine.

To be a Great Investor, Worry More About Being Wrong Than Right

If all you learned from the stunning surprises of 2016 is that the unexpected will happen, you haven't learned nearly enough. Great investors like Warren Buffett practice trying to disprove their investing assumptions to determine whether they are correct. 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 deluding ourselves into thinking we were right all along.

If you were a Hillary Clinton supporter, every statement by Donald Trump fortified your faith that he would lose the election, and you took the consensus of polls as proof she would win. Mr. Trump gave supporters reason to think he'd chasten Wall Street, and as the election approached, pundits predicted a market meltdown if Mr. Trump won. Yet the S&P 500 has returned more than 5% since his election…

When the U.S. stock market produced its worst start to a year in modern history, losing 10.5% in January and early February, terms like "contagion," "panic" and "fear and loathing" filled the air. Stocks promptly shot up. In the summer, with the world awash in negative interest rates, The Wall Street Journal reported that this "new abnormal" was "here to stay," and that, as yours truly wrote, "you will have to lower your expectations" for bond income. Right on cue, the yield on the 10-year U.S. Treasury—then 1.37%—has nearly doubled in less than five months...

The common culprits in all this are two quirks of the human mind that psychologists call confirmation bias and hindsight bias. The first drives us to seek and favor evidence that confirms our pre-existing beliefs while ignoring warning signs that we might be wrong. The second compels us, after everyone knows the outcome, to believe we saw it coming all along…

A few techniques can help combat these cognitive biases.

Shun peer pressure from social media or the internet. If you reveal your opinion to a group with strong views, the sociologist Robert K. Merton has warned, the ensuing debate becomes more "a battle for status" than "a search for truth." Instead, get a second opinion from one or two people you know and can trust to tell you if they think you are wrong.

Listen for signals that you might be off base. Use Facebook or Twitter not as an amen corner of people who agree with you, but to find alternative viewpoints that could alert you when your strategies are going astray…To be a good investor, you have to be right much of the time. To be a great investor, you have to recognize how often you may be wrong.

Excerpt from an article written by Jason Zweig that appeared in The Wall Street Journal in December of 2016.

The Negative-Yield Story of 2016

The end of 2016 has been dominated by a sharp rise in global bond yields. But the most remarkable development of the year—the widespread emergence of negative bond yields even for long-dated securities—is leaving a legacy that will persist. The total amount of global fixed-income securities with a negative yield has fallen from its late September peak of $13.3 trillion—more than double the level of $5.6 trillion at the start of 2016, data from Bank of America Merrill Lynch shows…

But the real oddity of 2016 was negative yields for long-dated securities, which turned on their head assumptions about the behavior of fixed-income markets. Germany and Japan got the most attention as their 10-year yields turned negative, but that was far from the most extreme: The yield on a Swiss

government bond maturing in 2064 briefly turned negative after the U.K. vote to leave the European Union. That underlines just how far the bond market went into unknown territory in 2016. The lure of fixed income lies in the word "fixed"—it is an asset designed to provide a known stream of cash flows. The rally of the first half of 2016 that took long-dated yields into negative territory turned bonds into a pure vehicle for speculation, as future cash flows were already accounted for in the purchase price. The price of the Swiss 2064 bond topped 200% of face value at its peak. With a coupon of 2%, investors were being asked to pay more up front than the total value of future coupon payments and the principal…

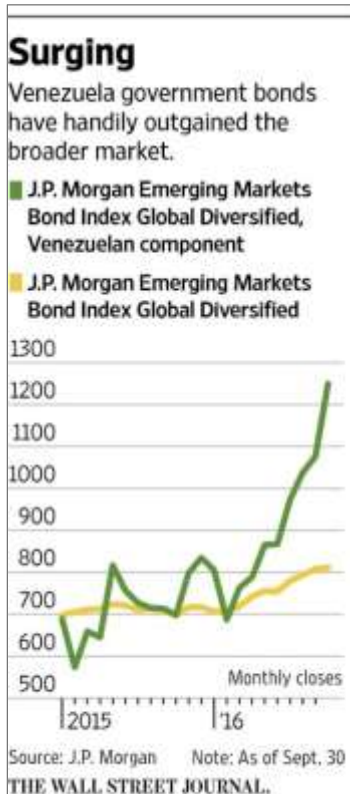
Excerpt from a Wall Street Journal article written by Richard Barley on December 27th 2016.

For a 46% Return, Bond Investors Go to Venezuela—If They Dare

Venezuela is plagued by widespread hunger, skyrocketing infant mortality and 500% inflation. Yet its sovereign bonds are the best performers in emerging markets this year, delivering investors a return of 46% through Friday. The government of President Nicolás Maduro continues to pay billions of dollars annually to service Venezuela's debt, even as it is unable to import enough food and medicine. The situation has polarized emerging-markets investors.

Some large fund managers are doubling down on Venezuelan bonds for their high yield. Others are avoiding the country altogether, because they believe default to be inevitable. Fidelity Investments owns at least $1.8 billion in face value of bonds issued by Venezuela and state-owned oil company Petróleos de Venezuela SA, or PdVSA, according to fund tracker Morningstar Inc. The asset manager's emerging-markets fund, 7% of which is invested in Venezuelan debt, has returned 16.7% this year, about 3 percentage points more than comparable mutual funds, according to Morningstar…

Venezuela faces $15 billion of bond payments by the end of 2017 and has foreign reserves of about $12 billion. With approximately $65 billion of government and PdVSA bonds outstanding, a default could have widespread political and financial consequences. Buyers of the country's bonds are betting it will continue paying to keep bondholders from trying to seize overseas assets, including oil shipments, which are the lifeblood of the deeply unpopular Maduro government….



To save scarce dollars for bond payments, the government is halting basic infrastructure maintenance and abandoning subsidies on food and services, making life increasingly difficult for ordinary Venezuelans and fueling runaway inflation…It all adds up to one of the most complex sovereign-debt crises in recent memory, said Anna Gelpern, a law professor at Georgetown University and fellow at the Peterson Institute for International Economics...

While there is always uncertainty in sovereign-debt crises, they tend to follow a predictable playbook. When investors stop buying new bonds from a country—as they did in Argentina, Greece and now Venezuela—its leaders ask multilateral lenders such as the International Monetary Fund for emergency cash. Those agencies usually demand economic reforms in exchange for new loans and often require bondholders to share in the pain through bond swaps that involve debt relief.

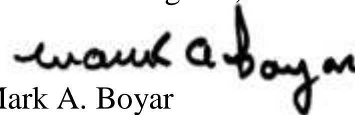
But Venezuela hasn't dealt with the IMF since former President Chávez broke with the fund in 2007. Instead it has relied on China for about $50 billion in oil-backed loans. China has increasingly become the lender of last resort to commodity-rich emerging markets but it is secretive about the terms of those agreements, heightening uncertainty for investors. For some investors who are sticking with the country's debt, the bet is that the country's regime can't last much longer. "Some sort of political change will happen," said Simon Lue-Fong, global head of emerging debt at Pictet Asset Management, which has $21 billion in emerging-market debt.

Such investors believe Venezuelan assets will be re-evaluated once a new government takes office and potentially opens the door for help from the IMF. With huge oil reserves underground, the country has huge upside potential, they argue.

Excerpt from an article written by Matt Wirz, Carolyn Cui, and Anatoly Kurmanaev that appeared in The Wall Street Journal in October of 2016.

We hope you enjoyed reading the excerpts we shared with you. If you have any questions or comments, please do not hesitate to call.

Best regards,



Mark A. Boyar

Jonathan I. Boyar

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