Soundings

What's New – December 2016

Quote of the month:
"In the end, you're measured not by how much you undertake but by what you finally accomplish." Donald Trump

So wrote the future 45th President of the United States in his defining tome nearly 30 years ago. The financial markets certainly think our President elect is going to be a doer. As I write, the "Trump bump" has taken the Dow Jones Industrial Average to a record close.

He might not have been your choice, but the Donald has put forth a number of pro-growth policy suggestions that have a very real likelihood of implementation given the new makeup of Congress. Corporate tax reform and a proposal to allow companies to repatriate overseas profits are a couple of my favorites. They'd provide powerful incentives for U.S. based multinationals to expand domestic operations and invest in hiring and capital improvement which could be a robust prescription for an economic uptick. Add a repeal and replacement of Obamacare, a repair of Dodd-Frank, and a more balanced energy policy, and this place called America could take off like a tightly coiled spring. There will be challenges and setbacks along the way…it's all a part of it, but for those looking for some words of encouragement, I have not been this excited about the opportunities for our kids and grandkids in a long time. Selfishly, we need them to thrive. They're the ones who'll be paying our social security.

So what will a Trump administration mean for the financial markets. Now that's the million dollar question. In this month's ***Market and Economic Commentary,*** I've I placed a piece from the Wall Street Journal that makes some predictions. One thing that's nearly certain, what worked last year will likely be very different in 2017. First, to the numbers…

Jon Kagan, CFP®, CDFA™, Registered Principal
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7552 Navarre Parkway, Suite 35, Navarre, FL 32566 | 201 East Government Street, Pensacola, FL 32502
850.936.6686 866.936.8816 Fax Toll-Free 866.936.6686
www.jonkagan.com jon.kagan@raymondjames.com

Market Update – Year to Date Returns

Major Stock Indexes	(As of 12/1/2016)*
Dow Jones Industrials	9.8%
S&P 500 Index	7.6%
NASDAQ	6.3%
DJ Global ex US	-0.1%
Russell 2000 (small cap index)	16.4%
XAU (gold/silver)	76.3%

Major Bond Indexes	
Broad Market – Barclays Capital Aggregate	2.8%
High Yield Corporate - Barclays Capital	14.8%
Municipal Bond - Barclays Capital	-0.5%

Lipper Mutual Fund Categories	
Large Cap Growth	0.5%
Large Cap Value	13.7%
Small Cap Growth	8.2%
Small Cap Value	22.6%
International	-0.2%
Balanced Fund	6.1%
US Govt Bond	1.7%
Corporate A-Rated Bond	4.8%

Source: The Wall Street Journal

Other Disclosures

- Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect investment performance. Individual investor's results will vary. The S&P 500 is an unmanaged index of 500 widely held stocks that's generally considered representative of the US stock market. The NASDAQ Composite is an unmanaged index of securities traded on the NASDAQ market. The Russell 2000 index is an unmanaged index of small cap which generally involve greater risks. The Dow Jones Industrial Average (DJIA), commonly known as the "Dow", is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal. The DJ Global ex US is an unmanaged group of non U.S. securities designed to reflect the performance of the global equity securities that have readily available prices.
- Lipper Indexes are based on the largest funds within the same investment objective and do not include multiple share classes of similar funds. Barclays Bond Indexes are designed to measure the market performance of various fixed income asset classes. The Philadelphia Gold and Silver Index (XAU) is an index of sixteen precious metal mining companies that is traded on the Philadelphia Stock Exchange. The information contained in this report does not purport to be a complete description if the securities, markets, or developments referred to in this material. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Any opinions are those of Jon Kagan and not necessarily those of RJFS or Raymond James Financial. Expressions of opinion are as of this date and are subject to change without notice. This information is not intended as a solicitation or an offer to buy or sell any security referred herein. There is no assurance any of the trends mentioned will continue in the future. Investing involves risk and investors may incur a profit or a loss, including the loss of all principal. Past performance may not be indicative of future results. Asset allocation does not guarantee a profit nor protect against loss. The Tactical Tilt methodology does not guarantee a profit nor protect against loss. The process of rebalancing may result in tax consequences.
- Opinions expressed in the Market Commentary are those of Gunjan Banerji and not necessarily those of Raymond James. All opinions are as of this date and are subject to change without notice.

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Market & Economic Commentary

Sectors and styles in the S&P 500 index have started to move independently after seven years of depressed volatility and tighter correlations. The catalyst is the U.S. presidential election, which Republican Donald Trump unexpectedly won, causing stocks to rally. Among the sharpest collapses is the link between financial stocks in the S&P 500 and the broader gauge. The correlation between the two over the last month has fallen to 0.59, compared with 0.89, where it was on Nov. 7, the day before the election, according to FactSet data. A correlation of 1 would indicate the two are moving in perfect sync. Shares of banks, asset managers and insurance companies as a group have jumped 11% since election day as investors bet on lighter regulation for the sector under the Trump administration. The financial sector's performance trounced other groups, such as utilities and consumer staples, each of which are down more than 3%.

While the S&P 500 climbed to a record for a second day on Tuesday, "there are elements of a bull market and a bear market at the same time," said Andrew Wilkinson, chief market analyst at Interactive Brokers. "You're seeing pressure on different sectors. In a typical bull market, you're going to get all stocks going higher." "It makes it very interesting for the stock picker and the active manager who's on his game," Mr. Wilkinson said. A volatility-related benchmark measuring expected average correlation among stocks—the CBOE S&P 500 Implied Correlation Index, or JCJ—dropped to its lowest level ever according to data going back to 2008, said a spokeswoman for the exchange. That was a year before the current bull market in equities was just getting started, as central banks around the world kicked off unprecedented policies to bolster growth, helping lift asset prices across the board.

The relationship between growth and value stocks in the benchmark equity measure has also decoupled, with the rolling correlation between the two groups sliding since voting day, FactSet data show. A Republican sweep of the U.S. presidency and Congress has boosted the inflation outlook, pushing investors into value names. Before the election, investors crowded into growth companies in 2015 amid a sluggish economy and then poured money into low-volatility equities in the first half of this year.

Options trading also has ramped up amid the increased volatility and falling correlations. After months of calm and flat options volumes, volume on single-name options climbed 66% to 23.8 million contracts on Nov. 9 from 14.3 million the previous day. The average daily contracts traded in November has surged 21% from the 2016 average of 14.5 million contracts, according to data from the Options Clearing Corp. Further clarity on the Trump administration's policy plans could change the direction of the market. Until then, Credit Suisse's Mandy Xu expects the dispersion trend to continue. "A lot of people are asking if this is a regime shift in the U.S. rate environment," Ms. Xu said. The Federal Reserve increased interest rates in December for the first time in almost a decade after keeping them near zero since 2008.

The weakening correlations could mean more opportunities for outperformance by active managers, said Mike Bailey, director of research at FBB Capital Partners, whose firm selects individual stocks for primarily high net-worth clients. The prolonged period of low volatility and high correlations have been hard on active managers, as many investors put their money into passive funds that mimic equity benchmarks. About $222 billion left U.S. stock-picking funds through October, the most ever in more than two decades and 29% more than last year, according to Morningstar data going back to 1993. Passive strategies continued to lure investors, attracting $144 billion this year. In the first 10 months of 2016, active domestic equity managers returned 3.9%, falling short of the 6% return passive managers posted, Morningstar data show. But the tide may be about to turn for active managers as stock sectors continue to disperse and market players say the U.S. is on the cusp of higher interest rates. Active managers could be able to point to 2016 as an example of how "you can't always bank on passive," Mr. Bailey said. ***Gunjan Banerji, Sectors Go Wild: S&P 500 Correlations Crumble, Wall Street Journal, November 23, 2016.***

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On a Personal Note

On a recent Sunday, the forecast was manliness. It started in the garage with some heavy wrenching on the motorbike. A few hours later, with the testosterone pumps in full gear, Kathleen and I mounted the trusty steed for a ride to the country and a little target practice. Don't get the wrong idea, we're not big gun people. Growing up in Massachusetts, I wasn't even allowed to say the word. We hadn't been to the range in more than a year but always had a good time when we did. This time was no different and I've got to say, should we find ourselves in the inevitable zombie apocalypse, I think we'll hold our own till the ammo runs out. On the way home, we stopped in downtown Pensacola and hit one of our favorite pubs, the World of Beer. Founded in 2007 by a Pensacola native who moved to Tampa after losing his home in Hurricane Ivan, WOB is now a global operation with over 80 pubs across the country and locations as far away as China and India. As the name implies, you'll find a brew or two from nearly everyplace that makes the stuff. To top it off, they have more televisions than Best Buy, all tuned to every sporting event you'd ever want to see (yes, I even saw one tuned to a motorcycle race). After a beer and an order of fried pickle chips, we headed back across the bridge for home. The final act of that manly day was our Sunday evening ritual. Stretched out on the sofa, toddies in hand, the latest episode of the Walking Dead on the tube, we basked in the comfort of a successful afternoon at the pistol range. Bring it zombies.

It was another nice Thanksgiving at the Kagan house. More than 25 of the extended family joined us to celebrate and nobody pulled a knife…a success in anyone's book. Alex and Collin came home, of course, and Alex brought his girlfriend Claire. She is the first "real" girlfriend for either of my boys and all I can say is wow…what a special person. Four generations were represented at our shindig. I love everyone but was most interested this year in talking with the sophomore class. These were my nieces and nephews who, over the past few years, have transitioned from high school and college graduates, to become official grownups. We've got a diverse bunch. There's a techie, a couple teachers, a firefighter, a hairdresser, a realtor, a banker, a med student, a merchant mariner, and FedEx guy. A veritable economy. Most are married, some have kids, all are independent and slugging it out just like they're supposed to be. To a T, they've got great attitudes and are giving it their best shot, knowing that it's up to them. I'm already looking forward to next year.

I can't believe it's been 23 years since the cool and drizzly afternoon when Kathleen made an honest man out of me. It still defies all logic, but she's stuck around. We're folks of simple pleasures so we celebrated this year with dinner and a music show. The White Tie Ensemble is a local act that specializes in carefully selected, multi-media "theme" gigs. The theme of the evening was the British Invasion. As such, they covered some of the greatest hits of the Rolling Stones, Wings, and the Who. While they performed, a large screen behind flashed live concert video of the acts they impersonated. When they transitioned from one band to another, the screen played old interviews with the original bands and clips from the Ed Sullivan show and others. Great stuff, totally google worthy. We grabbed dinner at one our favorite spots in downtown Pensacola, the Global Grill. It's a tapas joint so you basically just order of bunch of appetizers and mix and match, the garanimals of dining. Great stuff and a wonderful end to a special day.

As always, I hope you're enjoying each day as it comes.

Warmest regards,

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