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2016: A Year of Transitions

The October 2015 edition of The Weiss Report focused on the idea that both sides of the political debate use economic news to create partisan stories of how the bad the economy is. We outlined several innovative trends emerging in the domestic economy that should keep the U.S. as a dominant economy for some time to come. We introduced and discussed innovations that give us reason to be optimistic for the long-term future.

In this edition, we focus only on 2016. We think this year will be one of significant transitions in the areas of market trends, economic policy, and politics. We think this convergence could take the stock and bond markets on wild rides until the outcome of the election is known. In our 19 years of authoring The Weiss Report and our 38 years of working in the financial services industry, we have not seen two more starkly different potential outcomes in a presidential election. The outcome of the election may be the most important variable in the direction of stock and bond market for next eight years or so.

We want to discuss economic issues of today and how the election may affect them. First is the longevity of the current economic recovery. Statistically, the recession ended in 2009. We are currently in the seventh year of the recovery. The media coverage has not done a great job reporting the historical fact that recoveries only last so long until the next recession arrives.

The second issue is the recent history of recessions prior to a new president being elected. Presidents Carter, Reagan, both Bushes, and Obama have all inherited recessions when they were elected. That's five of the last six presidents. All prior recessions mentioned started at the end of their predecessor's watch and were inherited by the incoming administrations. Recently, Citigroup released its 2016 economic forecasts. They place the probability of a recession at greater than 50%. Without wading too deeply into their rationale, they are concerned that corporate earnings from Q2 and Q3 2015 were lower than expected. With the specter of higher interest rates, earnings may continue to flatten or decline in 2016. Markets tend to be grumpy if corporate earnings are stagnant or decline.

One of the greatest divides in the political polarization in 2016 is on economic policy. Whoever prevails next November will likely pursue a completely different economic policy course than would their opponent. Today, we have what we have called for some time a Plow Horse Economy. This is to describe the underachieving recovery post 2009. We are recovering, but at historically low levels.

We believe what has made this a Plow Horse economy is mostly attributable to economic policy. Many think that the ACA, Dodd-Frank, the large tax hikes of 2013 and increased regulations have been the primary retardant to robust growth. The election in November could elect a candidate that is in favor of larger government, tax hikes, and increased regulation. If this were to occur, it would be very difficult to make reasonable earnings estimates for stocks for 2017-2019. This could increase market volatility.

The other major party is currently being led by a candidate that may be fun to listen to, but seems ill equipped to take our current economy and turn it back into the thoroughbred we have seen in previous recoveries from recession.

We believe that robust economic growth is seeded in private sector incentives. The larger the government footprint, the more the country is likely to stay in the Plow Horse mode, or even move backwards for a while.

Last, no-one can know at this time what the economic dampening effects will be of an energy industry that has not recovered in a similar way oil declines have worked their way through in the past. The longer oil and natural gas prices stay depressed, the more this wave can have a deflationary effect in the economy, slowing growth at a critical time.

We believe the longer term picture for our economy is brighter than five years ago. We believe this because of how the organic side of our economy has flourished despite headwinds mostly from government policy. We also note that the level of economic pessimism is very high. It is from these conditions that long term secular bull markets flourish.

What We Expect Ahead:

However, we must respect that 2016 could be a year of markets needing to react to events rather than discount future earnings. For now our focus should be on the short term rather than the long term. Intellectual flexibility is a must when managing assets for long term security and growth.

We expect that 2016, and beyond, can be the time that begins to undo much of the policy headwinds that have kept the Plow Horse economy from accelerating. The fallout from the election regarding economic policy could tilt the stock and bond markets in one way or another.

Markets work best when they discount the future, not react in the present. Because the weight of the potential outcomes possible in November, strategists have an almost impossible task of trying to create a narrative of expectation for 2017 through such a thick fog.

We will take the position that the market could perform in 2016 as it has in the last 65 years. But we must also respect that the decisions made in 2016 can make or break robust GDP and earnings growth moving forward. We are preparing for either outcome

Portfolios:

The upcoming year will bring some changes in our portfolios. Early in 2015, we began to construct models that would integrate the investment process we have used at Weiss Wealth Management Group for some time. Our goal is to create a more disciplined, emotion free process that would marry computing power with sector investment vehicles. We think this should give us a better result at lower internal fees.

For retirement accounts we have created a tactical model designed to rebalance assets into sectors that are performing better than others each month. Because this model could make changes each month, we don't anticipate creating any long term capital gains. Because retirement accounts do not pay taxes on gains in the year earned we think this model is appropriate.

Our Strategic Model is also momentum based. We will use this model in taxable accounts because we anticipate less trading than the Tactical Model and should produce long term gains. Both models feature a systematic approach to momentum investing that has greater discipline, no emotion in investment selection at lower fees. We think this concept is the future of asset management.

Portfolios in 2016 and beyond will be a combination of both models as well as having a portion of the portfolio managed as we have for almost 40 years. However, portfolios are not monolithic. In this context, we will treat portfolios of clients older than 60-65 differently in 2016 than portfolios of clients below this age threshold for 2016.

We think 2016 has the potential to be an extremely volatile year. For those close to or in retirement, we must treat 2016 with a high degree of caution. Tepid economic growth, the trend of interest rates, domestic security and of course the November election may present too many potential wild cards for markets to endure. Accordingly, we intend to minimize or eliminate equity holdings and place these assets into investment grade short term bonds. This activity should minimize the effects of a chaotic down year for stocks. When the air clears later in 2016, we intend to return to the portfolio strategies and tactic we normally use.

Enclosures:

Enclosure #1 is a reaction piece to the recent move by the Federal Reserve Board to raise its benchmark interest rate. While this move has been discussed for quite a while, it has finally happened. The importance for investors can be debated and we lay out a few points regarding this change.

Enclosure #2 focuses on an amazing app called GoodRX. It allows users to scan their area for the price of their prescription drugs. Readers might be amazed to find out that the same medication can be purchased drastically cheaper without much effort.

We acknowledge that 2015 was a difficult year for one year performance. We ask you to read Enclosure #3 for some perspective on how difficult the investment environment was in 2015. The piece points out that a majority of stocks saw double digit declines from their 52 week highs.

Important Disclosures

This report is not intended as a complete description of the securities, markets or developments referred to herein. It should not be viewed as an offer to buy or sell any of the securities mentioned. Information has been obtained from sources considered reliable, but we do not guarantee that the foregoing report is accurate and complete. Additional information and sources are available upon request.

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The authors' opinions are subject to change without notice.

There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices rise.

Gross Domestic Product (GDP) is the annual market value of all goods and services produced domestically by the US.

U.S. Treasury Securities are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value.

Companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Investments in the energy sector are not suitable for all investors. Further information regarding these investments is available from your financial advisor.

It is not possible to invest directly in an index. The S&P 500 is an unmanaged index of 500 widely held stocks. The Russell 2000 index is an unmanaged index of small cap securities which generally involve greater risks. The Russell 3000 index is an unmanaged index that measures the performance of the 3000 largest US companies based on total market capitalization. Past performance may not be indicative of future results.

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Interest Rates Have Been Raised, Finally!

On December 16, 2016 the Federal Reserve Board (Fed) raised its benchmark interest rate it charges banks to 0.25%. This is the first rise in this rate since 2009. The Fed had reduced this rate to 0.0% to promote growth in the economy after the mortgage/banking/credit default swap crisis that began in 2008.

We have all heard, ad nauseam, for over two years that the Fed would raise interest rates at their next bi-monthly meeting. There has been a lot of coverage of the potential negative effects of such an action, while conceding not raising rates was also a sign of trouble. This type of coverage has caused frustration and confusion for investors. No one seems to have a handle of what raising interest rates by even a small amount might really mean.

The New York Times has cited job growth as the key reason for raising rates. They concede that this move may make it more difficult to accelerate GDP growth. We agree with this assessment. They also cited higher borrowing costs to keep the national debt afloat.

The Wall Street Journal pointed out that the Fed may have also made its move because non-financial debt as a percentage of GDP has been rising while rates were held at 0%. They cite a concern of a debt bubble, and raising their rates slowing should put a damper on this potential threat. They also worry about liquidity in lower quality debt as seen this month with several high yield bond funds delaying investors' redemptions.

We think, for investors, the coverage of the Fed action is overrated. We know that interest rates have been at historical lows for years now. We know that the 0.0% interest rate program could not last forever. Additionally, despite the media's constant analysis, no one can really know the longer term effects of yesterday's rate hike. One thing we are sure of is that our daily lives change little because of the Fed's action. We can still buy cars, shop online, attend movies, and sporting events.

Now that this action has finally occurred, we think markets will turn their focus back to corporate earnings and the state of growth in the domestic economy.

Saving Money on Prescription Drugs?

Like so many things in our lives, the way we get prescription drugs has changed. Rarely do we have a long term relationship with one pharmacist. Anyone who takes prescription medicines knows that prices for drugs not covered by insurance or co-pays can vary widely. Calling multiple pharmacies or superstores to check prices can be time consuming and frustrating.

In our last edition, we noted the incredible proliferation of mobile applications to make it easier to find what we need as quickly as possible at the best price. In that edition, we focused on transportation apps.

In this edition, we would like to focus on an app designed to let us find the best price for prescription drugs near our home. GoodRX – found online at www.goodrx.com or via a smartphone app provides an amazing service.

After you input your location (if using the website), the name of the drug you take, and the dosage, GoodRX provides a list or map of places that can fill the prescription. Amazingly, it gives estimated costs, based on historical contracts, at each location. What may cost \$75 dollars at one location may be \$9 at another. Sometimes there are even coupons available, within the app, to reduce costs even more.

We think this service is a great value. Today, prescriptions are not only filled at pharmacies, but at megastores like Meijer and Target. Some megastores fill popular medication for free as a loss leader thinking that by bringing you in their store for a prescription, you would stay and shop for other items.

Since prices for prescriptions can vary widely, this service allows you to check many different outlets in just a few minutes. We urge our readers to take a look at GoodRX.

A Stealth Bear Market

A veteran of daily market reporting, Art Cashin, was recently asked to comment on the stock market in 2015. He said: "this has been one of the most difficult markets in 50 years."

We recently received a market analysis from our friends at Day Hagen Asset Management that sheds more light on the difficulty of 2015. Chief Strategist, Don Hagen, looked "under the hood" of the stock market and made the following comments.

"...it is easy to see why investors are distressed:

- The average stock in the S&P 500 is now -13.5% below its 52 week high.
- The average stock in the Russell 3000 Index (1000 large cap plus 2000 small cap stocks) is -20.2% below its 52 week high
- The average stock in the Russell 2000 Index is down 23.7% below its 52 week high.
- And according to Morningstar, the average Tactical Allocation fund is down -6.62% the average Large Value fund is down -5.62% and the average Small Cap fund is down -6.20 year to date.
- Only 28% of Russell 3000 are trading above their 50-day moving averages and just 35% are trading above their 200-day moving averages. Only 38% of S&P 500 companies are trading above their 200 day moving averages.

Noticeably, the broad market weakness is being masked by a minority of stocks doing well-and those tend to lead media discussions." - All data through 12/11/15.

In many issues of The Weiss Report we have noted that there is a difference between the "stock market" and a "market of stocks". This year saw weighted indices decline modestly. However, when we look at the market of stocks, we see a much larger decline.

This type of stock market creates broad pessimism. Pessimism in the short term creates price volatility, but in the longer term, pessimism is bullish because people have acted on their pessimism by selling their portfolios.

We know from our experiences from 2002 and 2009 that selling after the market has declined is usually the wrong call. We reiterate that advice as we move into 2016.