

"Cup of Joe"

Well, Christmas is over and the Santa Claus rally is progressing! The markets have come out relatively unscathed after both the election and Janet Yellen's interest rate hikes. We have received several questions from our clients that we need to address. First, with a substantial post-election rally, will we get more positive financial news to move the markets forward in 2017 or are we setting up for a pull-back? In the short-term, we may see a pull-back of some sort due to valuations becoming stretched after the recent rally. Knowing we can't time markets, we feel that any downturn would be short-term and we would be buyers of the dip. Long term we see the stock market continuing to remain positive but hinging on policy decisions in the next couple of months. Even with infrastructure and tax reform on the immediate agenda, these wouldn't be felt until 2018. Risks on the horizon could come from a strong dollar or policy rhetoric that doesn't come to fruition. Tailwinds could be coming from tax reform; an infrastructure spend and de-regulation. We remain cautiously optimistic moving in to 2017, riding the new wave of emboldened market participants representing over $5 trillion dollars who have been on the sidelines for the last 8 years. This large amount of money coupled with the money rotating out of bonds looks to be positive for equities in the future.

Next, since we have the new President-elect juicing the markets with pro-growth rhetoric that caused a surge in interest rates in addition to the Fed's quarter of a point increase on December 14th; what will that do to the bond market and how have we positioned your portfolio for such a move? As many of you know, when interest rates rise, the value of bonds go down. If you noticed November 10th, we sold out of one of our biggest bond positions and moved into cash to protect you against this foreseeable event. And looking at prices today, this was a great move. When you look back through history, you will notice that rates always move ahead of the FED so one must make anticipatory decisions to protect assets. We will remain underweight in fixed income while the FED continues on its path of normalizing rates.

In our most recent full rebalance of your portfolios, we also made some minor adjustments and added a few new positions. We are maintaining a substantial position invested in the United States to take advantage of the perceived (need to see how it shakes out in congress) pro-growth agenda of the new president-elect. We also remain positive on the ongoing stimulus package by the ECB and its effect on Europe. While trouble remains on the political front in Europe, the region is still trading at a substantial discount to the U.S. and pays a 3-4% dividend yield. And finally, in the high-risk portfolios, we added exposure to Mexico as our contrarian trade for next year. Since Mexico is receiving so much negative publicity from the election, the peso has tanked to historical lows along with the price of its stock market index. While we feel this market has been oversold, we also believe that the potential for repealing NAFTA was election-rhetoric and is highly doubtful to play out. Remember, this was an historic trade agreement with a broad impact on the entire continent. One final positive note to consider regarding

the Mexican economy is the weak peso. As the talk of jobs being brought back to the U.S. intensifies, Mexico will actually benefit in trade with extremely low costs for labor and goods. As one comparison showed, U.S. labor costs for manufacturing on average is $37/hour vs. a Mexican manufacturing wage now at just $5/hour. Even if the U.S. companies are prohibited from outsourcing jobs, other countries such as China will look at the attractive demographics to produce goods this close to the United States. This move substantially reduces their transportation costs as well. Overall, we think this emerging market presents an interesting 2-4 year play for the high risk portfolios.

Another portfolio move is the addition of Disney. As many of you know, Disney is a large blue-chip stock that has many positive characteristics that we look for when choosing equity positions. Over the past year or so, Disney's stock has had a shadow cast over it due to the underperformance and loss of subscribers in one of its content assets, ESPN. While this remains a problem, we feel there are a lot of positive growth stories that could play out. First, Disney is one of the last remaining content companies (they own the original movie franchise for Star Wars, Beauty and the Beast out in 2017, cartoons and TV shows produced by such entities as Hulu, ESPN, ABC, A&E, MARVEL, Disney Media, and Pixar) that has not been acquired by a larger entity. With the direction of consumer TV viewing moving toward streaming video, this makes a large content provider such as Disney, very valuable. We also feel that if Disney were to divest ESPN, it's valuation in regards to its growth potential would be very attractive. As a company, Disney also strongly represents what Warren Buffett coined as a stock's moat. A moat is the competitive advantage Disney has over other competitors. This large moat provides the company a competitive advantage over other companies with pricing power, brand strength and key barriers to entry. And when you get right down to it, there isn't another company like Disney. In a way, they have a monopoly on the business of children's entertainment. Another positive note coming in the last week was that the state of Florida announced that they are Zika free. This will help boost the attendance at Disneyworld, which also took a hit in the last year.

Now for speculation: What if Apple would consider buying Disney? As the new regime in Washington reduces corporate taxes, this provides an incentive for Apple to repatriate its money from overseas. It would have roughly $200 billion AFTER TAXES ARE PAID. Yes, that's $200 billion with a B. We feel that even as a long shot, the synergies between the two companies are immeasurable. With Apple's IPAD numbers waning, capitalizing on the content and barriers to entry that Disney has would be a match made in heaven. It would provide a huge trove of content for Apple's TV ambitions as well as provide new avenues of growth that Apple seems to be looking for. Let's paint the picture. Apple Play in every car now has Disney content for your kids in the backseat. Apple's IPAD's now are retrofit with Disney branding and unique content. And the wildest idea that Apple has not brought out yet is Augmented Reality which many of you know from experiencing the Pokémon Go phenomenon. These could be exciting times.

To wrap things up; we are feeling quite positive moving into to 2017. We have your portfolios perfectly in balance based on your chosen risk preference. We, the staff at Chapel Hill Investment Analysts, hope you had a very Merry Christmas and wish everyone a prosperous New Year. Please don't hesitate to refer your friends, family and coworkers. Remember, we built this firm on the strong word of mouth referrals over the past thirty-six years and we are in a strong position to grow the firm with your help in the future!

-Joe, Ryan, and the Chapel Hill Investment Team

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