Looking forward to 2017
Some food for thought....

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Your Qualified Retirement Plans

Making consistent contributions to retirement plans over time and reviewing those plans at least once a year, is a key component of any successful financial plan. As we start the new year:

Maximize your retirement plan contributions. And, if you are 50 or over, take full advantage of the catch-up provisions that allow you to make additional annual contributions.

Be certain to review your investment selections, both the funds you already hold in the plan, and the funds you designate to receive your future contributions. Ensure that your selections continue to align with your overall financial goals and with your financial-allocation objectives.

Review your beneficiary designations to ensure they are up-to-date with your wishes and with any life-changes that may have occurred.

Roth Conversions?

With the possibility of lower income tax rates in 2017, consider a partial or total Roth Conversion. This strategy can be very beneficial, but it requires careful analysis from a tax planning perspective and from the standpoint of timing. For instance, a conversion that is executed after a stock market correction (rather than when the market is at or near highs), provides you with the potential to shelter significant future market appreciation from income taxes.

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Key Investment Takeaways

* *We are still in the midst of a "secular bull market" in equities, in spite of a mild earnings-recession since 2014, a narrow trading range, and a quick cyclical bear market in early 2016.*
* *The probability of a recession over the next year is relatively low.*
* *Political and geo-political risks are high and could have a meaningful impact on markets.*
* *Investors' optimism after the U.S. elections, regarding deregulation, tax reform, fiscal stimulus and stronger economic growth, has resulted in significant "rotation" within the market, higher long-term rates and a stronger Dollar. In this environment we favor economic-sensitive sectors vs. low-volatility and high-yielding groups, "value" vs. "growth", smaller companies vs. larger ones, and businesses less sensitive to the U.S. Dollar appreciation and potential trade disruptions. However, we would wait for better entry points to invest in some of these sectors & industries. Moreover, we believe these rotations are temporary, and favor a less-cyclical, less-risky positioning over the longer-term.*
* *We believe "Value" can only be properly assessed in relative terms. History is an important guide, but in practical terms, investors can only make investment decisions based on the relative risk-return tradeoff of the available investment and asset class alternatives. In this context, we believe equities are attractive relative to bonds and other investment opportunities, but expensive when compared to historical data. Stay invested, but with the proper cash-cushion to protect against "tail-risk".*
* *The U.S. market trades at a premium to other markets thanks to better fundamentals; however, in some cases this premium seems excessive to us, and we will be looking outside the U.S. for investment opportunities.*
* *Even though we are positive on equities in the short- and medium-term, we have serious concerns about the economy over the longer-term. Political "populism", extreme expansionary global monetary policies, and fiscal irresponsibility are dangerous headwinds for global economies and equity markets.*
* *Higher short-term and log-term interest rates are likely to open new investment opportunities in fixed-income; however, after a 30-year secular bull market in bonds, the market reaction could be swift and meaningful.*
* *Credit risk has increased and spreads have widened over the past year, but credit conditions remain favorable for the economy. We favor selective opportunities within the better-quality segment of high-yield bonds and lower-quality of investment grade.*
* *We continue to be opportunistic and patient, and as always, are keeping an eye on your long-term objectives.*

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Protect Your Family & Your Estate

Review the spectrum of your insurance needs and current coverages, to ensure that you and your family will be sufficiently provided for in the event of a death, disability, or long-term care need.

In addition, while the possible elimination of the federal estate tax under the Trump administration could reduce your need for life insurance to fund federal estate-tax obligations, state-level estate or inheritance taxes will likely remain, so life-insurance funding provisions may still be appropriate.

Your Social Security Planning

If you are 62 or older and are not yet taking Social Security benefits, review whether to take benefits now, or to defer until age 70. Your financial planner can model the financial impact of various alternatives for you, taking in to account your own options and those of your spouse.

Income Tax Deductions

Another element of the Trump administration's tax proposal is to put a cap on the total amount of itemized deductions allowed on your federal income taxes. This may require you to construct new plans for your charitable giving, and may also impact the optimal timing for making your state and local income tax payments.

For some taxpayers, the use of Qualified Charitable Distributions from an IRA account (up to $100,000 per year for taxpayers at least 70 ½) may become a more valuable charitable-giving strategy. Such distributions have the additional benefit of satisfying, in whole or in part, the giver's annual Required Minimum Distribution.

Take Action!

Your financial planner can model the likely impact of these various scenarios and alternatives as they relate to your unique situation. It is important to remind you that, before taking any action, you should review plans with your tax and legal advisers. As always, we can work with you and your other professional advisers through the planning, implementation and monitoring process.

FP/CM Close-Up

Zoetis not your Typical Pharmaceutical" Company

CHRISTOPHER CONWAY
Portfolio Manager

We'd like to share our insights into one of our holdings, Zoetis (ticker: ZTS). Zoetis is the largest Animal Health company globally, providing medicines, vaccines, parasitides and other pharmaceuticals for the Livestock and Companion Animal end markets. We think very highly of the company but believe that the company and its business model may not be understood by investors.

Zoetis is not a Typical "Pharmaceutical" Company:

Zoetis is classified as a Pharmaceutical company but its business model as an Animal Health company is very different…in a positive way. Unlike many traditional pharmaceutical companies, Zoetis does not depend on "blockbuster" drugs, does not sell its products to large, price-sensitive managed care companies and government entities, and does not need to engage in long and expensive R&D projects. Furthermore, the looming threats of patent expirations, generic competition and increased government regulations that have pressured pharmaceutical stocks and business models are not overly material for Zoetis. Instead, Zoetis sells a diverse set of products in which brands and product innovation, not patents, create significant loyalty from their customer groups - veterinarians and livestock producers. Brands play an important role in the Animal Health industry because the products are generally lower-priced but are still very important to veterinarians and livestock producers in their respective businesses - all of which helps reduce the impact of generic competition and pricing pressure for the industry.

Why Do We Own Zoetis?

We own Zoetis because it is a defensive stock and the premier player in the industry, with leading market shares in most geographies and products, scale advantages in manufacturing, R&D and sales, and well established brands and products. The company has a strong balance sheet, high margins and attractive returns. Additionally, the company, along with the Animal Health industry overall, will benefit from a number of secular trends such as growth in companion animals (e.g. dogs and cats) and demand for animal proteins. In most geographies, the number of companion animals continues to increase and spend per animal increases as companion animals become more integrated into households. Demand for animal proteins in diets continues to increase as well, especially in those markets with growing middle classes and urbanization. Zoetis serves both of these markets closely and should benefit from these secular trends.

What are the Risks?

The largest risk with the investment is that the stock trades at a high multiple to current earnings, and this multiple would contract if industry growth slows or the company does not follow through on its financial objectives. The company had previously been a subsidiary of Pfizer, and since it's IPO in 2013, the company has grown faster than the market while increasing its operating margins substantially. These trends need to continue in order to justify the stock's multiple and healthy returns for shareholders. In addition to valuation risk, there has been some consolidation between competitors, and while this development may be a risk or an opportunity, it will need to be monitored. Finally, there is some regulatory risk regarding the future use of antibiotics and vaccines with livestock. Zoetis's geographic and product diversification helps minimize this risk but industry growth would slow materially if limitations were implemented.

FP/CM Knowledge Corner
Yield to Maturity & Duration

AARON COHEN, Ph.D.
Partner, President, Portfolio Manager

You want to invest in a bond and your banker shows you two bonds issued by the same company, with exactly the same credit risk, but with slightly different **yield-to-maturity (YTM)**. Your banker suggests you buy bond "A" because it offers a slightly higher YTM. You are unsure and you decide to consult with your friend Maureen at FPCM.

BOND	PRICE	COUPON	FREQ	YRS	SETTL.	MAT.	YTM
A	129.00	12.00%	1	5.0	12/20/16	12/20/21	5.25%
B	95.00	4.00%	1	5.0	12/20/16	12/20/21	5.16%

Maureen points out to you that YTM is an incomplete measure, as it is calculated under the implicit assumption that interest income can be reinvested at the YTM rate. Since current short-term rates are well below the YTM of bond "A', the likely "realized" return is probably going to be below the "promised" YTM of 5.25%. She proceeds to show you that if the coupons could be reinvested at the current short-term rate of 2%, Bond B would be preferably at current prices since its annualized return would be 4.93%, 21 basis points higher than the 4.72% return for Bond A.

Moreover, Maureen points out to you that this difference between the YTM and the actual return is due to different sensitivities to interest rate changes. To show this, Maureen introduces a zero-coupon bond from the same company, Bond "C", which matures in 4.6 years and trades at $80. As shown in the interest rate sensitivity columns below, the new zero coupon bond "C" behaves much closer to bond "B" than to bond "A" when rates change. This is because they have a similar "**Duration**" (or **Modified-Duration, M-Duration**), as shown.

BOND	PRICE	COUPON	YRS	MAT.	YTM	M-DURAT	INT RATE SENSITIVITY 100 bps	-100 bps
A	129.00	12.00%	5.0	12/20/21	5.25%	4.0	-3.85%	4.06%
B	95.00	4.00%	5.0	12/20/21	5.16%	4.4	-4.27%	4.52%
C	80.00	0.00%	4.6	07/20/21	4.99%	4.4	-4.25%	4.48%

"**Duration**" is simply defined as the time-weighted average of a stream of cash flows, and as such it measures the sensitivity of the present-value or price, to small changes in interest rates (higher duration means greater sensitivity to rate changes). Thus, when comparing bonds with different coupons we should be more concerned with their "Duration" than their respective maturities.

1 The mathematical formula is :

$$D = \frac{\sum_{t=1}^{n} \frac{C_t}{(1+r)^t}(t)}{\sum_{t=1}^{n} \frac{C_t}{(1+r)^t}}$$

Where: D=Duration, t=period: 1,2,...n; C_t=coupon or cash flow at time "t", & r=YTM.

A Quick Take - Investment Implications of the Election

AARON COHEN, Ph.D.
Partner, President, Portfolio Manager

ISSUES	Positives & Concerns	INVESTMENT IMPLICATIONS
Macro Economy	+ **Pro-growth agenda**: (1) Lower regulatory pressure. (2) Fiscal stimulus. (3) Corporate tax reform. - Protectionist and activist **trade policy** could be disruptive to global growth. - Higher **inflationary** expectations.	+ Favor **economic-sensitive** sectors & industries. + Favor "**Value**" vs. "**Growth**" + Favor companies **less sensitive to trade**. + Lower regulatory pressure should be particularly positive for: financials, energy & health care. - **Stronger U.S. dollar** will negatively impact EPS growth, but benefits market multiple. - Protectionism will negatively impact importers and exporters (**tech, retailers, aerospace**). - **Stronger U.S. dollar** & trade restrictions are a headwind for **emerging- market** equities and fixed income. Additionally, it puts additional pressure on **China's** efforts to controlled out-flows.
Interest Rates & Inflation	- Uncertainty regarding **Fed** Chairmanship and new nominations. **- Higher long-term rates.** **- Higher inflationary expectations.** + **Steeper yield curve**.	**- Long-term bonds** are expected to underperform. - Negative for **Gold** in the short-term as the US$ and real rates have increased. **- Yield Plays**: utilities, REITS, telecom. - Higher inflation should be negative for **restaurants & hotels**. + Favor **TIPS**, **floating-rate bonds** and **selective corporates**. + **Financials** should be major beneficiaries of a steeper yield curve and lessened regulatory pressure. + **Homebuilding**: a bit higher LT rates, faster growth and higher inflation expectations are positive for homebuilding in the short-term.
Fiscal & Tax Policy	+ **Corporate tax reform** is well overdue, and should increase competitiveness of U.S. firms, accelerate M&A activity in the U.S., and accelerate profit repatriation. + **Infrastructure** spending should be positive for the economy in the short-term ($250B-$750B). - Spending will increase **the fiscal deficit** and **government debt** outstanding by at least 50% of spending. Debt is already at a very high level. - Trump has not indicated a willingness to tackle **entitlement** programs. ? **Extent & timing of stimulus**. Will Europe, Japan & China add to stimulus?	+ **Capital Goods Sector**: Faster economic growth, deregulation and tax reform should push capital spending. + Firms with large international profits a/o overseas cash balances (**health care, tech**) would benefit significantly from lower taxes on profit-repatriation. - Infrastructure spending is not likely to be reflected in orders or revenues until late 2017, at best. - Higher deficit translates into **higher supply of government bonds**, and eventually higher interest rates. ? Changes in tax policy are likely to also generate losers (ex. mortgage interest and/or interest deductibility, elimination of subsidies & tax credits, other).
Other	- Trump's personality and **government inexperience** increases uncertainty & should increase market volatility. ? **Immigration** reform: how & when. ? **Health Care:** Timing and extent of ACA repeal & replacement.	? **Immigration** reform could end up being positive or negative, depending on its impact on worker availability, wages, HB1 Visa program & others. + ACA repeal or reform could have a major impact on the health care sector, and other sectors dependent on lower-paid employees. Overall, changes are expected to be positive for the health care sector & the economy.

Our Investment "Balance Sheet"

POSITIVES

+ Except for the risk of serious external shocks, it is difficult to foresee another deep recession at this time because the typical down- levers (capital expenditure, auto production, housing, credit) are not over-extended.
+ Central banks are unlikely to tighten monetary policy aggressively over the next 2 years.
+ Global earnings are starting to grow after almost 2 years of an "earnings-recession".
+ Fiscal stimulus would be a tailwind for the U.S. & global economies in the short term.
+ Corporate tax reform & lower regulatory pressure could be an important catalyst for faster economic growth.
+ U.S. consumer spending should continue to grow due to increasing employment, a recovery in household wealth, and the end of consumer de-leveraging.
+ Economic growth in Europe and in Japan, while still lackluster, has improved. Growth is also likely to re-accelerate in emerging economies ex-China.
+ The rate of inflation is expected to remain reasonably low in the short- and medium-term.
+ **Valuation:** Equity valuations are low relative to free-cash flows and interest rates.

CONCERNS

– The global economy, and in particular manufacturing, has slowed down since late-2014.

– Earnings revisions have been negative since late-2014. An upturn in earnings is necessary for U.S. equities to move higher.

– The Federal Reserve has reversed policy, and further interest rate increases are expected over the next couple of years, albeit at a moderate pace.

– Expectations for higher economic growth after the election, has resulted in higher long-term rates and a stronger U.S. Dollar, which could negatively impact earnings in the short-term.

– Fiscal stimulus would be a tailwind for the U.S. economy in the short term, but debt level is high and too much stimulus could end up being counter-productive in the long-term.

– An aggressive trade policy by the new administration could be highly detrimental to global economic growth.

– The Chinese economy has slowed down considerably over the past 3-4 years, accelerating the decline in commodity markets, and slowing down emerging economies.

– Lower productivity, the aging of the population in the developed economies, and low labor participation are important long-term headwinds for global economic growth.

– Inflationary expectations are extremely low. Even a random increase in headline inflation figures could scare the markets and put significant pressure on monetary authorities.

– Geo-political risks continue to increase across the globe.

– Political "Populism", on the rise across the world, could have major long-term economic consequences.

– **Valuation:** Equity valuations are high in absolute term versus historical standards.

We hope you have enjoyed this publication. Please contact us with your questions, and with your thoughts and ideas at **contact@fpcm.net.** We look forward to hearing from you!

Thank you for your continued confidence and support.

Your FP/CM Team

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