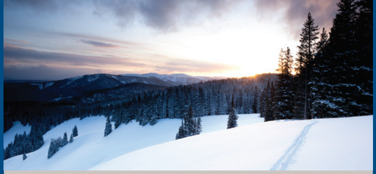

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OBERMEYER WOOD **NEWS**

WINTER 2017

MARKETPOINT

The year 2016 will be remembered for many things, but its place in history could best be described as the year of the "unpredictable." The professional "forecaster class" got most everything wrong: The Brexit vote where British voters chose to exit the European Union, shocking the bureaucrats; the U.S. Republican nominee; the U.S. Presidential election; and financial markets' favorable reaction to a Trump victory. Voters, it seemed, had become un-poll-able by conventional methods. These outcomes again confirmed the futility of attempting to predict the future and then tying those forecasts to investment decisions. Instead, the unfolding of these events reinforced the message that investors are well served by developing a long-term plan based on a time-tested investment philosophy and then sticking to it as investment "weather squalls" come and go. Furthermore, when substantial, unpredictable occurrences happen, the new information can be thoughtfully assessed and changes can be made in a deliberate fashion based on significant, sustainable developments. Historically, that process has guided us well.

For investors, perhaps the most surprising outcome of the election was the strong rise in U.S. stock markets since mid-November, which had been predicted to fall sharply in a Trump victory. Looking past this contentious election, it seems financial markets are anticipating that Washington will have a more positive stance towards business than in recent years. The post-election market appreciation was also arguably a result of investors realizing that the underlying economy and job environment weren't as dire as had been portrayed during the election cycle.

With the new makeup of Congress and the Presidency, the likelihood of passage of some proposals designed to stimulate the economy has improved. Some of the more impactful include the following: **Tax Reform**, with lower rates for individuals and businesses, as well as elimination of some deductions; **Repatriation** to the U.S. of potentially hundreds of billions held by U.S. companies in foreign banks; **Reduction of Regulations**, especially for small businesses, which are the principal job creators for the economy, and **Infrastructure Spending** focused on needed facilities.

Beyond these specific programs, an intangible shift in sentiment could emerge. For example, following the election, a meaningful improvement was recorded in the University of Michigan's Index of Consumer Sentiment. Also, surveys of business leaders have suggested early signs of a pickup in investment spending and hiring plans. While hard to quantify, some increase in confidence could boost economic activity above recent expectations. ›

ObermeyerWood
INVESTMENT COUNSEL, LLLP

Despite the recent stock market rise, a number of challenges and uncertainties will face the new administration. Key to realizing the benefits of initiatives such as tax reform and others will be their timely implementation. Roadblocks created by overly aggressive Republicans, politically motivated Democrats, or simply the bureaucracy could prove unsurmountable. Also, if enacted, punitive trade policies – the implementation of which Trump supported during his campaign – could dampen economic activity worldwide. While not considered likely, the possibility of a serious trade war exists. Another longer-term concern is the potentially negative impact on the federal deficit and, by extension, possible inflationary pressures from the various tax cuts and spending proposals; however, this may be partially offset by higher tax receipts from greater economic growth. Finally, rising interest rates will likely challenge investors, with the Fed communicating its intent to increase rates again in 2017.

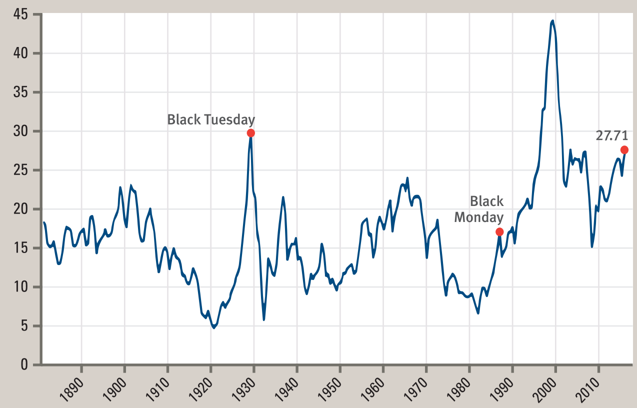
The new President's own personality creates the greatest area of unpredictability, namely in the foreign policy arena. Some see the risk of destabilization from foreign policy snafus as a significant threat. There is also concern about social issues and environmental regulation. It is too early to tell how these factors will play out, but it is prudent to expect increased volatility as we transition to the new administration.

Overall, the U.S. stock market has rallied sharply since the election as investors are partially discounting some of the potentially positive economic developments, even though meaningful results are some time away. While the uncertainty associated with new policies and geopolitical developments could lead to some volatility in the markets, it seems likely that the various economic initiatives could extend the economic expansion, providing the basis for growing earnings and attractive equity returns.

Our premise remains that the direction of the equity market in the short-to-intermediate term is unpredictable. However, we believe continued innovation, improvements in business productivity, and U.S. economic resilience will produce attractive returns far into the future.

It is worth noting that current equity valuations are somewhat expensive on an historical basis, suggesting a careful, measured approach to investment decisions. As an example, the chart below shows the cyclically adjusted price-to-earnings ratio (aka, "Shiller PE 10"), which looks at the inflation-adjusted previous ten-year average earnings compared to current prices. One can see that prices are indeed on the high side:

Shiller PE Ratio

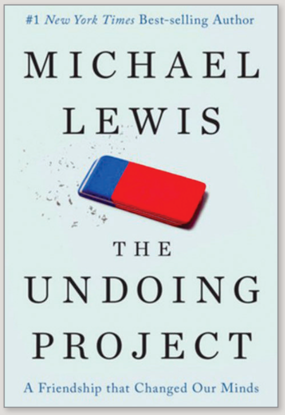


Source: www.multpl.com

Regardless of the various predictions, we believe that our focus on valuation and quality companies will tilt the scales in our clients' favor, increasing the likelihood of achieving good long-term results. Investing for each client in a manner consistent with his or her objectives, situation, and temperament is also key. It is for this reason that we encourage an open and ongoing dialogue with our clients so we can understand any changes in their overall financial picture and adjust portfolios accordingly.

WINTER READING

***The Undoing Project*, Michael Lewis**



In 1974, an article appeared in the journal *Science* with the somewhat inscrutable title of "Judgement under Uncertainty: Heuristics and Biases." The scholars, Amos Tversky and Daniel Kahneman (author of *Thinking, Fast and Slow*), had set out to quantify and describe how people behaved when confronted with uncertainty. What they found was a strong tendency towards systematic bias – and error. Previously, there had been high faith in the idea of *the economic man*: someone who behaved with optimal efficiency, was analytical and dispassionate, and ultimately rational. What Tversky and Kahneman found – and what would go on to reshape the thinking in a host of fields including economics, politics, medicine, and law – was the presence of systematic cognitive biases and miscalculations, or better understood as irrational, emotional behavior. A revolution in behavioral theory was afoot, and Tversky and Kahneman were leading the charge.

Michael Lewis, author of multiple books including *The Big Short*, *Liars Poker*, and *Moneyball*, has chronicled Tversky and Kahneman's lives and bodies of work in his latest book, *The Undoing Project*. In many ways Lewis is a natural fit for this endeavor as several of his prior books have focused on those who use data in unique, groundbreaking ways. In the case of Tversky and Kahneman, they excelled at designing experiments that teased out how people make decisions. For example, they asked two groups of students to attempt one of the following math questions within an impossible five seconds: **8 x 7 x 6 x 5 x 4 x 3 x 2 x 1** or **1 x 2 x 3 x 4 x 5 x 6 x 7 x 8**. The median guess of those who tackled the former was 2,250; for the latter, it was 512 (40,320 is correct). Rationally, there should have been no difference between the median guesses. This and similar experiments led the researchers to posit the existence of an innate "anchoring and adjustment" heuristic. Among their many other discoveries: the tendency to overly weight whatever examples most immediately spring to mind when evaluating a concept or decision (the availability heuristic) and the preference to avoid losses over realizing gains (loss aversion).

Tversky and Kahneman are notable not just for their collaborative academic work, but also for their remarkable friendship. The pair met in Israel, Tversky's native and Kahneman's adopted homeland. Where Kahneman was socially aloof, awkward, and somewhat depressive, Tversky was irrepressible, loyal, and thrived on human interaction. Together they augmented and balanced one another, endlessly urging on the intellectual brilliance in the other. While *The Undoing Project* doesn't shy away from describing the pair's psychological and economic theories, it is ultimately a narrative, diving deep into the story behind the subjects' unique lives and (at times heartrending) friendship.

Lewis has earned a dedicated readership for his ability to relate dense, rigorous topics with warmth, humor, and clarity. *The Undoing Project* is no exception. We invite you to contact us if you would like a copy.

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TOP OF MIND

FINANCIAL STRATEGY MEETINGS

Many investors start each year with a resolution to reevaluate their finances. We believe this is a prudent practice as an individual's financial strategy evolves as life changes, and it is important to examine one's overall balance sheet periodically to make sure it is on course to achieve one's long-term goals. Recognizing this is an important need, our firm has invested in a new financial strategy software package to answer clients' questions about spending levels, gifting desires, and retirement. This analysis can cover the accounts we manage as well as other assets, including real estate. Once we develop an initial model for clients, we can update this information as circumstances change. Please let us know if you would be interested in learning more about this capability and whether it is appropriate for your particular situation.

TAX TIME

In the first few months of 2017, many of you will be gathering information for your annual tax filing. Please note that realized gains and losses amounts are included on 1099s, which will be mailed to you directly from the custodian of your accounts. Historically, these reports have been issued in early February; however, you may consider delaying filing until closer to the tax deadline as amended 1099s may be issued at any time. Please reach out to our team if you would like us to provide these reports to your tax preparer on your behalf or if any questions arise. We can also provide income and capital gain/loss updates during the course of the year to aid in calculating quarterly estimates.

THANK YOU FOR YOUR REFERRALS

One of the greatest compliments we receive is when our clients and business associates recommend our firm to their friends or family members. Your confidence in our team and approach is greatly appreciated; we wouldn't be successful without your ongoing business and trust. Thank you for your continued support.

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