**MacMillan Financial**
**John MacMillan, ChFC, RICP**
**P.O. Box 66**
**Annandale, NJ, 08801**
**T: (908) 236-7500**
**F: (908) 236-7511**
**www.macmillanfinancial.com**

# SENIORS/BOOMERS NEWSLETTER

***"THE RETIREMENT EXPERTS"***

**April 2017**

> **'We could certainly slow down the aging process down if it had to work through Congress'**
> **.** **Will Rogers**

I always try to steer clear of politics; especially in my newsletters. As my father was fond of saying, 'Folks who wrestle with pigs end up smelling like *@#!" (you get the picture). But watching Congress work is about as good as a tour of a sausage factory.

The reason that I bring up Congress has to do with their impact on the markets. Markets hate uncertainty, and we have a load of that. Will we get tax reform? Less regulation? Infrastructure spending? How are we going to deal with our mounting debt load?

In addition to what lies ahead for us legislative-wise, there are a few other items out there to keep us on edge.

- What is going to happen with Brexit?
- How is Europe going to react?
- How will USA protectionist policies play out?
- What happens with the Fed tightening?
- What effect will higher interest rates have?
- How will oil prices affect our economy?
- Will China have a hard landing?

The financial media – television & print – sell more advertising when they promote bad news. Bad news sells! What they rarely reference is the ***good*** news out there.

Yale researchers William Goetzmann and Robert Shiller found that, on average, investors pegged the likelihood of a market crash at 20 times the historical precedent...because of all the bad news they come in contact with.

Notwithstanding this phenomenon, we must still face the current reality in Washington. Unfortunately, what we can expect is political squabbling which will probably result in the messy way of getting things passed. Although this would be an annoyance to the market, I don't believe it will knock it off the rails.

It is highly likely that the stock market will roll on…but…we should not be surprised to see some consolidation after a very torrid pace since the November election. Consolidation is healthy. We'll know when a bear market is on the horizon – recession will be in the air.

## How are you affected by interest rate hikes?

The Federal Reserve has raised interest rates once so far this year, and there are two or three more to come. Do you know how this affects you?

If you owe money on a variable rate basis, any interest rate hike will most likely increase your monthly payment. This will be true for homeowners with an adjustable rate mortgage; those with a Home Equity Line of Credit; and of course, credit cards.

Savers may catch a break if rates continue to rise by seeing higher rates on savings accounts, money market accounts and even on CD's. However, don't expect huge moves until inflation picks up and longer term interest rates also rise.

For those in the stock market, higher interest rates can have a negative effect on company overall earnings as the cost of borrowing could eat into profits. There is a big current saving grace here: many US corporations have very healthy balance sheets so the issue of having to borrow money will play a diminished role.

Some may know the name of Jeffrey Gundlach of DoubleLine Capital. He is considered by many to be the bond guru in the United States. When he talks about yields it pays to listen.

1st -he believes the 10-year rate will rise to 3% in 2017.

2nd – his forecast is that the 10-year yield will rise to 6% within 4 years.

3rd – if that happens the housing and the bond markets will have serious corrections.

BOTTOM LINE: Keep an eye on rates.

## Is the market over-valued?

There is a raging debate going on as to whether the market is fairly valued; or over-valued. Even though valuation measures are not as extreme as they were in 1999, the economy was stronger then than it is now.

Michael Lebowitz of 720 Global recently wrote that a comparison of valuations and economic activity shows that todays' P/E ratios might actually be more over-valued than they were in 1999.

The chart in the next column over offers a summary:

| 720GLOBAL | 1995-1999 | 2012-2016 |
|---|---|---|
| GDP Growth | 4.08% | 1.90% |
| GDP Trend | 2.30% | 1.80% |
| Productivity Growth | 1.84% | 0.49% |
| Federal Debt (Trln$) | 5.36 | 17.47 |
| Federal Debt : GDP | 60.23% | 101.40% |
| Personal/Corp. Debt (Trln$) | 15.493 | 41.11 |
| Personal/Corp. Debt : GDP | 156.09% | 220.13% |
| Govt. Deficit (% of GDP) | -0.33% | -3.29% |
| 10-Year Tsy. Rate | 6.05% | 2.13% |
| Fed Funds | 5.38% | 0.18% |
| S&P 500 3yr Earnings Growth | 7.53% | -3.84% |
| S&P 500 5yr Earnings Growth | 9.50% | 0.49% |
| S&P 500 10yr Earnings Growth | 7.74% | 0.89% |

## Is the market over-valued?

### $1.7 trillion blown on making EPS look less bad

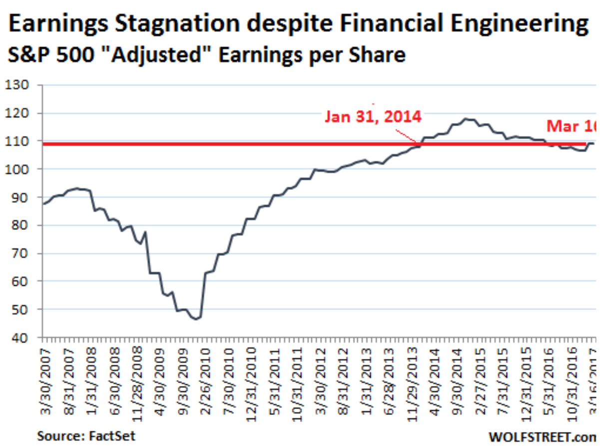
The S&P 500 index, recently closing at 2343 hovers near its all-time high. Total market capitalization of the 500 companies in the index exceeds $20 trillion, or 106% of US GDP. In the three-plus years since the end of January 2014, the index has soared 33%.

And yet, over these three-plus years, even with financial engineering driven to the utmost state of perfection, including $1.7 trillion in share buybacks, and despite "ex-bad-items" accounting schemes that are giving even the SEC goosebumps - despite all these efforts, the crucial and beautifully doctored "adjusted" earnings per share, perhaps the single most manipulated metric out there, has gone nowhere.

"Adjusted" earnings per share [EPS] are back where they'd been at the end of January 2014. It's a sad sign when not even financial engineering can conjure up the appearance of earnings growth.

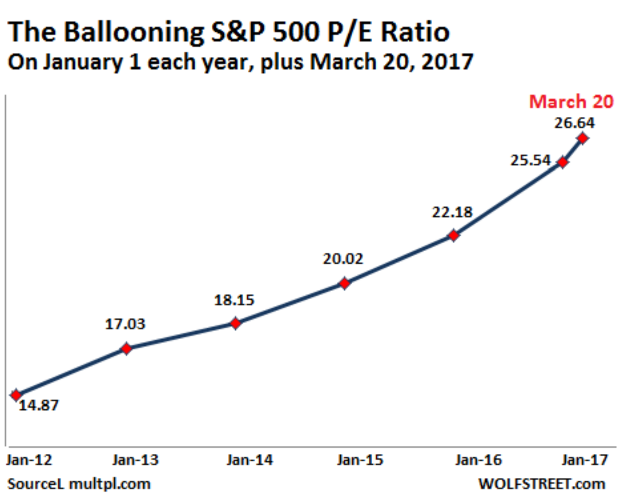
Companies report earnings in two ways:

1. All companies report as required under GAAP (our slightly inconvenient Generally Accepted Accounting Principles). These earnings are often a loss or way too small and shrinking, instead of growing, and hence, are not very palatable.
2. So most companies also report pro forma, ex-bad items, "adjusted" earnings, based on their own notions of what matters. Analysts and the media hype that metric. This is just a method of reporting the same results in a more glamorous manner.




The rule here is: NEVER LOOK AT ADJUSTED EARNINGS.

Next, let's take a fresh look at P/E ratios:




There are many ways companies try to disguise real numbers with smoke and mirrors, so how are you to protect yourself and your investments. You have to be value investors; you have to know what to keep and what to get rid of; you have to know when to sell; you have to know HOW to get out.

Here's how you do it:

## GETTING BEST VALUES

>try to buy with a P/E of around 10
>look for high earnings growth
>demand lots of free cash flow
>a price/book of around 2 or less
>return on investment capital of 20%

## AUDITING YOUR PORTFOLIO

>would you buy the same stock today
>is the company still an industry leader
>are sales/profits still growing
>can you explain to others what they do
>is it more than 5% of your portfolio

## WHEN TO SELL

>reason you bought the stock is gone
>stock is fully valued
>you found something better to buy
>profits/earnings are shrinking/falling
>the trailing stop-loss was pierced

## LEAVE THE FIELD IN ONE PIECE

>don't get emotional with your stocks
>set an amount you're prepared to lose
>do this BEFORE you buy the stock
>set a trailing stop-loss on everything
>don't waiver...follow through & sell

# DOW COMPARISON...1896-2016

I finish this month's newsletter with a most intriguing and fascinating chart. I'm sorry the print could not have been larger – I couldn't have fit everything on one page. Take out the trusty magnifying glass if it helps.

# The Dow Jones Industrial Average: 1896-2016

## Human Innovation Always Trumps Fear