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AMERICAN RETIREMENT & Investment Strategies, LLC

1st Quarter 2017 Newsletter

A LOOK BACK AT 2016

In many ways, the start and end of 2016 were mirror images. As the year began, financial markets were dominated by fears of recession and deflation, and investors were uneasy over the Federal Reserve's December 2015 rate hike. This environment produced a sense of malaise that resulted in a 10% drop in equity markets by early February. From that point, dovish global central bank policies, improving liquidity and a stronger labor market boosted economic growth modestly. As corporate earnings began to recover, stock market indices rose through most of the rest of the year, and rallied strongly following the presidential election. For the first time since 2013, the small-cap-oriented stocks outpaced the S&P 500.

Energy and basic-materials stocks led the way within the broad Russell 3000 Index in 2016, after being the two worst-performing sectors from 2013 through 2015. By the same token, commodity prices fell sharply in recent years amid excess oil supply and global growth concerns, but they have trended upward since hitting their bottom in early 2016. The financial sector was up around 20% in 2016 as investors bet that a Donald Trump presidency will bring higher interest rates and a rollback of Dodd-Frank regulations. After being the best-performing sector from 2013-15, healthcare is the only one that posted a loss during 2016. Biotech stocks were down more than 25% as the government stepped up scrutiny of drug-pricing practices. Dividend-heavy consumer defensive and real estate stocks also posted gains even though the Federal Reserve signaled it would raise short-term interest rates.

Historically, value stocks have tended to outperform growth stocks, and small-cap stocks have tended to outperform large-cap stocks. However, in recent years, growth stocks -- particularly on the large-cap side -- have posted better results, driven partly by investors hunt for earnings growth in a sluggish economic recovery. Last year marked a return to the historical norm: small-cap stocks outperformed their larger-cap counterparts for the year. Large growth was the worst-performing category for the year gaining just above 3% (this also explains in part why the Dynamic Portfolio lagged this year).

In addition to changes in equity market performance, we saw several other key inflection points. Amid economic growth concerns, the yield on the 10-year U.S. Treasury bottomed at 1.37% on July 8 and has climbed more than 1% since. We believe the July low marked the end of what has been a 35-year bull market for bonds. Fed policy also shifted as the central bank again hiked rates in December and indicated additional increases would follow in 2017. And, of course, the global political environment changed markedly. The Brexit vote, Donald Trump's election and the Italian constitutional referendum all point to a world that is increasingly rejecting globalization and growing more nationalistic and protectionist.

The Dynamic Portfolio

The first half of the year proved particularly difficult for the Dynamic Portfolio, especially since growth-oriented large cap stocks did not keep up in 2016 with the rest of the market. During the second part of the year, we focused more on Energy and Banking sectors, added companies like Chevron, Exxon Mobil, JP Morgan and Bank of America and by looking at more dividend-like companies.

Our intent was to position our Dynamic Portfolio toward a more overall balanced portfolio where not just "growth" but also "value", "dividends" and "international" themes are all inclusive under the same umbrella for the foreseeable future.

We still favor particularly robust companies with great dividends, as we strongly believe that when these are re-invested into their stocks, over the long-term they will prove to be a very successful strategy.

Our 2017 Outlook

2017 could be labeled as "A Year of Transition," as many of the trends that emerged in 2016 should continue and perhaps accelerate. We expect a shift from an environment of stagnation and deflation fears to one marked by somewhat better growth, higher inflation and rising interest rates. This environment will likely trigger several key changes in the economic, investing and political landscape. The election of Donald Trump may lead to significant changes to tax, trade, immigration and regulatory policies. At the same time, fiscal stimulus should lead to higher wage inflation over the long-term. As interest rates rise, a critical question is whether an equity bull market that has been driven by liquidity can continue as one driven by revenue and profit growth. Only a real growing GDP can sustain the rally.

The 35-year disinflationary, falling interest rate world is coming to an end, and that brings with it some challenges. We think investors should expect more subdued returns over the next few years from nearly all asset classes as a result of relatively slow long-term global economic and earnings growth and generally full valuations. If the US will stage a strong and lasting growth rate — pulling with it the rest of the world's economies — then we could even see an acceleration of the stock market on the upside in the next few years. One that could resemble the roaring 90's. Very bullish scenario but realistic.

Overall, we expect the investing environment will be driven more by security-specific fundamentals and we forecast the following investment themes: stocks over bonds, small caps over large caps, value over growth, cyclical sectors over defensive ones and credit sectors over government bonds. Natural resources and commodities should have a decent comeback. We think that making the right portfolio decisions will require a focus on individual security selection to generate outperformance in all asset classes. Diversification will remain king.

Thank you for continuing to put your trust in our firm.

All the best,

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