Demming
Financial Services Corp.

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2016 Year End Report

You know you're deep into a longstanding bull market when you see things like average pedestrians keeping one eye on the market tickers outside of brokerage houses to see when the Dow Jones Industrial Average has finally breached the 20,000 mark. Who would have imagined record market highs at this point last year, when the indices ended the year in negative territory? Or when new year 2016 got off to such a rocky start, tumbling 10% in the first two weeks—the worst start to a year since 1930?

The markets eventually bottomed in mid-February and began a long, slow recovery, turning positive by the end of March, suffering a setback when the U.K. decided to leave the Eurozone and endured another hard bump right after the elections. In the end, we were disappointed; the Dow finished at 19,762.60 for the year—but the bull market has continued for another year.

1st Quarter

Special Notes…

As a friendly reminder, for your protection, it is now our policy that any **requests** for funds sent to us via email **will also be confirmed by phone**.

Please be sure to let us know if there are any changes to your contact information (**address, phone number, email, etc**.)

Please be sure to send us a copy of your 2016 tax returns as they're completed!

Also, please be sure to check out our website at www.demmingfinancial.com!

This was the second year in a row that the final quarter provided investors with solid gains. The Wilshire 5000--the broadest measure of U.S. stocks—was up 4.54% in the fourth quarter of 2016, ending the year up 13.37%. The comparable Russell 3000 index gained 4.21% in the final quarter, to finish up 12.74% for the year.

Large cap stocks were up as well. The Russell 1000 large-cap index closed with a 3.83% fourth quarter performance, and finished the year up 12.05%, while the widely-quoted S&P 500 index of large company stocks was up 3.25% in the fourth quarter, finishing up 9.54% for calendar 2016.

The Russell Midcap Index gained 3.21% in the fourth quarter, and was up 13.80% in calendar 2016.

This was a year to remember for investors in small company stocks. The Russell 2000 Small-Cap Index finished the year up 21.31%, while the technology-heavy Nasdaq Composite Index rose 1.34% in the fourth quarter, to finish the year up 7.50%.

International investments contributed a marginal decline to overall portfolio returns. The broad-based EAFE index of companies in developed foreign economies lost 1.04% in the fourth quarter of the year, finishing the year down 1.88% in dollar terms. In aggregate, European stocks lost 3.39% for the year, while EAFE's Far East Index gained just 0.14%. Emerging markets stocks of less developed countries, as represented by the EAFE EM index, gained 8.58% for the year.

Looking over the other investment categories, real estate investments, as measured by the Wilshire U.S. REIT index, lost 2.28% during the year's final quarter, but managed to finish up 7.24% for calendar 2016.

Last year, investors were wondering why they owned commodities in their portfolios, when their statements showed that the index delivered a whopping 32.86% loss. This year, they may be wondering why they weren't more committed to the asset class, as the S&P GSCI index gained 27.77%, fueled in part by a 45.03% rise in the S&P crude oil index. Gold prices shot up 8.63% for the year and silver gained 15.84%.

In the bond markets, it's possible that the decades-long bull market—which basically means declining interest rates—has ended, and the fixed-income world is experiencing rate rises. But despite the nudge by the Federal Reserve Board, the moves have not exactly been dramatic. Over the past year, rates on 10-year Treasury bonds have risen from 2.25% to 2.44%, while 30-year government bond yields have risen from 3.00% to 3.07%. According to Barclay's Bank indices, U.S. liquid corporate bonds with a 1-5 year maturity have seen yields rise incrementally from 2.4% to 2.8% on average.

As always, there were many unpredictable anomalies in the investment world. In the international markets, anyone lucky enough to have speculated on the Brazilian Bovespa index—comparable to the U.S. S&P 500—would have reaped a gain of 68.9% this year, despite all the headline drama around the Zika virus and political uncertainties that were reported on during the Olympic games. Russian stocks were up 51% for the year, despite the recent sanctions from the U.S. government and the lingering international sanctions related to the invasion of the Crimean Peninsula.

What's going to happen in 2017? Short-term market traders seem to be expecting a robust economic stimulus combined with lower taxes and deregulatory policies that would boost the short-term profits of American corporations. But it is helpful to remember that we are entering the ninth year of economic expansion, making this the fourth longest since 1900. In addition, growth has not exactly been robust; the U.S. GDP has averaged just 2.1% yearly increases since the Great Recession, making this the most sluggish of all post-World War II expansions.

Slow but steady has not been a terrible formula for workers or stock investors. The unemployment rate has slowly ticked down from a post-recession peak of 10% to less than 5% currently. U.S. stock indices are posting record highs with double-digit gains, and that Dow 20,000 level, while essentially meaningless, is still catching a lot of attention.

"REMEMBER, JOEY, LIFE IS A GOOD PREPARATION FOR STOCKS-- LOTS OF UPS AND DOWNS."

It's clear that the new President-elect wants to accelerate America's economic growth, but the policy prescription has not always been clear. Will we rip up longstanding trade agreements, cut back on immigration quotas and deport millions of workers who crossed the border without a visa? Will there be a wall built between the U.S. and Mexico? Will the government pay for huge infrastructure projects, at the same time reducing taxes and thus raising the national debt? Will Congress raise the debt ceiling without protest if that happens? Will the Fed raise rates more aggressively in the coming year, or cooperate with the President-elect in his efforts to drive the economy into a faster lane?

At the same time, there are many unknowns around the globe. China's economic growth has stalled for the second consecutive year, and you will soon be reading about a banking crisis in Italy that could force the country to leave the Eurozone—potentially a much bigger blow to European economic unity than Brexit or a still-possible Greek exit. Russian hackers may have ushered in an era of unfettered global intrusions into our Internet infrastructure, and there will surely be a continuation of ISIS-sponsored terrorism in Europe and elsewhere.

Every year of this longstanding bull market, we have to look over our shoulders and wonder when and how it will end. With the January downturn and so much uncertainty at this time last year, nobody could have predicted double-digit returns on U.S. stocks at year-end. Next year could bring more of the same, or it could fulfill the dire predictions many have made during the election cycle, including both Democrats and Republicans who believe the country is in worse shape than the numbers would indicate.

What we have learned over the past few years is that the markets have a way of surprising us, and that trying to time the market, and get out in anticipation of a downturn, is a loser's game. At the county fair, when we get on the roller coaster, we don't bail out and jump over the side at some scary point on the track; we hang on for the ride. The history of the markets has been a general upward trend that benefits long-term investors, and looking out over the long-term, that—and a few hard bumps along the way--is probably the best outcome to expect.

Investments to Avoid

Every year, the Morningstar mutual fund tracking organization releases a list of the worst new ETF investments—and generally, these tend to be trendy new offerings that are designed to catch the eye of investors who are responding to yesterday's headlines rather than their long-term economic future.

This year's top nomination is something called the VelocityShares Leveraged Crude Oil ETN, closely followed by the VelocityShares 3x Inverse Crude Oil Fund.

What do you get when you invest in these shares? Every day, the VelocityShares products give you three times the daily movements of the price of oil on the global markets. The first fund gives you three times the amount that the price changes in the same direction, while the second gives you three times the movement in the opposite direction.

Set aside the fact that there is no conceivable reason why you would want daily exposure to an investment as volatile as crude oil. For the moment, ignore the fact that the typical portfolio already has plenty of oil exposure, since energy companies are among the largest of the large caps, and just about every U.S. and global organization uses energy as one of its major expense items.

The bigger problem with these shares is that the more volatile an investment is, the lower its long-term performance will tend to be in dollar terms. When a stock or ETF goes down 50% and then back up 50%--and this could happen in a week with these shares—the round trip delivers you a 25% loss. Lather, rinse and repeat, and you're looking at an underperforming asset—at three times the normal velocity.

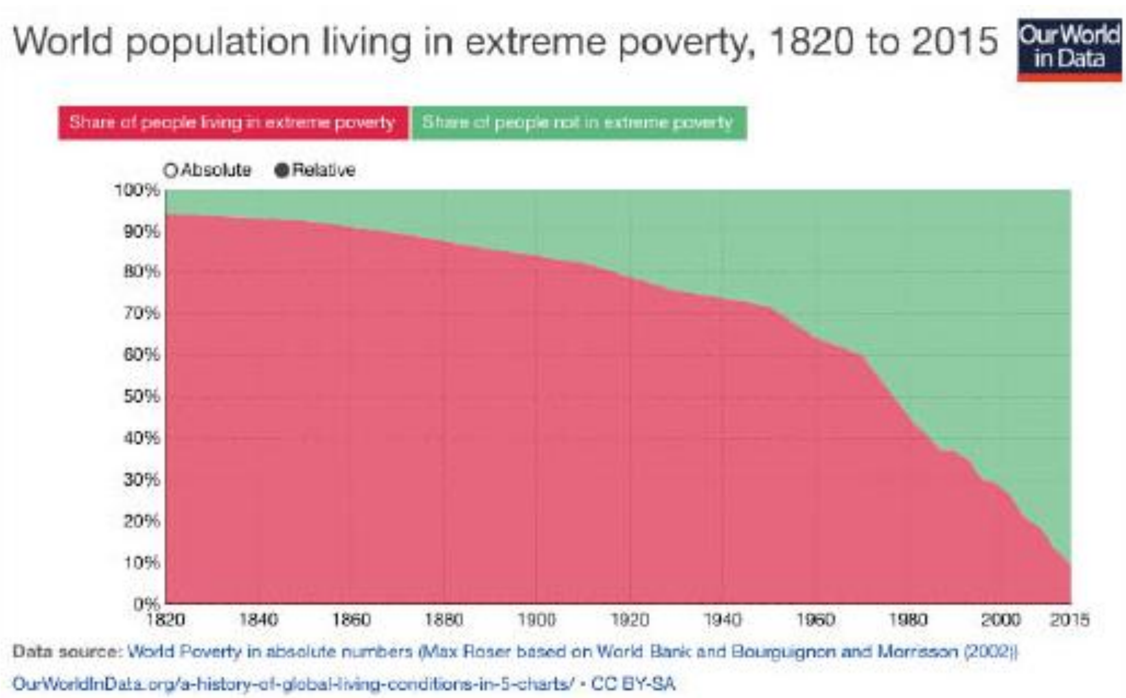
What else did Morningstar single out? You might also consider avoiding the Whisky & Spirits ETF. Not only is this portfolio concentrated on a small component of a much larger business sector, it is even highly-concentrated within the small realm of alcoholic beverages. A single stock accounts for 23% of the portfolio, and its top 10 holdings comprise 79% of the total dollars invested. And for this absurd lack of diversification, you pay 75 basis points a year—as much as you might pay for a diversified international fund. Why not just buy your own distillery instead?

Article courtesy of Bob Veres

THE UPTRENDS WE NEVER SEE

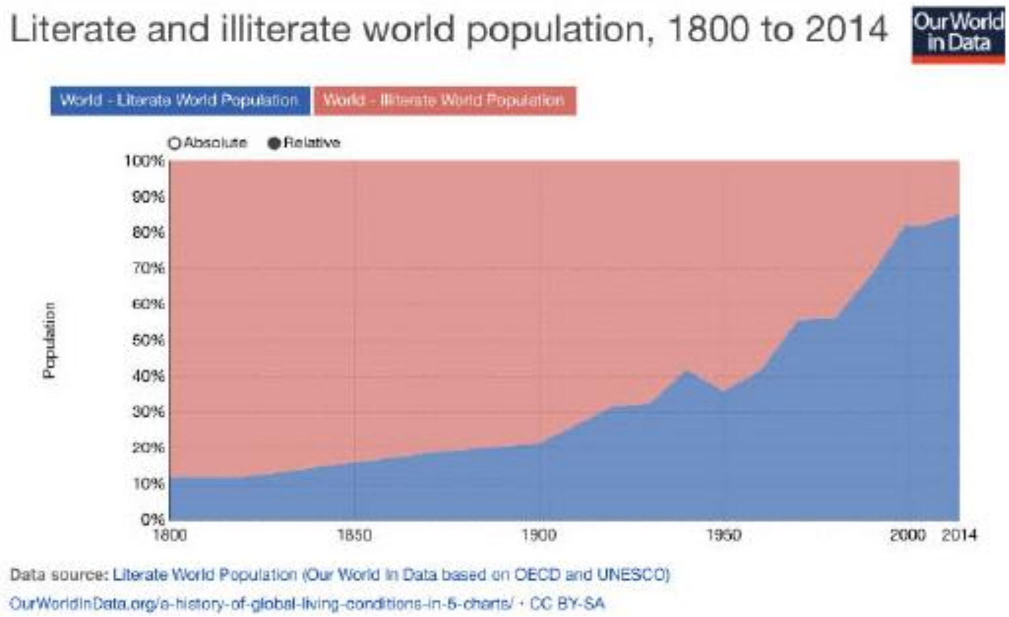
Most of us suspect that the world is going to hell in a handbasket—or at least getting worse over the long term. In the U.S., only 4% of respondents will tell you that our world living conditions are improving.

If you're in the majority, the website "Our World in Data" (https://ourworldindata.org/a-history-of-global-living-conditions-in-5-charts/) has posted some charts that might change your mind. Looking back over the long-term, it finds that we're living at the very peak of world living conditions. And the trend still seems to be upward.

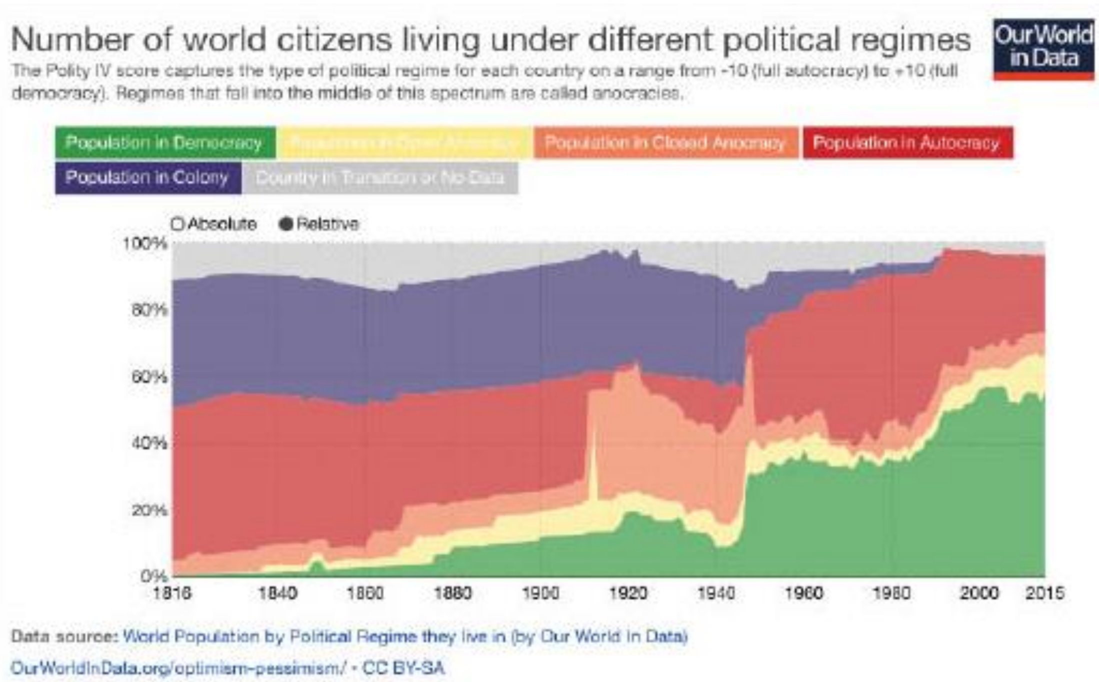


Consider global poverty. The accompanying chart shows the share of the world population living in extreme poverty—and you can see that this was a very high percentage in 1820, when the dataset begins. Since then, the share of extremely poor people has fallen dramatically and steadily, as more world regions have embraced industrialization, created social safety nets and slowly built a middle class. Today only about 10% of the world's citizens live in extreme poverty.

Take another example: literacy. In 1800, only around 10% of the human population could read. Today, as you can see from the chart, the number hovers around 80%. If you believe that science, technology and political freedom are important to solving the world's problems, then it helps if more people can read and write and therefore participate.



Finally, there have been dramatic changes in the percentage of people around the world who live in a democratically free vs. closed totalitarian society. The accompanying chart shows that virtually no people live in colonies any more, and closed autocracies are becoming scarce. Meanwhile, the green-shaded area shows the percentage growth of individuals who now live in a democratic society—more than half currently, up from nearly zero in 1816.



What does all this mean? If we take a longer-term perspective than, say, the recent presidential election cycle or last quarter's earnings reports, we begin to see that all the time and energy and labor that all of us are putting in every day to improve the world, are actually paying off with substantial—if sometimes incremental--results. Other charts show that we're healthier, better-educated and better off than our ancestors.

Let's hope we can keep it up! The trends say we will!

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Sources:

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https://ourworldindata.org/a-history-of-global-living-conditions-in-5-charts/

Wishing you a prosperous and Happy New Year!

From all of us at Demming Financial Services Corp.