21st Century
Equity Advisors Corporation

Market Commentary
Year End 2016
Prepared January 5, 2017

Dear Clients and Friends,
Following is a summary of the performance of major market averages during 2016:

Market Index	2016 Index Close	2016 Change	Date All-Time High	All-Time High Index Close	% Off All-Time High
Dow Jones Industrial Average	19,763	+13.4%	12/20/16	19,975	-1.1%
S&P 500	2,239	+9.5%	12/13/16	2,272	-1.5%
New York Stock Exchange Index	11,057	+9%	5/22/15	11,240	-1.6%
Dow Jones Transportation Index	9,043	+20.4%	12/30/14	9,497	-4.8%
Russell 2000 (Small Cap)	1,356	+19.5%	12/9/16	1,388	-.9%
NASDAQ	5,383	+7.5%	12/30/16	5,432	-.9%
Dow Jones Utility	660	+14.2%	7/6/16	723	-8.7%

The effect of dividends not reflected in the "3026 change" amounts. Estimated dividend yields for 2016 were:
DJIA - 2.4%; S%P 500 – 2.1%; Dow Transports – 1.4%; Dow Utilities – 3.4%

The Stock Market for 2016. The stock market was not kind to investors early in 2016. After reaching extreme oversold levels in February the market rallied strongly into May. Although the trajectory of the rally leveled off, the major market stock indices made all-time new highs during August and then corrected into the early November election period. The overwhelming majority of analysts, political experts and pundits predicted a market debacle if Trump were elected. It was the same group of experts that said there was no way "Brexit" could pass. So, on the way to the predicted market crash, the market went straight up from election day into early December. If this isn't proof positive that the crowd is usually wrong, I don't know what is. The rally was parabolic in its ascent. In early December, the market recorded extreme overbought readings that are just begging for a pullback at any time. Because of the rarity of parabolic moves in general, I thought a detailed analysis of this particular rally is in order.

TECHNICAL, SENTIMENT AND TIMING CHARACTERISTICS
OF TYPICAL BULL OR BEAR MARKETS/CURRENT STATUS

Bull or Bear. A bull market has been in progress since March 9, 2009. I have given some thought to whether or not the sharp correction experienced earlier this year (15.3% decline) could have been a "short and over" bear market. I rejected that premise in that the multi-month downtrend comprised too short of a time frame to constitute a full-fledged bear market. Therefore, I will consider that decline to have been a correction in the context of an aged, but ongoing, bull market. Since new highs in most major stock market averages were seen late in 2016, that is proof enough of an ongoing bull trend. **CONCLUSION: BULLISH**

Investor Sentiment. Since the election investor sentiment has turned abruptly, and decidedly positive. Recent examples are: Strong evidence that the retail investor has returned to the markets with a vengeance after a long absence; November mutual and ETF fund inflows were of a magnitude last seen during the summer of 2007; A late November poll of the American Association of Individual Investors suddenly flipped to 50% bull/22% bear; A December spike in U.S. Consumer Sentiment to a 15-year high (Consumer Sentiment poll, The University of Michigan); A plethora of "outlandish" predictions of the DOW (22,000, 24,000, 40,000, and 50,000), take your pick;

Conversion of long-term bears to bulls right at the point of all-time highs – euphoria of this nature often precedes market tops. **CONCLUSION: BEARISH**

Parabolic Advance. From the point of the short panic sell-off during the morning hours following election day, the DOW advanced 2,400 points through December 20 without an intervening correction exceeding 1%. The Dow rose vertically, as did the Russell 2000 index that notably rallied 15 straight days. In comparison to the spirited rallies of the Fall of 2015, and earlier this year ("steeply ascending" rallies in their own right), the "Trump rally" has been steepest of them all. Parabolic moves such as this often stall and are subject to reversals. **CONCLUSION: SHORT-TERM BEARISH**

Volatility. The volatility index (VIX) closed at 11.47 on December 20, a low reading for the Trump rally. For the entire bull market since March 9, 2009, the low in the VIX was an ultra-low reading of 10.3 on July 3, 2014. The VIX is an indicator of LACK OF market volatility and a sign that investors are comfortable and confident in the market. Stock market rallies spanning 2 months, with no intervening corrections exceeding 1.5%, can make you happy and complacent, that's for sure. A related data point is that as of December 27, more than 15% of S&P 500 components were reading VIX levels under 10, indicative of a level of investor confidence that often signals short-term market tops. Let me say this about that: long periods of low volatility are associated with bullish stock markets. However, one characteristic that is present at most market tops is extreme investor confidence that is manifested in low volatility. So, a low VIX is bullish for a majority of the time, but it's the minority of the time that can strip away some of your net worth. At the moment, a short-term top is likely. **CONCLUSION: SHORT-TERM BEARISH**

RSI (RELATIVE STRENGTH INDICATOR). RSI is a momentum indicator that measures the speed and change of price movements in reference to stocks, commodities and indices. RSI oscillates between 0 and 100, with overbought readings of 70 or higher at the high extreme and oversold readings of 30 or lower at the low extreme. As an investment advisor, I often use RSI readings as one guidepost to enter or exit a particular position. As an example, the RSI for major market averages dipped below 30 during February of this year. This, along with subtle improvements in other technical indicators, pointed to the premise that a market bottom was close at hand. The flip side of the RSI is evident now, with the Dow RSI at an overbought level of 70 or more for more than 7 weeks (with a high reading of 88!). This is an unusually long time to be stuck in extreme overbought territory. And 19 out of 30 Dow stocks have reached overbought territory (over 70) at some point in this quarter. At a minimum, this is not a "high odds" buying zone for the market at the moment**. CONCLUSION: SHORT-TERM BEARISH**

Participation. Advance-decline lines of most major averages made all-time new highs in December, leading to the expectation that the bull market should last at least 6 more months. 52-week new high/new low statistics for stocks comprising the New York Stock Exchange Index also demonstrated good strength through December 8 when 490 stocks, or a healthy 15% of total issues traded on the NYSE, made new 52-week highs. From that date this metric steadily deteriorated while the major averages continued to post new highs. For example, on December 23, with the Dow trading 319 points higher than it did on December 8, only 76 stocks posted new highs. This is a demonstration of a significant loss of momentum. The two statistical results, the advance-decline line trending positively as the new high/new low statistic trends negatively, are contradictory to each other. How can this be? One answer lies in decimalization (stocks trade in increments of a minimum of one penny) – that any increase in the stock's price is computed in a positive way, for purposes of compiling the advance-decline line. For example, if 8 stocks advanced by a minimal $.01 per share and 2 stocks declined by a significant $5 per share, the advance-decline line on that day will still show a positive net gain of 6, although market behavior was obviously negative. The new high/new low metric cannot lie, as it is based on pure price performance of individual stocks – either more or less stocks are making new price highs/lows, or they are not. My preference for reliability is the new high/new low statistic. For illustration, I would note that while the all-time high of the broad-based New York Stock Exchange Index made on May 22, 2015 at 11,240, has not yet been exceeded, the AD line has continued upward. On the bullish side, 52-week new lows have behaved quite well during the fourth quarter, with expansion in new lows being inconsequential. **CONCLUSION: NEUTRAL**

Seasonality. Historically, the fourth quarter through April of the following year has been bullish for stocks relative to the May through October time frame. This bullish bias seemed to be in force late in 2016. Any bearish tendencies during the first four months of 2017 could be offset by the bullish bias of the early part of the year. The takeaway is that when the long overdue correction does arrive, it is likely to be short-lived, in terms of time. **CONCLUSION: BULLISH**

Initial Public Offerings (IPOs)/ Mergers and Acquisitions (M&A) Activity. IPOs and M&A activity was brisk during 2015 coincident with the market correction that commenced in August 2015. Peaks in IPO and M&A are usually bearish for stocks, as was the case in 2015. IPO and M&A activity declined in 2016, and hardly made a dent in the headlines. A major top in stocks won't take place until I start getting tips from waitresses on the next hot new IPO. **CONCLUSION: BULLISH**

The Economy/Earnings/Valuations. The GDP increased by 3.5% in Q3 2016 according to a recently announced report by the government. This is welcome news if the trend continues, as the U.S. economy has not grown more than 3% in any year since before the Obama presidency. Earnings have been flat for 5 quarters now, so perhaps earnings are ready to breakout of their flat trend. The proposed reduction in the corporate income tax rate to 15-20% will have the mathematical effect of improving the bottom line for most corporate taxpayers and especially for corporations in the top 35% tax bracket. Price-Earnings (PE) ratios are high compared to the long-term average of 15: the PE ratio of the aggregate of companies that comprise the S&P 500 is 26, and the PE ratio of the 30 component companies of the Dow Jones Industrial is 21. Announced economic plans by the Trump Administration are generally stimulative, economically speaking**. CONCLUSION: BULLISH**

"Three Steps And A Stumble". There once lived a legendary stock market timer, Edson Gould, whose hay-day spanned the decades of the 60's to 80's. He had an uncanny ability to forecast market turning points with incredible accuracy. While not right every time, he was right often enough to conclude that his correct calls were not luck. The basis of his "three steps and a stumble" rule is this: After the Federal Reserve Board raises the discount rate three consecutive times, the indication is that the Fed is getting serious about raising interest rates. The effect on the economy and the stock market will eventually become negative. The Fed did raise the discount rate in December for the third consecutive time and indicated that three more hikes would be forthcoming in 2017. The history of precisely connecting a major market top to the third rate hike is spotty, at best. But broadly speaking, since the year 1919, stock peaks have occurred, on average, approximately six months from the point of the third hike. The data also tells us that the average gain following all previous third hikes was just under 9%. **CONCLUSION: BULLISH - THE BULL MARKET HAS NOT YET SEEN ITS FINAL PEAK**.

PROPOSED CHANGES TO THE TAX LAW. The Trump presidency promises sweeping changes to existing tax law. Long overdue, in my opinion, as the tax law has gradually become much too complicated - this coming from an individual who first prepared a tax return for compensation in 1971! Major changes proposed are:

- Reduction in the federal corporate tax rate to 15-20% from the current 35% rate. I think this is the most significant change, as it should halt the exodus of jobs to foreign countries. The top corporate tax rate in Mexico is 30% and 25% in Communist China. A second affect is that corporate net income will immediately increase by more than 20% for companies currently in the 35% bracket. Dividend distribution rates should rise **SIGNIFICANTLY** as a result. **A GOLDEN AGE OF INCOME INVESTING WILL ARRIVE IN THE NOT-TOO-DISTANT FUTURE!** Companies currently paying taxes at the 35% maximum rate would especially benefit by the proposed reduction in corporate income taxes.
- Tax rates for individuals will be reduced. The current rate structure on taxable income ranges from 15% to 39.6%. The proposed rate structure ranges from 0% to 33%. Surcharges on investment income and the dreaded alternative minimum tax will be eliminated. One think-tank estimates that the Trump tax plan will increase individual taxpayers' after-tax income by 10.2% on average.

- Standard deduction amounts will substantially increase. A large portion of taxpayers who previously itemized deductions will no longer benefit by doing so.
- The estate tax (also known as “The Death Tax”) will be eliminated.

THE BUDGET DEFICIT/NATIONAL DEBT. There has been a bull market in Federal debt, that’s for sure. After trending down since 2008, the budget deficit increased by the uncomfortable amount of $149 billion for the fiscal year ending September 30 - disappointing considering that the economy is expanding. What will happen to the deficit if the economy turns down? Also, the national debt has been growing at about twice the amount of the country’s annual budget deficit. This is because various expenditures are considered “off-budget”. So clearly the government has not paid any attention to the words of the sage, PGA Hall-of-Fame member Jackie Burke, who wisely proclaimed that “If you make $50, you can’t spend $51”. It’s a mess that needs to be cleaned up! But I do vow, if called upon by the Trump Administration to clean it up, I will not serve!

INTEREST RATES. The general level of interest rates has risen since the election. While still low when compared to all of history, they are just not as low as they were 3 months ago. Bonds with long-dated maturities such as U.S. Treasuries have sold off sharply since the election. At the December meeting of the Federal Reserve Board a .25% increase in the federal funds rate was announced. At the moment, the bond market is oversold to an extreme arguing for a rally in the near-term. The government should be the number one proponent of maintaining low interest rates since the government has the most to gain from low rates as budget deficits will be adversely impacted if interest rates rise. During the “Trump rally” of late 2016, stocks that benefitted from low interest rates did not participate. I would expect a reversal of this trend as interest rates peak and possibly decline from here.

COMMENTS ON THE ECONOMICS OF THE TRUMP PRESIDENCY. The bullet points of the Trump economic agenda closely resemble those of the Reagan administration. The main points are: low taxation, reduced government regulation, and job growth through economic growth – “Make America Great Again!” Trump could turn out to be Reagan with a higher level of competence, economically speaking. We’ll see in the fullness of time. The huge bull market of the 1980’s and 1990’s began approximately 17 months after Reagan was sworn in. So why should we expect a different outcome this time?

LATE THOUGHTS. The Dow is likely to punch through 20,000 in the next few trading sessions……Much energy has been expended in getting there, 20,000 may act as resistance for a while……Bond market rallying in the first days of 2017 – look for interest rate sensitive stocks to perform well in the first half of 2017……The healthcare sector performed poorly during the “Trump Rally” – look for this sector to rebound in 2017……Long-term supply and demand metrics for oil are favorable – the price of oil should trend upward in a strengthening economy……Happy New Year!

I invite clients to review 21ST CENTURY’S most recent disclosure forms – ADV Parts 2A and 2B. Please call the office and I would be happy to send you an updated copy. 21ST CENTURY EQUITY ADVISORS CORPORATION January 5, 2017

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