The Worst of Times to the Best of Times

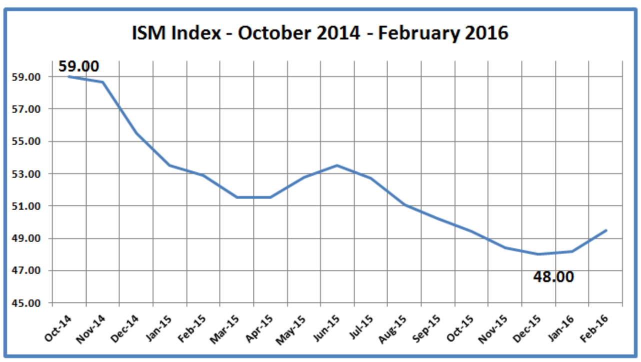
January 3, 2017
Gregory M. Drahuschak

It was a Dickens of a year.

Three times in 2016, investor angst rose to a fever pitch. But, as they say, all's well that ends well.

2015 began with the S&P 500 falling 5.07% - the third consecutive January loss for the S&P. It was not until late April that the S&P crawled back to its late 2014 level. But eventually it was the best of times as all the major market indices set new all-time highs.

The equity market's early 2016 fate was set late in 2015 when after multiples tries the S&P 500 failed to break through resistance around its prior high. From 2116.48 on November 3, 2015, the S&P 500 sank to as low as 1812.29 by January 20. A sharp but short-lived rally eventually led to the S&P bottoming at 1810.10 on February 11.



The market's lackluster start to last year was rooted in a consistent drop in earnings expectations that by February suggested that aggregate earnings would produce the first consecutive three-quarter decline since the first quarter through the third quarter of 2009.

A manufacturing malaise weighed on investors' minds as the ISM Manufacturing Index slipped into contraction territory late in 2015.

Despite these two fundamental issues along with others, the February 11 low proved to be a seminal event. A Janney Investment Strategy group proprietary indicator that day reached a level that suggested the market had set a major bottom.

This premise, however, would be tested twice in the ensuing nine months - once on June 27 when the market sank as British voters chose to leave the European Union and again November 4 when election concerns permeated the market. Interestingly, neither the June 27 or November 4 pullbacks negated the basis for thinking that the February 11 low had presented a durable bottom for market. In fact, activity at the June 27 low strongly reaffirmed this belief. Many analysts missed the fact that during the pre-election slump, the Dow Jones Transportation Average completely ignored the market's concerns by moving higher.

And then there were the election surprises.

To some people, it was a far gone conclusion that Hillary Clinton would take residence in the White House January 20, 2017. Overnight November 9, when it was known that Donald Trump had won the election and fearing what the new president-elect might propose, futures were forecasting a massive drop at the opening. By the 9:30 opening, however, the market not only did not drop, it embarked on an upside rampage that in 12 trading session pushed the S&P 500 to a new all-time high that would be followed by a string of new highs. The Dow Jones Transportation Average that before the election had been performing better than all other indices, eventually set a new all-time high of its own, which confirmed the previously set new high for the Dow Industrial Average and ignited additional gains in the overall market.

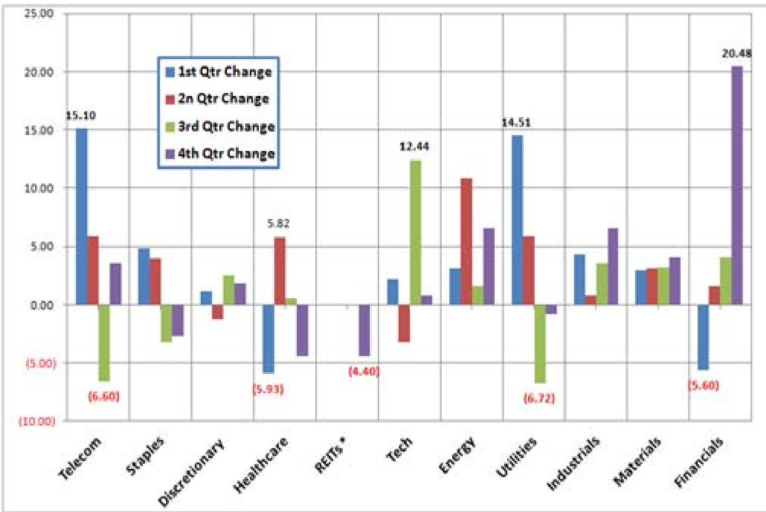
GREGORY M. DRAHUSCHAK, VICE PRESIDENT GDRAHUSCHAK@JANNEY.COM
412.561.0497

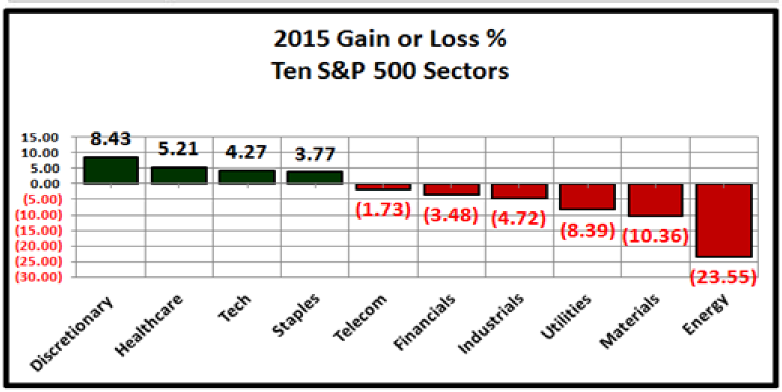
2016 was a year of major swings among the 11 S&P 500 sectors. Prior to the September inclusion of Real Estate Investment Trusts (REITs) as a separate sector in the S&P 500, REITs performed extremely well. However, the combination of a massive shift into pro-cyclical stocks and the sharp post-election rise in interest rates shoved the REIT sector rapidly lower. A modest rebound was not enough to bring the sector back to a breakeven with its September 19 entry as a separate S&P 500 sector.

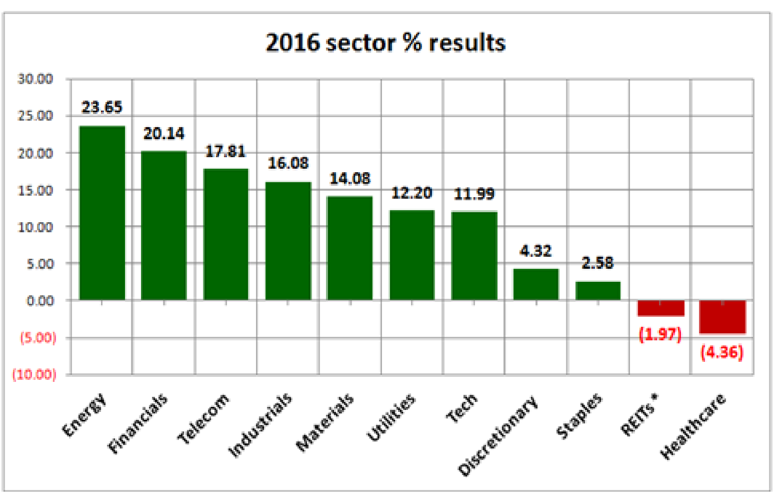
Sector shifts are common also on a year-to-year basis. Often the top performing sector in one year is at or near the bottom for the next year and vice versa. This certainly was true last year.

As illustrated in the charts on the left, by far, the energy sector was the worst performer in 2015 but was the best in 2016. Healthcare was second best in 2015 but last in 2016.

There is another interesting aspect to sector shifts. Despite data showing it usually is unwise to assume that one year's best sector will be the best in the following year, investors often think that the outperformance will continue in the next year. Often it is the second best sector in one year that becomes the next year's best. We suspect that this could be how 2017 unfolds. The financial sector was the second best sector last year and could be one of the best in 2017. Potential regulatory reform and higher interest rates could provide financials with a major tailwind. Conversely, healthcare was at the bottom of the 2016 sector performance list but we think it will be near the top of the list in 2017.







*** - REIT 2015 close number is the close 9/16 when the new sector was added to the S&P 500**

The market's 2017 fate is likely to be tied to several key factors.

Earnings growth will be the primary driver for stocks.

GREGORY M. DRAHUSCHAK, VICE PRESIDENT GDRAHUSCHAK@JANNEY.COM
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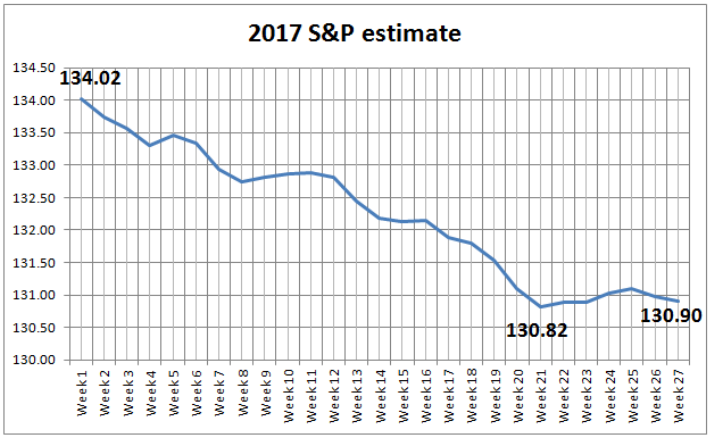
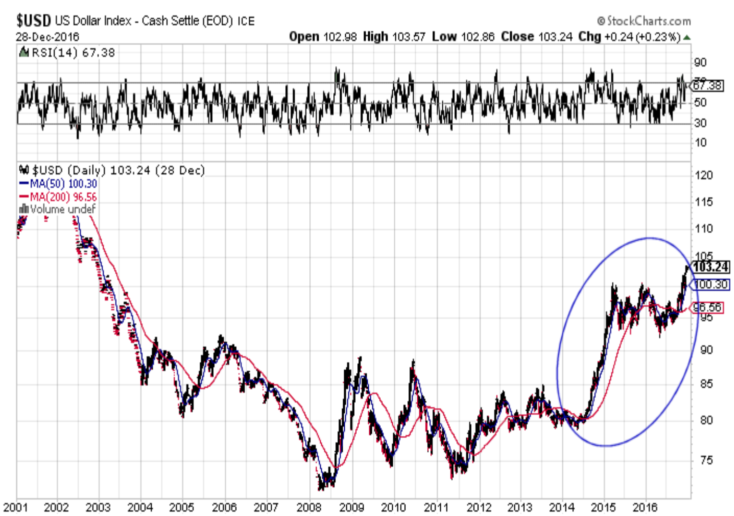
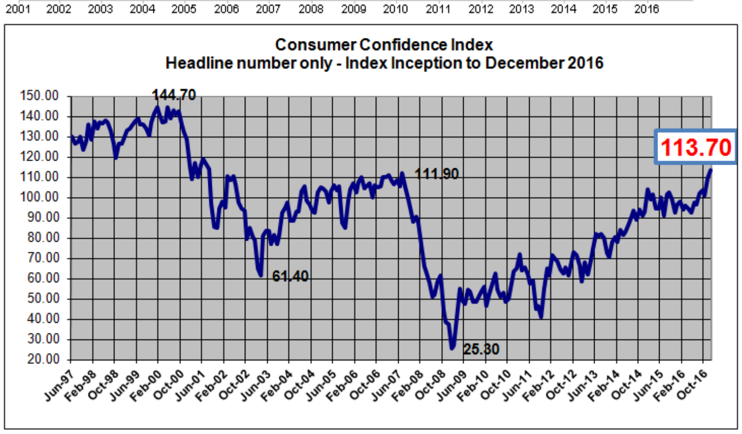


It appears that the final earnings for the S&P 500 will be around $117. We think that a realistic number for 2017 is in the $125-$127 range versus the current $130 consensus. Our less-than-consensus estimate, however, could prove to be low if tax reform ends with a major reduction in the corporate income tax rate. With the currently elevated price-earnings ratio for the S&P 500, achieving reasonable earnings growth is critical to justify a higher equity market.

The new administration in Washington appears to be prepared to propose a fiscal stimulus program. If approved, there undoubtedly would be a boost to GDP growth, but the timing of any program could be crucial. Even if a program is approved early this year, it could take many months before the program is implemented, which could make any such fiscal plan more likely to impact 2018 than this year. Potential repatriation of corporate cash held overseas could be a major issue, particularly for some technology companies.

The dollar could be a major factor this year.





As illustrated in the chart on the left (courtesy of Stockcharts.com), the dollar has been on a strong upswing since the middle of 2104. Its rise accelerated immediately after the U.S. election to reach a 14-year high.

If the dollar's move is sustained it could severely pressure revenues and earnings for U.S. multinational companies.

The most recent Consumer Confidence Index suggested that consumers could make a major contribution to overall U.S. GDP.

As reported on the last week of 2016, the Confidence Index at 113.7 was at its highest reading since 2001. The rise in the expectations component, which hit a 13-year high, was the biggest contributor to the overall index.

The start to 2017, however, could be encumbered by somewhat stretched technical conditions.

Weakness late in December eased some of the extreme overbought conditions in many major market indices, but the pullback was not enough to bring the market back to a technical level that would support an immediate resumption of the market's rise.

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Energy prices will be a major factor this year. The late-year rise in the price of crude oil and the lift in gasoline prices were not enough to disturb the economy or the market, but a rise to $60 or more for crude could be problematic.

In sum, 2017 shapes up as a positive year for stocks with total return potential in the upper single digits. It also shapes up as a year that could be choppy, particularly until the market becomes comfortable with proposals from the new administration.

Have a great 2017.

Final 2016 Market Statistics

2016		Prior			%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
Market Data		CLOSE	LAST	CHANGE	%CHG	YTD	Jan.	Feb.	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.
D J Industrials	.DJIA	19819.78	19762.60	(57.18)	(0.29)	13.42	(5.50)	0.30	7.08	0.50	0.08	0.80	2.80	(0.17)	(0.50)	(0.91)	5.41	3.34	1.49	1.38	2.11	7.94
S&P 500	SPX	2249.26	2238.83	(10.43)	(0.46)	9.54	(5.07)	(0.41)	6.60	0.27	1.53	0.09	3.56	(0.12)	(0.12)	(1.94)	3.42	1.82	0.77	1.90	3.31	3.25
NASDAQ Comp	COMP	5432.09	5383.12	(48.97)	(0.90)	7.50	(7.86)	(1.21)	6.84	(1.94)	3.62	(2.13)	6.60	0.99	1.89	(2.31)	2.59	1.12	(2.75)	(0.56)	9.69	1.34
SOX Index	SOX	921.20	906.47	(14.73)	(1.60)	36.62	(7.51)	1.37	8.81	(4.66)	8.37	(1.10)	10.86	4.53	4.26	(1.45)	6.79	3.07	2.02	2.18	20.81	8.48
DJ Transports	.TRAN	9085.14	9043.90	(41.24)	(0.45)	20.45	(8.02)	6.35	8.16	(0.91)	(0.93)	(4.02)	4.83	0.41	2.54	(0.26)	11.46	0.69	5.80	(5.78)	7.93	11.95
DJ Utilities	.UTIL	662.93	659.61	(3.32)	(0.50)	14.15	5.80	1.53	7.71	(2.11)	0.76	8.66	(0.71)	(6.26)	0.19	1.06	(6.30)	4.26	15.71	7.17	(6.75)	(1.28)
MSCI EAFE ETF	EFA	57.53	57.73	0.20	0.35	(1.69)	(5.52)	(3.33)	6.58	2.22	(0.09)	(4.39)	3.96	0.55	1.34	(2.22)	(1.78)	1.66	(2.66)	(2.34)	5.93	(2.37)
Volatility Index	VIX	13.37	14.04	0.67	5.01	(22.90)	10.93	1.73	(32.12)	12.54	(9.62)	10.15	(24.06)	13.06	(0.97)	28.37	(21.86)	5.33	(23.39)	12.04	(14.97)	5.64
Equally Weighted S&P 500 ETF	RSP	86.89	86.64	(0.25)	(0.29)	13.05	(5.56)	0.99	7.43	1.25	1.36	(0.30)	4.14	0.16	(0.26)	(2.44)	5.24	0.96	2.47	2.32	4.03	3.65
S&P 100	.OEX	996.29	991.43	(4.86)	(0.49)	8.78	(4.73)	(1.02)	6.22	0.23	1.38	0.05	3.62	(0.17)	(0.15)	(1.54)	2.65	2.33	0.16	1.66	3.29	3.42
Gold ETF	GLD	110.29	109.61	(0.68)	(0.62)	8.03	5.41	10.93	(0.84)	5.11	(6.14)	8.97	1.98	(3.26)	0.69	(2.94)	(8.36)	(1.91)	15.95	7.51	(0.66)	(12.76)
Russell 1000 Index	RUI	1247.23	1241.66	(5.57)	(0.45)	9.70	(5.49)	(0.30)	6.78	0.43	1.50	0.05	3.69	(0.11)	(0.07)	(2.08)	3.69	1.72	0.61	2.00	3.50	3.28
Russell 2000 Index	RUT	1363.18	1357.13	(6.05)	(0.44)	19.48	(8.85)	(0.14)	7.75	1.51	2.12	(0.25)	5.90	1.64	0.95	(4.81)	10.99	2.63	(1.92)	3.40	8.66	8.43

25 Best & worst performing S&P 500 stocks

		LAST	2016 final % result			LAST	2016 final % result
NVIDIA Corp	NVDA	106.74	223.85	Endo International PLC	ENDP	16.47	-73.10
ONEOK Inc	OKE	57.41	132.81	First Solar Inc	FSLR	32.09	-51.37
Freeport-McMoRan Inc	FCX	13.19	94.83	TripAdvisor Inc	TRIP	46.37	-45.61
Newmont Mining Corp	NEM	34.07	89.38	Perrigo Co PLC	PRGO	83.23	-42.48
Applied Materials Inc	AMAT	32.27	72.84	Vertex Pharmaceuticals Inc	VRTX	73.73	-41.41
Quanta Services Inc	PWR	34.85	72.10	Under Armour Inc	UA	25.17	-37.56
Spectra Energy Corp	SE	41.09	71.64	Stericycle Inc	SRCL	77.04	-36.12
Comerica Inc	CMA	68.11	62.83	Alexion Pharmaceuticals Inc	ALXN	122.40	-35.83
Martin Marietta Materials Inc	MLM	221.53	62.20	Illumina Inc	ILMN	128.04	-33.30
Halliburton Co	HAL	54.09	58.90	Mallinckrodt PLC	MNK	49.82	-33.24
Zions Bancorporation	ZION	43.04	57.66	Allergan plc	AGN	210.01	-32.80
Chesapeake Energy Corp	CHK	7.02	56.00	Regeneron Pharmaceuticals Inc	REGN	367.09	-32.38
Cummins Inc	CMI	136.67	55.29	L Brands Inc	LB	65.84	-31.29
Micron Technology Inc	MU	21.92	54.80	H&R Block Inc	HRB	22.99	-30.98
Albemarle Corp	ALB	86.08	53.69	Mylan NV	MYL	38.16	-29.42
Hewlett Packard Enterprise Co	HPE	23.14	52.24	Gilead Sciences Inc	GILD	71.62	-29.22
Southwestern Energy Co	SWN	10.82	52.18	McKesson Corp	MCK	140.45	-28.79
Cimarex Energy Co	XEC	135.90	52.05	Frontier Communications Corp	FTR	3.37	-27.84
Regions Financial Corp	RF	14.36	49.58	Hanesbrands Inc	HBI	21.57	-26.71
F5 Networks Inc	FFIV	144.74	49.28	Pitney Bowes Inc	PBI	15.19	-26.44
Time Warner Inc	TWX	96.53	49.27	AmerisourceBergen Corp	ABC	78.19	-24.61
Nucor Corp	NUE	59.52	47.69	Signet Jewelers Ltd	SIG	94.26	-23.79
Linear Technology Corp	LLTC	62.36	46.83	Legg Mason Inc	LM	29.91	-23.76
United Rentals Inc	URI	105.58	45.55	CF Industries Holdings Inc	CF	31.48	-22.86
FMC Corp	FMC	56.56	44.54	Delphi Automotive PLC	DLPH	67.35	-21.44

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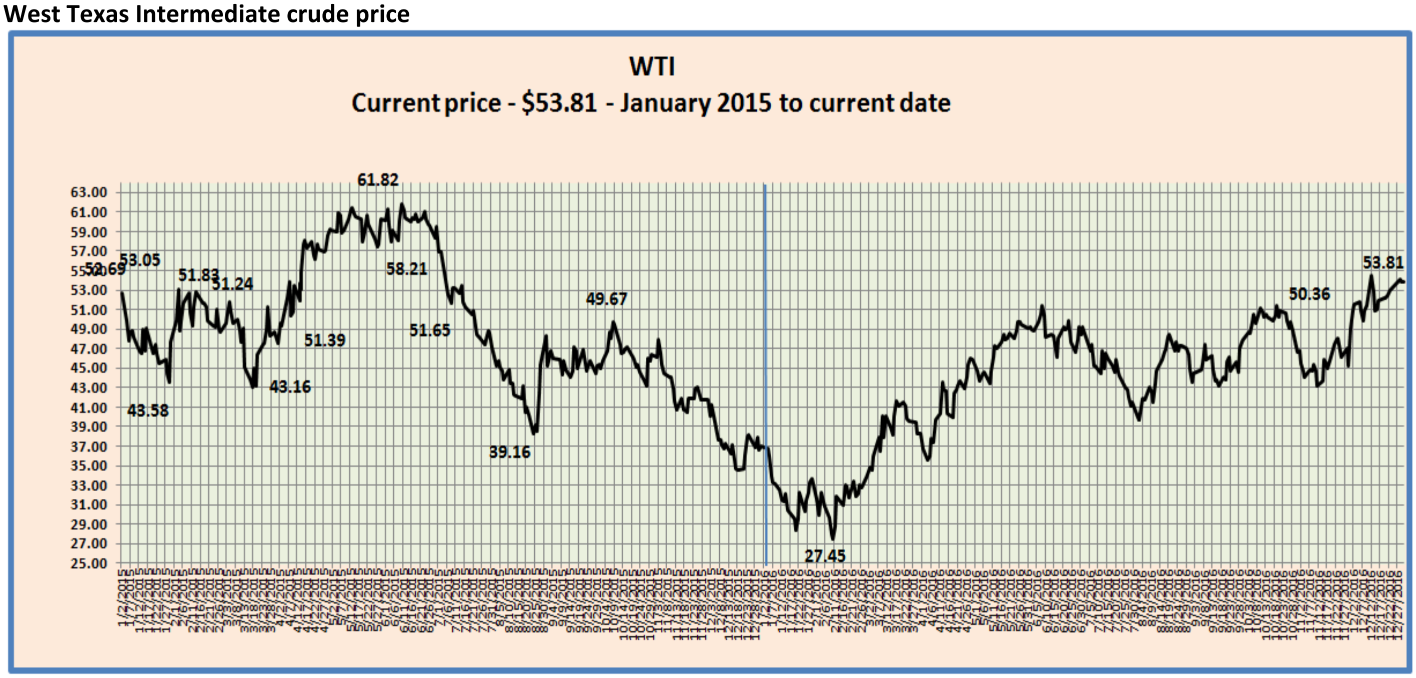
Dow Jones Industrial Average stocks

		% 2016			% 2016
Caterpillar Inc	CAT	36.46	E I du Pont de Nemours and Co	DD	10.21
UnitedHealth Group Inc	UNH	36.04	Apple Inc	AAPL	10.03
Goldman Sachs Group Inc	GS	32.86	Travelers Companies Inc	TRV	8.47
Chevron Corp	CVX	30.84	Boeing Co	BA	7.67
JPMorgan Chase and Co	JPM	30.68	American Express Co	AXP	6.51
International Business Machines Corp	IBM	20.61	Procter & Gamble Co	PG	5.88
3M Co	MMM	18.54	Intel Corp	INTC	5.28
Exxon Mobil Corp	XOM	15.79	McDonald's Corp	MCD	3.03
Verizon Communications Inc	VZ	15.49	General Electric Co	GE	1.44
United Technologies Corp	UTX	14.10	Home Depot Inc	HD	1.38
Wal Mart Stores Inc	WMT	12.76	Pfizer Inc	PFE	0.62
Johnson & Johnson	JNJ	12.16	Visa Inc	V	0.61
Microsoft Corp	MSFT	12.00	Walt Disney Co	DIS	(0.82)
Merck & Co Inc	MRK	11.45	Coca-Cola Co	KO	(3.49)
Cisco Systems Inc	CSCO	11.27	Nike Inc	NKE	(18.67)

West Texas Intermediate crude price



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