ACCESS FINANCIAL SERVICES, INC.

Quarterly Review and Outlook — *Fourth Quarter, 2016*

Table 1: Benchmark Returns as of December 31, 2016

INDEX	Last 3 Mo.	Last 6 Mo.	Last 12 Mo.
US STOCKS			
S&P 500 Index (large-cap stocks)	3.83	7.83	11.96
Russell 2000 Index (small-cap stocks)	8.83	18.68	21.31
FOREIGN STOCKS			
MSCI EAFE Net Total Return Index (US$)	(0.72)	5.67	1.01
MSCI Europe Net Total Return (US$) Index	(0.40)	4.98	(0.40)
MSCI Japan Net Total Return (US$) Index	(0.17)	8.42	2.38
MSCI AC Asia ex Japan Index (US$)	(6.64)	2.12	2.88
MSCI Emerging Markets Net Total Return Index (US$)	(4.16)	4.49	11.19
COMMODITIES			
US Dollar Index (DXY)			
Gold	(13.35)	(14.49)	0.00
Oil (WTI)			
BONDS			
Bloomberg Barclays US Aggregate Bond (investment-grade bonds)	(2.98)	(2.53)	2.65
ICE U.S. Treasury 20+ Index	(12.12)	(12.61)	1.45
S&P National AMT-Free Municipal Bond Index	(3.46)	(3.77)	0.36
Markit iBoxx USD Liquid Investment Grade Idx (corporate bonds)	(4.30)	(2.47)	6.15
Bloomberg Barclays US Corp. High Yild Bon Index (high-yield bonds)	1.75	7.40	17.13
S&P/Citi Intern'l Treas Bond Ex-US (foreign bonds)	(9.84)	(9.05)	1.62

Source: iShares.com & Bloomberg

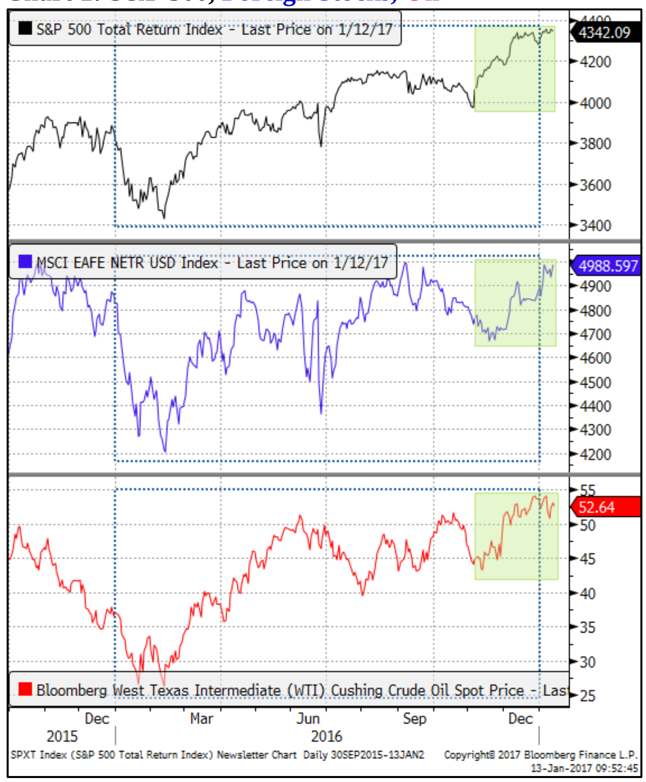
The year for financial assets started on a weak note right out of the chute (Chart 1). China-fueled turmoil sent a number of regional stock markets into bear markets during the first two months of 2016 and oil reached a 13-year low. However, following the initial decline, the year surprised many as financial markets barely flinched following the Brexit shock and Donald Trump's presidential victory was strongly embraced by the markets (S&P 500 +3.8% between November 11 and December 31).

The hallmarks of president-elect Donald Trump's campaign promises – deregulation, deglobalization and aggressively reflationary[1] fiscal policy – mark a sharp break with the post-crisis status quo and markets have responded favorably. Across asset classes and regions, prices have gone vertical since the election (green boxes, Chart 1). The policy proposals, and the market responses to them, have left investors facing two big questions: Have the markets gone too far in discounting the potential policy changes? Does the election herald an inflection point for the US economy?

The first question is tactical, the second is cyclical. Regarding the former, we are with the too-far, too-fast camp. Given the swiftness and the magnitude of the moves, it seems as if markets have brushed off any consideration of the uncertainties surrounding the details of the incoming administration's proposals and the compromises that will be required to implement them.

Key swing factors include the details of tax reform and spending proposals, revised regulatory measures, and trade and immigration policy with regard to their effects on consumption and capital expenditures (capex).

Chart 1: S&P 500, Foreign Stocks, Oil



Source: Bloomberg

From the perspective of a cyclical timeframe, the question is whether the economy can break out of the 2 – 2.25% growth range it has settled into (Table 2). GDP growth is the sum of labor force and productivity growth. Due to demographics and the administration's pledges to tighten and more stringently enforce immigration laws, labor force growth is unlikely to move the needle.

With regard to productivity growth, it's helpful to consider the complete self-reinforcing productivity growth chain: productivity gains from capex, capex from consumption, consumption from employment, income and spending. This leaves open the possibility that a strong labor market generating real income gains could generate a self-reinforcing lift in activity over the next few years. A sizable increase in fiscal spending could energize both channels.

[1] Fiscal or monetary policy designed to expand a country's output and curb the effects of deflation.

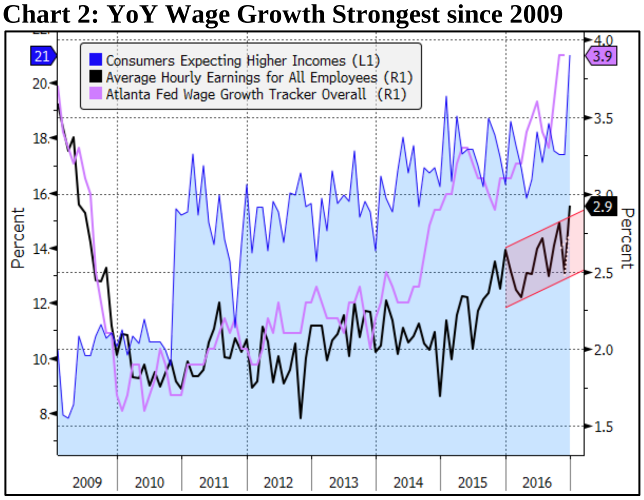
Table 2

Year	Year Over Year GDP Growth*	GDP Compound Annual Gr. Rate Since 2Q 2009
2009	2.61%	2.61%
2010	2.73%	2.69%
2011	1.68%	2.29%
2012	1.28%	2.00%
2013	2.66%	2.14%
2014	2.49%	2.21%
2015	1.88%	2.16%
2016	1.71%	2.11%

**4Q/4Q growth rate, annualized 4Q/2Q for 2009 and 3Q/4Q for 2016*
Source: BCA Research

On the employment front, faster wage gains are finally emerging. The government's most recent employment report showed average hourly earnings last month rose 2.9 percent from December 2015 (Chart 2), matching the biggest year-over-year advance since the expansion began in June 2009. As the chart shows, the pickup coincides with the largest share of Americans anticipating rising incomes over the next six-months in 10-years. Consumer confidence has also surged recently (Chart 3, top panel).

Chart 2: YoY Wage Growth Strongest since 2009

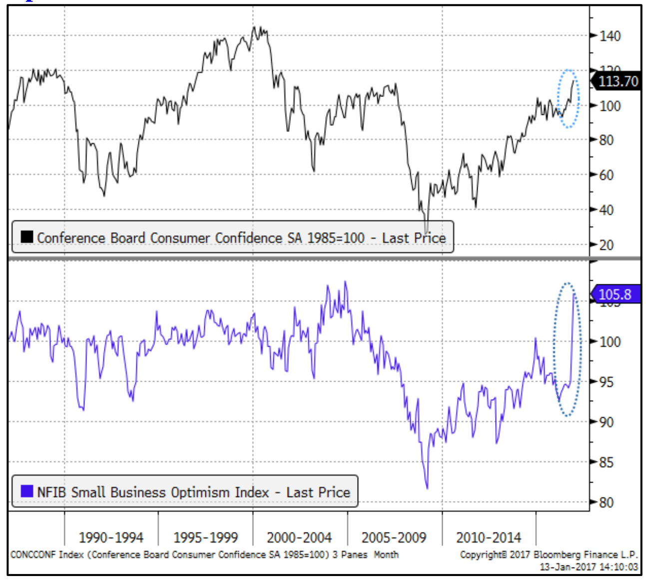


Source: Bloomberg

Our take is that the uptrend in consumer confidence has the potential to be lasting, and therefore lead to acceleration in consumption throughout the year. In contrast, the rise in business optimism (Chart 3, bottom panel) is built on shakier fundamentals, and therefore vulnerable to disappointment – at least temporarily.

As noted earlier, we believe global equity markets have overshot and that policy stands a reasonable chance of under-delivering. It is a high bar to assume that the new American government will succeed in implementing a pro-business strategy of lower corporate taxes, increased infrastructure spending and lighter regulatory burden, while simultaneously avoiding any negative shocks from trade reform and foreign policy mistakes. Thus, we envision a temporary pullback in business confidence and immediate intentions to expand.

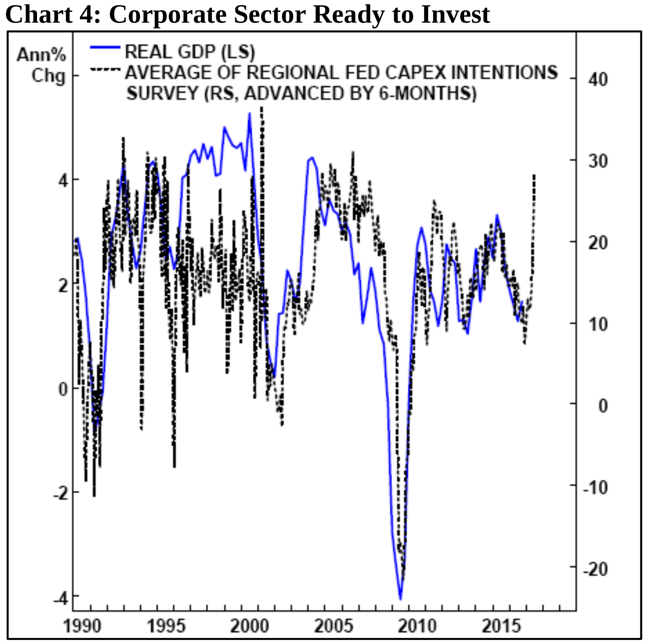
Chart 3: Consumer Confidence & Small Business Optimism



Source: Bloomberg

With that said, capex follows consumption as noted earlier, and capital expenditures are one of the best predictors of productivity growth (one of the two components of GDP growth), as efficiency gains occur when workers are supported by new tools, facilities and software. If we assume the trend in consumer confidence has more upside potential, and this leads to increased consumer spending (demand) which is then followed by increased capex, higher levels of real economic growth should follow. And, as Chart 4 shows, capex intentions have surged according to regional Fed surveys.

Chart 4: Corporate Sector Ready to Invest



Source: BCA Research

While capital-intensive manufacturing's share of employment has been falling since the fifties, on-shoring could partially roll back this trend, boosting capex as manufacturing facilities are built or refurbished. Dollar strength and stricter immigration enforcement will increase the cost of on-shoring, however.

POTENTIAL PITFALLS

Efforts to stoke the economy seven years into an expansion have more complicated consequences than those undertaken near a cycle trough. They are much more likely to lead to overheating and monetary policy makers may be obliged to counteract them.

Infrastructure spending is difficult to get just right. There is not necessarily a correlation between a given project's shovel-readiness and its relative net present value. It is unclear just how many skilled workers are available to execute projects. Infrastructure is a comparatively small element of the proposed fiscal plan, but it is not likely to come on full blast in 2017.

Mainstream economists unanimously agree that protectionist policies and immigration restrictions dampen growth. The US economy is comparatively closed, but its multinational corporations are vulnerable to the imposition of new trade barriers. Limited access to foreign end-markets and disruptions to low-cost global supply chains would quickly show up in the earnings of large corporations. Continued dollar strength would be a headwind for many of the largest corporations as well.

Many assume that with strengthening support for economic growth, the financial markets will continue generating strong returns. The issue that concerns us is the notion that the stock market has already paid for (moved higher in advance of) a significant expected acceleration in earnings and economic growth this year and beyond and is therefore vulnerable to disappointments.

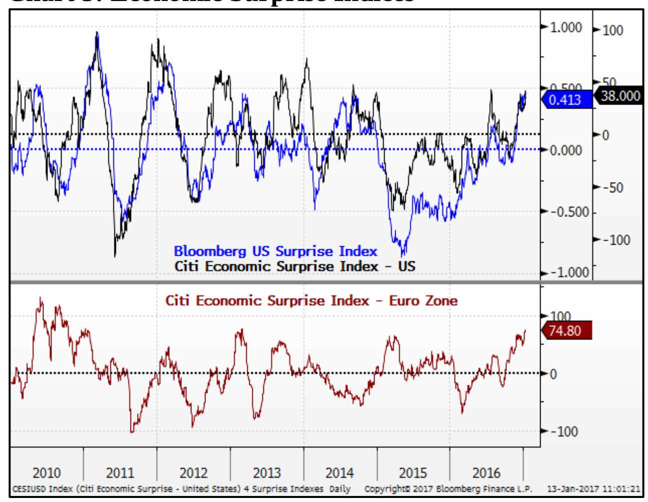
As shown in Chart 5, positive economic surprises (actual data versus what was expected) have surged to relatively high levels recently. The risk is that this has driven expectations to such high levels that the actual data begins to disappoint relative to now higher expectations and the surprises go from being positive to being negative.

US stock market valuations have also continued to advance as stock prices have surged in advance of expected stronger corporate earnings growth. With valuations sitting at a near 14-year high (Chart 6), the margin of safety is quite thin.

According to a recent article published by Bloomberg, BMO Capital Markets divides market performance since 1955 into two categories – one in which prices are driven by changes in valuation (which has been the case since 2012), the other driven by earnings growth. BMO found the S&P 500 Index rose an average 4.2% a year in earnings growth-driven periods, trailing the 14% advance in the valuation driven periods like we are in today.

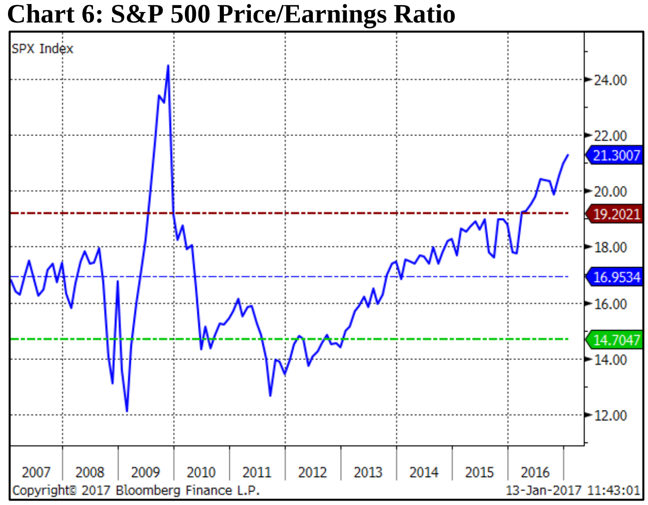
Moreover, earnings-driven periods experienced negative returns about a third of the time, compared with 18% for valuation-driven periods, and suffered almost two times as many 10% declines.

Chart 5: Economic Surprise Indices



Source: Bloomberg

Chart 6: S&P 500 Price/Earnings Ratio



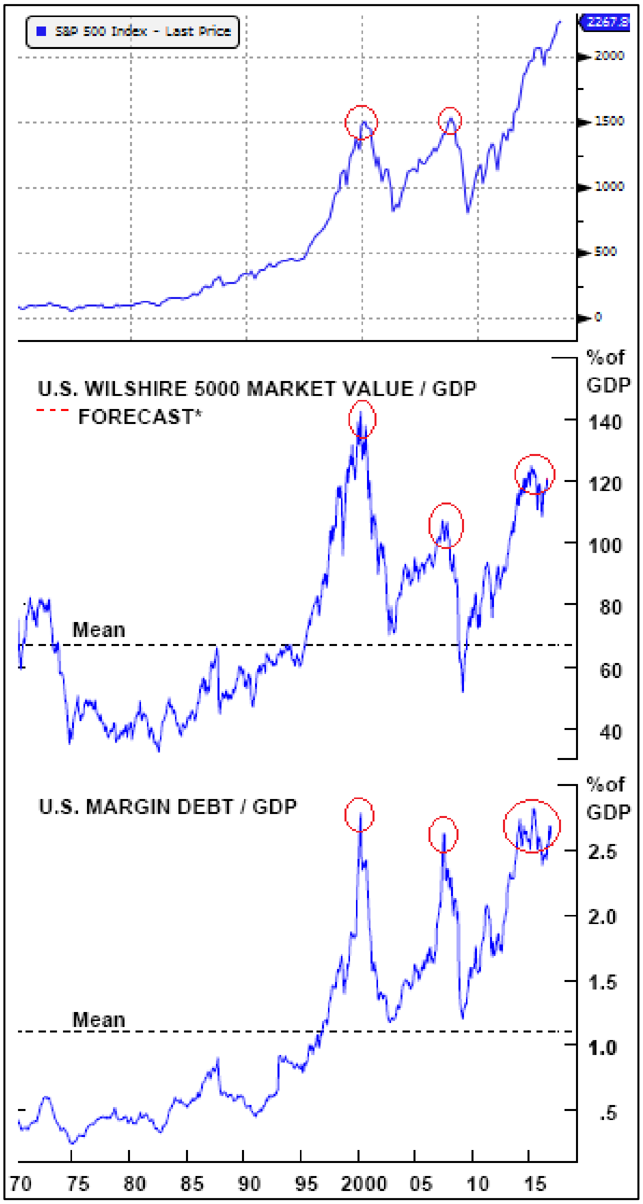
Dashed blue line: average, red and green lines: one standard deviation
Source: Bloomberg

Market internals have also become increasingly speculative.

According to GaveKal Capital, the recent surge in global stocks has been concentrated in low quality stocks. The top three deciles of stocks with the highest return on equity (ROE) returned about 0.4% during the fourth-quarter while the bottom three deciles of stocks with the lowest ROE returned 4.7%. Similarly, stocks with the lowest sales growth have outperformed stocks with the highest sales growth by nearly 8% during the fourth-quarter. Additionally, the decile of stocks that have the most debt returned 9% over the past three-months while the average return for the other nine deciles is just 1.3%, and stocks with the least amount of debt have fallen by -1.4%. All in all, the rally in global equities over the last three months has been clearly led by stocks with the shakiest fundamentals.

Another warning flag is that the total value of the US stock market is more than 120% of nominal GDP, more than double the 2008 trough (Chart 7, Panel 2). Market value as a share of GDP has only been higher during the dot-com bubble in the late-1990s. Margin debt (loans to clients by brokerage firms used to purchase securities) is also now at previous peaks relative to GDP (Chart 7, Panel 3).

Chart 7



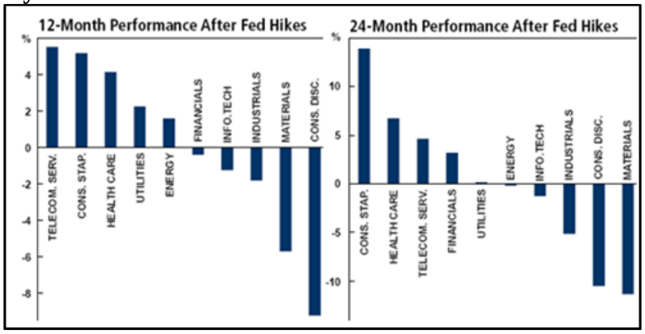
Source: Bloomberg & BCA Research

INVESTMENT STRATEGY

The election results, and their promise of reflationary policy, were not particularly friendly for our defensive/conservative positioning during the fourth-quarter. Neither was our specific exposure to health care which suffered relative to the overall market on Trump's remarks about forcing pharmaceutical and biotech companies to bid for government business. Still, given the headwinds discussed above, we don't think this is an environment to chase post-election winners, nor turn bearish on the recent relative losers that have been used as a source of capital to fund more speculative investments in areas levered to global economic growth.

This is consistent with historic market performance during Fed tightening cycles (periods of rising short-term interest rates) which we believe we're currenty in. Going back to the early-1970s and using the last seven Fed interest rate hiking periods, it is evident that non-cyclical/defensive sector relative performance benefits on both a 12- and 24-month horizon from the onset of Fed tightening (Chart 8).

Chart 8: Sector Performance Following Fed Tightening Cycle



Source: BCA Research

While the returns shown in the chart above are averages, and no two cycles are exactly the same, we believe that the divergence over the last six-months between defensive and cyclical stocks (Chart 9) is likely to reverse as 1) the rate of change for cyclical stocks since the early-November is almost surely unsustainable and 2) defensive stock valuations are much more compelling.

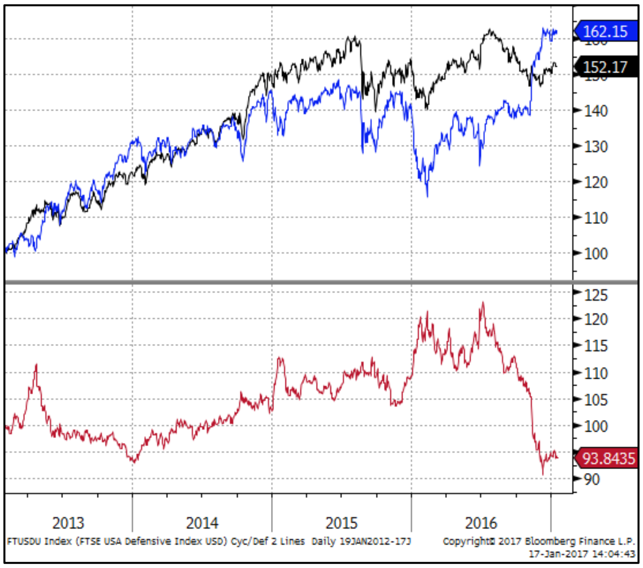
While we remain overweight health care and energy related stocks for the reasons we outlined in last quarter's commentary (please contact us if you would like a copy), consumer staples are now trading at attractive levels both technically and fundamentally and are a likely addition during the first-quarter, 2017.

In the fixed-income space, we continue to believe that floating rate securities offer the best potential risk/reward trade-off. These are senior secured loans with a floating interest rate. Because the interest rates on the loans in the portfolio are tied to market interest rates, the values of the loans are far less sensitive to changes in interest rates.

We also like preferred securities and anticipate adding them to our clients' portfolios during the first-quarter.

Preferreds are a class of capital stock that pays dividends at a specified rate and has a preference over common stock in the payment of dividends and the liquidation of assets. The S&P Preferred Stock Index has an indicated dividend yield of 6.35% (as of December 30, 2016). The asset class is heavily weighted towards financials, especially banks, which we think are particularly attractive because banks have become much safer than in the past with regulators making capital decisions largely to maximize safety. Capital levels are at their highest since the 1930s; bank free cash flows are strong; and dividend payout ratios are low.

Chart 9: FTSE US Defensive Index, FTSE US Cyclical Index, & Defensive Returns Relative to Cyclical Returns



Source: Bloomberg

As an endnote, I recently read a note written by Dennis Gartman in a commentary from another investment advisory firm that I will pass along. It relates to the recent phenomena of the government picking corporate winners and losers (e.g. Trump with his Tweets and meetings).

Here is what Dennis Gartman wrote:

"Finally, we offer up a bit of advice... wholly unsolicited of course... to the nation's CEOs: in light of the damage that can be wrought upon your company's stock price should you find yourself in the rifle scope of Mr. Trump's displeasure, before Mr. Trump can take issue with your company, rush to his home on 5th Avenue in New York for a one-on-one meeting. At that meeting, tell Mr. Trump what a brilliant man he is, appeal to his narcissism and enjoy the benefits that accrue instead, as he inevitably shall tell the world what a fine leader you are and what a wonderful company you lead. It is a fact that the stocks of the companies whose CEOs or chairmen have visited with Mr. Trump in this fashion have risen even more sharply than the broad market itself has done. 'Tis a word to the wise that hopefully shall not fall upon deaf ears."

– Dennis Gartman, January 12, 2017.

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