OFG FINANCIAL FOCUS

First Quarter, 2017

2016: The Pouting Pundits Of Pessimism Punished.....Yet Again

LET IT BE RECORDED THAT IN THE SIX WEEKS FROM the morning after Election Day to the winter solstice, common stocks in this country increased in value by $1.6 trillion dollars. All of the major stock indexes advanced far into new high ground.

Like so many of the signal events of 2016—Brexit, the Chicago Cubs, and the election of Donald Trump—this was not supposed to happen.

It is far too easy to see this whole year was an outlier—an exception to the rule, importantly out of the norm. Dear reader, be assured that it was nothing of the kind. Instead, it was in the largest sense—for the patient, desciplined long-term investor—the pure, Platonic essence of same old same old.

Some of the recent melt-up in stock prices is surely attributable to the world's conviction that the incoming administration will on balance prove more pro-growth and pro-capital than was probable under Mrs. Clinton. Some is a reflection of significantly strengthening corporate earnings, and indeed the prospect that both earnings and dividends may record new all-time highs in 2017. Some, surely, is attendant on the stabilizing of oil prices and nascent resumption of America's drilling boom.

But to focus on the near-term trends propelling a near-term breakout in the equity market is to miss the larger point. Which is that this year—as indeed it always has—pessimism has been relentlessly and even mercilessly punished.

It was ever thus. Sometimes, the punishment comes on relatively slowly, as after the Great Panic of 2008-09. Sometimes it comes on quite rapidly, as it did after the relatively mundane (and indeed overdue) market corrections of August 2015 and January-February 2016. And sometimes it comes on so fast it makes your head spin, as it did in a matter of a few days after the shock of the Brexit vote. *But—historically, at any rate—retribution in the form of higher corporate earnings, increasing dividends, and most pointedly new high stock prices* ***has always come, to break the heart of the pessimist.***

If you doubt this—and you wouldn't be human if you hadn't doubted it sometimes—I would encourage you to inquire of your financial advisor where the S&P stock index was when you were born, and contrast this with wherever it is today. (This is admittedly an excessively conservative comparison, in that it ignores dividends, but for most of us it's still pretty dramatic.)

Then, with your advisor, list all the allegedly existential crises our country and the world have passed through in your lifetime. You will find this not at all a fanciful exercise; indeed you may discover a profound and powerful message in it. To wit: ***pessimism has always turned out to be terribly wrong, and has usually done so rather sooner than later.***

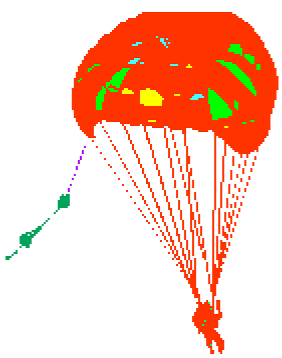
This is historically inarguable. One's only defense against it is what I've always thought of as the four-word death song of the hardcore pessimist: ***this time it's different.*** And indeed, I heard that song a lot in 2016, as I'm sure you did: after the straight-down first six weeks of the year, again after the stunning outcome of the Brexit vote, and once more about 2:30 in the morning after Election Day. It was wrong every time.

In an economy as dynamic, innovative and entrepreneurial as ours has historically been (albeit not so much lately), betting against the values of good companies has rarely been very rewarding—and never for very long. In just the last 80 years (since 1935), U.S. population has gone up two and a half times, but real GDP has risen about seventeen times. That's an increase in real ***per capita*** GDP on a scale never experienced in a country even remotely this size. And it had to have been a very good thing for American companies.

As indeed it was, and continues to be. The S&P stock index closed out 1935 at 13; as I write it's 2,250. And why? That's simple: ***the growth of corporate earnings.*** How comes the index to be up 170 times (again ignoring dividends)? Because that's almost exactly how much earnings have risen. In fact, according to Bloomberg, ***the correlation between earnings and stock prices since 1935 has been 0.95,*** which is probably about as close to statistically perfect as you can get.

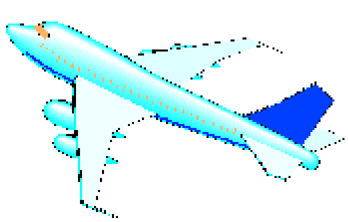
Hence: same old same old. 2016 was a singularly bad year for an investor to be a pessimist. I think I could make a pretty good case for the thesis that 2017 might end up being worse. But I'm sure your advisor can make the same case as well as or better than I can.

So I suggest you have that conversation with him or her ***Quickly.***.



Society needs both optimists and pessimists. For example, an optimist invented the airplane, while a pessimist invented the parachute.

- Gil Stern



Take Action! An inch of movement will bring you closer to your goals than a mile of intention.

- Steve Maraboli

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