HOULIHAN FINANCIAL RESOURCE GROUP, LTD.
FINANCIAL PLANNING & INVESTMENT MANAGEMENT

4th Quarter 2016

Markets are positive on the year heading into the forth quarter but we remain cautious. In analyzing the risk-reward tradeoff we look for potential catalysts that could lead to unexpected outcomes and repercussions. Below we share a few:

Economic Growth:

It is now 8 years since the Great Recession and economic growth remains sluggish. Current expectations seem to indicate continued slow/low growth with Gross Domestic Product (GDP) numbers ranging from 1.5% - 2.5%. This consensus expectation is the driving force behind the thought that markets will produce low-to-mid single digit returns for the near future.

If the unexpected occurs (GDP < 1.5% or 3%+) what could this mean? If we miss to the low side, fears of recession would greatly increase and we could see substantial downside volatility. If we surprise to the high side, markets would likely be rewarded but to what degree is debatable based on current valuations.

Earnings Growth:

Economic growth and earnings growth tend to have a chicken and egg relationship. Returns are driven by many factors, but for simplicity, we will look at earnings-per-share (EPS) growth and price-to-earnings multiple (P/E) on the S&P 500. Returns should be a product of how much investors are willing to pay for future earnings. When compared to historical averages, most would contend that the S&P 500 is either fairly valued or overvalued at current levels. Because investors have already paid an above average "multiple" for future earnings, we would expect price appreciation in stocks going forward to be derived from earnings growth. Barron's recently ran a poll of money managers and roughly 60% forecasted EPS growth of 1-5% over the near term. This, much like the GDP numbers above, supports the low-to-mid single digit return estimates.

What happens if we fail to meet (or exceed) growth expectations? A failure to meet growth expectations with fairly to overvalued markets, would likely lead to a challenging investment environment. On the flip side – if we exceed earnings expectations and multiples remain the same, we are rewarded by the amount of growth we've experienced. The win-win would be a scenario where we exceed growth and investors are willing to pay even more for that growth (although this may be the most unlikely scenario mentioned).

Interest Rates:

The markets have changed direction multiple times on the likelihood of rate hikes over the last year. Going into 2016 the expectation was for two or more rate hikes. Currently, the fed funds futures are pricing in a 60%+ probability of a December 2016 rate increase. Interest rates are important for a variety of reasons, from discounting future cash flows on stocks and bonds to the cost of both personal and institutional debt.

Other Uncertainties:

- Upcoming elections both domestic and abroad
- Further implications from the Brexit vote and the impact on the European Union
- China's growth and debt
- Geopolitical uncertainties
- Inflation

Planning is Key:

Given these uncertainties, planning remains our focus. As we have said before, liquidity needs and time horizon are extremely important variables to asset allocation and investment direction. For investors who are close to (within 5 years) or in retirement and relying on their investment portfolios for cash flow, preservation of this cash flow is paramount. We would not want to be forced to liquidate equity in a volatile market, making allocation a very important topic. Equity investments require a longer time horizon, 5 years minimum and preferably 10 years, to account for the risk factors associated with the asset class.

As a reminder, we do not view financial planning or cash flow analysis as a static exercise. We know that your lives are fluid and situations and needs may change over time. We encourage everyone to come in at least annually to review cash flow analysis. This allows us to make certain we continue to stay on target to meet goals.

If we have not recently reviewed, we would like to evaluate Investment Policy Guidelines, 401(k) allocations not under our active management and 529 plans.

Remember to keep us informed of any changes made to your estate planning documents as well as updated beneficiary changes.

As always, we love working with you!

- Patti, Ryan, Carlton, Becca