TFC FINANCIAL
The Financial Counselors

MARKET UPDATE
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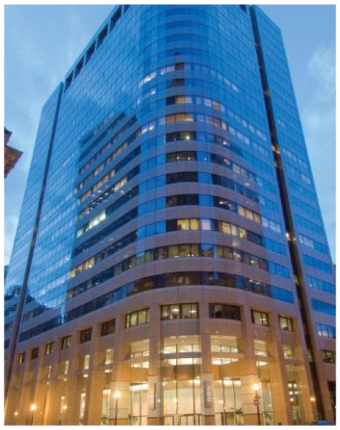
OUR VIEW



Searching for Universal Investment Truths (What's Worked and What Hasn't?)

"Stocks are the new bonds," "just buy index funds," "ETFs are all that are required," "use liquid alternatives to modify portfolio price volatility," "control your currency exposure with hedge funds," or "pick the guys who pick the guys who pick the best performers"—all are admonitions offered by today's talking heads on cable, the media, consultants, and other investment consiglieri, but almost never in the context of an individual's investment circumstances, goals, and time horizon.

We all are continually looking for simplified universal models to support our personal forecasts, or to rationalize current events. Einstein explained the formation of the universe in one simple equation ($E=MC^2$), which during a full college semester of a History of Science course the writer still failed to grasp. Einstein famously also decreed (what could be the closest we get to a universal truth in economics) that the most powerful force in the universe is the rule of compound interest. But as he also allegedly suggested, "everything should be made as simple as possible, but no simpler."

Reducing complex concepts to mantra-like comfortable confirmational biases is an unavoidable human trait. Unfortunately, as we all know, we cannot find in economics or economists, social behavior, or free markets, universal prescriptions explaining or predicting investment outcomes. Wall Street brokers (or "sell-siders"), traffic in computerized financial models promising advantages over "the mob." "Buy-siders" (i.e., fee-based advisors and portfolio managers) flog algorithmic strategic and tactical approaches encouraging the impression that their unique systematic new wrinkle will produce superior investment results. Most prey on investor naiveté, or worse, greed, and the hope for a better-than-the-crowd performance. Troubling also is the tendency to apply "today's lessons learned" from recent investment market behavior to current circumstances. Recent market action almost always has little to do with today's or tomorrow's financial market outcomes. The quest to find the lowest common denominator with which to build personal wealth continues unabated, and is probably doomed to remain unfulfilled.

Financial models drawing upon the conventional wisdom of the day seldom yield the expected results.

AI to the Rescue?

Tesla's Elon Musk, and a group of other high tech Silicon Valley worthies have banded together to finance and influence possible AI (artificial intelligence) future applications. Targeting their own social concerns, and advancing the cause of robotics, driverless cars, medical diagnostics, and influencing the fundamental direction AI development takes in the future is the group's mission. AI programming, in a number of minor ways, pervades software development today (e.g., natural language voice recognition programs offered by Nuance, Siri on your Apple iPhones, and Facebook's facial recognition feature), but to date this software architecture which is supposed to learn from its own experience has advanced at a glacial pace.

Needless to say, AI in the context of financial market modeling has had the attention of entrepreneurial high frequency traders and major sell-siders on Wall Street. If any of these players have discovered universal investment algorithms, they have either been patented or held as closely guarded secrets. Since relatively free financial and investment markets are driven by the interaction of virtually thousands of dependent variables, the chances of AI-based computer modeling sorting through all the ambient noise, and discovering actionable trends in today's global market environment seem remote.

But one issue Elon Musk's "digital intelligence project" might usefully opine upon would be the ethical framework software emulating spontaneous human cognition should adopt. What moral compass should guide an AI-based medical diagnostic program that has discovered a patient's genetic disposition to Hodgkin's disease? How should the soul of an AI logic tree programmed into algorithms influence the computerized outcome? If an extraordinarily talented AI programmer discovers a high frequency trading algorithm which disadvantages all other market participants, and which isn't per se illegal, how should the program solve the resulting ethical dilemma and present the outcome on the screen? Clearly, there remains much to be determined on all fronts.

The Most Anticipated Rate Increase in Fed History . . .

This Week in the Markets

The Federal Reserve raised its benchmark rate by one-quarter point on Wednesday, marking the end of an extraordinary seven-year period of near-zero interest rates. In announcing the change in policy, Fed Chairwoman, Janet Yellen, cited the Fed's confidence in the U.S. economic recovery. Ms. Yellen noted the considerable improvement in job growth and expansion of domestic consumer spending in her announcement of the Fed's first step toward normalizing interest rate policy.

The Fed's unanimous vote in favor of the rate move was released with a statement that emphasized that rate increases are expected to follow a "gradual" path, and that economic and other factors will influence the Fed's decision-making process. In the press conference that followed, Ms. Yellen discussed the Fed's outlook for the coming year which is for moderate growth to continue, diminishing labor market slack, and a gradual increase in inflation toward the Fed's long–term target of 2%.

Initially, markets responded favorably to the Fed announcement, with U.S. equities rallying on the news and Asian and European equities following suit overnight, but this rally has proven to be short-lived. Notably, long-term Treasuries and the dollar had a muted reaction to the well-telegraphed announcement. Investors appear to be comforted by the Fed's signal of a slow pace for subsequent rate increases as well as no immediate plan to shrink the size of the Fed's balance sheet, and sensitivity to the impact on the dollar if Fed policy moves too far, too fast relative to the rest of the world.

Our expectation is for 2016 to be a year of moderate global economic growth, slowly rising developed equity markets, and continuing long-term transition for emerging markets. Bond markets will take their cues from the Fed and from the pace of economic momentum. Our views on the economy and markets will continue to evolve during the year as we monitor market, economic and geopolitical developments. We will, of course, keep you informed of changes to our outlook and positioning.

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As always, we welcome your comments and questions.

Sincerely,

James L. Joslin, CFP®
Chairman & CEO

Renée Kwok, CFP®
President

Daniel S. Kern, CFA
Chief Investment Strategist

TFC Financial Management, Inc.
260 Franklin Street, Suite 1888, Boston, MA 02110
p 617.210.6700 | f 617.210.6750 | tfcfinancial.com

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