Sheaff Brock

Innovative Portfolios for Intelligent Investors™

MARKET UPDATE

December 2016

8801 River Crossing Blvd.
Suite 100
Indianapolis, Indiana 46240

317-705-5700 or 866-575-5700
sheaffbrock.com

Monthly Update

Publication date: 12/23/16

- 2017 Could be a Barnburner
- Portfolio Updates

Check out sheaffbrock.com for our latest column at abcnews.com.

abc NEWS

(continued from page 4)

2017 Could Be a Barnburner

Barnburner - An exciting, extremely good, or dramatic event

"Barnburner" had a considerable history before it came to mean an exciting event, especially a hotly contested sporting event. It first appeared around 1810 as a slang synonym for "radical," apparently in allusion to a parable in which a short-sighted farmer burns down his own barn in order to drive out the rats living within. "Barnburner" was applied in the years leading up to the Civil War to radical abolitionist members of the Democratic Party who were said to be willing to "burn down the barn," to destroy their party, in order to rid it of pro-slavery "rats." This "cut off your nose to spite your face" sense of "barnburner" is now obsolete.

Ironically, "barnburner" in the "exciting" or "extremely good" sense was first used in that most un-athletic of games, bridge, to mean a very good hand of cards. From there it spread to encompass anything that "takes off" to become excellent or very exciting, from a basketball game to a political campaign.

The year-end rally in U.S. stocks has been a welcome relief to a year that started with a short-lived, but wicked correction, followed by a complete snoozer until the day after the election. As we showed you in the last newsletter, until recently stocks had made little progress for well over a year. The seventh year of the bull market was 2015, which was a flat year for the S&P 500. A seventh inning stretch of sorts. Many thought that the combo of a flat 2015, paired with the early 2016 market tumble presaged the end of the bull market. But alas, the doubters were wrong, and the bull market has continued for an eighth year. Could we have a ninth year of a bull market in 2017? Our contention is not only could a strong market continue, but it should continue. A strong run after a pause in a bull market has happened 9 times before, so why not again?

The prospect of reduced regulation and lower taxes has propelled stocks to new highs. But there could be more if you use legendary investor John Templeton's logic. He said, "Bull markets are born on pessimism, grown on skepticism, mature on optimism, and die on euphoria." The current bull was born at the depths of the recession (pessimism), has grown for several years despite rampant skepticism, and might now be entering the optimism phase. We are nowhere near euphoria, so there is still time to sing along with the Beatles.

To the right is a table from Ned Davis Research, an institutional equity research firm. They analyzed every bull market since WWII and found that all of them had at least one year (and most more than one year) where the bull market paused to catch its breath. The pause happened nine times, and 2015 was the tenth. After the first nine pauses, the next two years delivered barnburner combos. In fact the two year combination delivered a median gain of 53% to the S&P 500! Why couldn't it happen a 10th time? As of today, 12/21, the S&P 500 is up about 12% for 2016, which means 2017 would have to be a barnburner to get anywhere near the 53% median two-year combination.

S&P 500 PERFORMANCE AFTER WEAK SECULAR BULL YEARS

		Gains After Weak Year (%)		
Weak Year*	**Gain (%)**	**First Year**	**Second Year**	**2-Year Total**
1946	-8.2	5.1	5.0	10.4
1948	5.0	17.8	30.2	53.4
1953	-1.1	52.3	31.4	100.2
1957	-10.9	43.4	11.9	60.4
1960	0.4	26.8	-8.8	15.6
1962	-8.8	22.6	16.3	42.7
1990	-3.2	30.4	7.6	40.3
1994	1.2	37.4	22.8	68.8
2011	1.9	15.7	32.2	53.0
2015	1.4	9.9**	??	??
Median	-0.4	26.8	16.3	53.0

Notes:
**Weak Year= 5% or less gain in the S&P 500 Total Return Index during a secular bull period.*
*** As of 2016-11-28*
Median does not include 2016
Source: Standard & Poor's

Ned Davis Research Group *T_SP20161201.1*

But the doubters say it is different this time, right? Global debt has never been this high, growth is anemic, politics worldwide are in an upheaval, Russia and China are flexing biceps, and Trump's tweets are the cherry on top! Things aren't that good, why would the stock market go up, especially a barnburner?

Stock prices don't go up because things are good. Stocks prices go up because investors think things are getting better. Big difference.

Portfolio Updates

As expected, the Fed raised rates in December and then announced they will likely repeat the increases next year, maybe as many as three times. If that is the case, traditional high-grade, long-term bonds will suffer in price. I even saw a warning sign the other day with the bond price teeter-totter on it! Warnings are everywhere, even the DOT knows the risk!

If you have a bond portfolio and want a Bloomberg stress test done on it, call your Portfolio Consultant. We can run it through the simulator and tell you the downside if rates move up.

Preferred Income

The price drop during the last six weeks have made preferred stocks more attractive. A December 17th article in Barron's cited preferred stocks and closed-end muni funds as the best bet in the fixed income space. Why? Because the portfolio's current yield is over 5.8%, has a yield-to-worst call of 4.3%, and the average call is about 4 years and 4 months. The average price of shares in the portfolio is $25.33. There are no guarantees in life, but shares issued by companies like Allstate, Citigroup, eBay, Goldman Sachs, Morgan Stanley, Schwab, Southern Co., and Suntrust will probably be paying dividends long after you've met your maker. Remember the old "buy low, sell high" adage? Rright now, preferreds are at relatively low prices.

Dividend Growth & Income

We recently reinvested the cash raised before the election, so the portfolio is fully invested. During the year we added 11 stocks to the mix, which is about 3 more than our historical activity. Every company (except one) has raised its dividend during 2016 and the portfolio's dividend yield is still over 3% and growing. In aggregate the dividend income is the highest it has ever been. We feel the "Downside Risk" research we have been using for about a year now has helped in the stock selection process. This week we met with Greg Forsythe, the founder of the research firm, (formerly Greg was the Director of Global Equity Research at Schwab before launching out on his own) and discussed even better ways to capture upside while avoiding downside.

IntelliBuilD Growth™

IntelliBuilD is our momentum stock growth equity portfolio. 2016 was a tough year for the momentum crew. The portfolio characteristics are ridiculously strong, such as high earnings growth, a reasonable P/E, super return-on-equity, and low debt. Greg Forsythe gave us a couple of ideas that might improve performance and reduce turnover. When the momentum stocks move the move is normally quick, and off-the-hook. So, we stay the course and wait for the race to resume.

Mid-Cap 10

Just like its momentum brother above, it has been a tough year. In recent months, when a growth stock has missed earnings, even by a penny, the market chops off the stock's head and asks questions later. It has not been unusual for a stock to drop 25% on an earnings disappointment, making the momentum potholes many and deep.

Invest 45 Minutes to Build your Knowledge as an Investor

Look for e-mail invites to our monthly webinars

We don't do these Knowledge Builder webinars for our health, we do them for your knowledge. Tune in, you'll learn something.

Watch your e-mails for January's

Covered Call

In the fall, as stocks were called away, we built up pre-election cash. Now, Wally has reinvested the cash. We are mostly using shorter-dated, closer to the money calls. This is because call premiums are very low, so you don't get paid enough to commit to a long holding period. The VIX (measurement of volatility) is very low, which means option premiums are pretty skinny. Today, across all accounts in the composite, the standstill-simple option yield is in the low double digits, which ain't to shabby given the VIX is in Rumpelstiltskin mode.

The following option overlay products are intended to be additive in return to other investments held in an account, and are not appropriate for all investors. Historically, the cash-flow from overlays has been positive from year-to-year. However, realized gains and losses are very inconsistent. These are long-term strategies and may not produce capital gains over the short-term.

Put Income

Please listen to the monthly option overlay call we did at the end of December because we had a long chat about all of the option overlay portfolios. The short put values have improved a lot this year, and now many of our problem-child positions are falling into line. Problem children often do that as they mature. It has been a l-o-n-g and arduous process of rolling some of these out, and we thank-you for your patience. Index puts on an S&P 500 ETF were added to accounts with notional exposure room in November and December. Another will likely be added in January, along with a few new equity puts. Besides a few weeks of thrills the stock market has been moribund, so a little pullback wouldn't be the worst thing because premium prices would be goosed a little, probably improving cash-flow.

Index Income

For over seven months we have managed a soft introduction to a more simple overlay using only put options on the big S&P 500 index ETF. Plain vanilla credit spreads staggered monthly over 3 months. It has been winning fans due to the simplicity, low volume of trades, diversification, and consistency. One trade a month. It is kind of equivalent to watching paint dry. Not as exciting as selling puts on equities, but often simpler is better.

Index Spread

One trade was placed in November. It was a half-the-risk position, a theta earning position, which accomplished its purpose. We have been wanting to place an opportunistic type of shorter-term position, but Rumpelstiltskin won't wake up long enough to give us any return. Short-term put premiums are low and short-term call premiums on indices are almost invisible. So….we wait.

If you have any questions or comments regarding this letter, including any portfolio or composite, please contact our Chief Compliance Officer, Audrey Kurzawa at audreyk@sheaffbrock.com; you can also reach her, or any other Sheaff Brock representative, at 317-705-5700.

Style	Performance Update Portfolio	Thru Nov - 2016	2015	2014	2013	2012	2011	2010
Fixed Income	**Preferred Income** - Preferred stocks	1.01	5.22	14.02	-4.57	9.10		
	High Yield Bond	9.19	-7.32	-1.93	8.78	15.38	3.99	15.93
Growth and Income	**Covered Call Income** - Quality stocks & covered calls	4.95	-1.20	6.39	23.56	11.56	-10.25	
	Dividend Growth & Income - Dividend paying stocks	8.08	-7.16	5.20	36.09	12.36	5.36	17.09
Growth	**IntelliBuilD Growth** - IBD growth stocks	-3.47	2.57	7.62	19.69*	*9/1/13 inception date		
	Bulls of the Dow - 10 strongest of the Dow 30	6.23	1.14	12.42	30.05	7.83		
	Mid-Cap 10 - Mid-cap growth momentum stocks	-9.50	-12.68					
Alternative	**Alternative** - Metals, foreign currencies, commodities	4.05	-8.25	-4.23	-0.70	9.02	-7.74	
Option Overlay	**Put Income** - Overlay of short equity puts	*-0.23*	*-9.17*	0.56	5.92			
	Index Income - Overlay of unleveraged put credit spreads	2.85*	*4/30/16 inception date					
	Index		**2015**	**2014**	**2013**	**2012**	**2011**	**2010**
	S&P 500	9.79	1.38	13.69	32.39	16.0	2.1	15.1
	CBOE S&P 500 Buy/Write	6.95	5.24	5.64	13.26	5.20	5.72	
	Barclays Aggregate Bond	2.50	0.55	5.97	-2.15	4.2	7.8	6.5
	DB Commodity Index Tracking Fund (NAV Total Rtn.)	14.32	-27.41	-28.18	-7.57	3.31	-2.71	

Composites include all fully discretionary, management fee-paying and, beginning on January 1, 2011, non-management fee-paying accounts, including those accounts no longer with the firm of reasonable size that are substantially invested in accordance with the composite strategy or style. Returns are presented net of management fees and all trading expenses, and the reinvestment of all income. Put income results are only realized gains and Index Income reflects the total return of only the option overlay. Net-of-fee results were calculated using actual management fees. Actual advisory fees and transaction fees will vary depending on, among other things, the portfolio, account size, and activity. Fees are described in SBIA's ADV Part 2A. *Denotes partial year, with note reference. Prior to 2015 Mid-Cap 10 was a model account. Prior to October 1, 2015 Preferred Income was sub-advised by Trust Investment Advisors, Indianapolis, IN.

Benchmarks: The S&P 500 Index is a market capitalization-weighted index comprised of the 500 stocks with the largest market capitalizations trading in the United States. This is not a managed portfolio and does not reflect the deduction of fees or expenses; returns include dividends. The Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market in the United States, including Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and CMBS (agency and non-agency). The CBOE S&P 500 Buy-Write Index (BXM) is a passive total return index based on buying an S&P 500 stock index portfolio, and selling the near-term S&P 500 Index (SPX) covered call option, generally on the third Friday of each month. The SPX call will have about a one month expiration, with an exercise price just above the prevailing index level, slightly out of the money. The BXM Index does not take into account significant factors such as transaction costs and taxes and, because of factors such as these, investors should be expected to underperform passive indexes. The BXM Index represents a hypothetical buy-write strategy. DB Commodity Index Tracking Fund (DBC) The PowerShares DB Commodity Index Tracking Fund seeks to track changes in the level of the DBIQ Optimum Yield Diversified Commodity Index Excess Return™ plus the interest income from the Fund's holdings less the Fund's expenses. The Fund is designed for those who want a convenient way to invest in commodities. The Index is composed of futures contracts on 14 of the most heavily traded and important physical commodities in the world. The Fund and the Index are rebalanced and reconstituted annually in November. The Alternative portfolio is a commodity centric portfolio of ETFs and mutual funds whose constituents' profits are highly sensitive to general commodity prices. It may perform differently than DBC since the composite does not hold futures contracts. Indexes are unmanaged and unavailable for direct investment. Benchmark returns include reinvestment of income, but do not reflect taxes, or other fees that would reduce performance. Performance information of benchmark indexes is included for comparison purposes only. Two general types of benchmarks are provided.. The first type is a well-known and widely-recognized index, such as the S&P 500 Index (described previously), and the Barclays US Aggregate Bond Index (described previously). These types of indices are not selected to represent an appropriate benchmark, but rather to allow for comparison of a composite's performance to that of a well-known and widely recognized index. The second type of index is a narrowly-focused (NF) index selected on one or more characteristics, (continued page 1)