

Special points of interest:

- US economy continues to strengthen
- Health care debate intensifies
- High-yield bonds forecast to return 4.5%
- Japanese corporate earnings to grow at double-digits
- Making the most of Social Security
- The outlook for commodities is improving

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Overview

The US economy continues to strengthen driven by strong consumption and stabilizing business investment. Monetary policy remains loose. Given the circumstances we see the US Federal Reserve Bank embarking on a more “normalized” path of tightening. The uncertainty of “whether” the Fed would move is now being replaced with “how fast?” We see the Fed on a parth to 3 to 4 hikes a year. Look for the 10-year to yield 3% by year-end 2017. In addition,

with the US moving towards a more hawkish trade policy, we generally see support for the US dollar. Our 12-month forecast is for the dollar to reach parity (bullish) with the euro. The potential weakness in the EUR is amplified due to heightened political risk. Around the world, the Bank of Japan may be at the start of a battle to prevent the 10-year yield from pushing above 0%. However, the BOJ may find it difficult to remain credible, encourag-

ing buying of the yen in case there is a policy changer. Our 12-month forecast for the USDJPY is 112 (bullish). We remain constructive on equities with the second half of the year expected to be more challenging. Our asset allocation model for a Moderate risk tolerance is approximately 50% equities and 50% fixed income. Of the equity portion, we are most heavily weighted in US equities and underweight foreign securities.

Energy Stock Valuations a Concern

Energy stocks rallied through the election, but reversed in 2017. Equipment and services, oil, gas and consumable fuels stocks outperformed strongly in the months leading up to, and immediately after, the election. But returns relative to the broader equity market took a sharp turn negative in 2017. We suspect the energy trade will continue to be choppy. However, the sector is somewhat intriguing; retail inflows to

the sector have been resilient, the earnings profile is strong, and there is a lack of red flags in sentiment and ownership. However, valuations vs. the broader market, especially in large cap are rich. Despite the sharp underperformance in Energy seen this year, it is still one of the most overvalued groups according to Credit Suisse. The 4Q16 reporting season was generally good for energy. There were strong EPS beats for the

second consecutive season along with an accelerating pace of revenue beats. There has also been a number of analysts’ upward revisions to their EPS estimates. If you have to like something (despite valuation concerns) equipment & services looks like the best bet as upward revisions are stronger and ownership levels are a bit depressed.

High-Yield Bonds Remain Attractive

We are overweight high-yield bonds, a sector that has now outperformed Treasuries for eight months in a row. That is tied with two prior record winning streaks which took place in 2009 and from late 2012 to mid-2013. The fact both those streaks ended at eight months raises a question for investors about how long this one can run, according to Marty Fridson the chief investment officer of Lehmann Livian Fridson Advisors. Some market commentators have linked recent strength to an improved economic outlook resulting from

the presidential election. However, the relative performance trend was underway well before Election Day. According to Morningstar, the sector's two big exchange traded funds, the iShares iBoxx \$ High Yield Corporate Bond Fund and the SPDR Barclays Capital High Yield Bond ETF are both up about 2% this year and up roughly 13% over 12 months. Within the high-yield sector CCC rated issues have shown the best relative strength up 4.7%. Supporting higher prices has been an improvement in the default rate, which has now fallen for five consecutive

months. Presently the rate stands at 4.8%. Analysts at Credit Suisse sees the rate at 2.75% at year end. According to the investment bank, there is still opportunity in the CCC and B credit space, particularly in Media, Telecom and Energy. While the relative strength of the sector may slow from recent performance history, the outlook for the balance of the 2017 remains positive with a forecasted total return of 4.5%. Of course, there are risks, among the most prominent would be a greater than anticipated rise in US high grade issues. We remain Overweight.

House Releases ACA Repeal Bill

House Republicans have revealed their ACA repeal and replacement bill - the *American Health Care Act*. The bill repeals numerous taxes and penalties, defunds Medicaid expansion after 2019, and offers tax credits for the individual market. The bill also preserves several key provisions of the ACA, including: 1) Insurers may not deny coverage based on pre-existing conditions; 2) Dependents can remain on parent's plan until age 26; 3) Essential Health Benefits appear to remain untouched; and 4) Cadillac Tax somehow remains (but is pushed out to 2025). The bill hits the Medicaid market hard. It would end the Medicaid expansion in 2020 and also sets the new Medicaid per capita allotment growth rate at CPI Medical. Conversely, the Medicare market is treated favorably

as all the Medicare related taxes would be repealed. Relative to the Individual market, there are so many different moving pieces (and a number that also stay the same) that it is impossible to determine at this point whether these changes would create market stabilization. However, there are a number of proposals in the House bill that could support a more balanced individual market risk pool, as well as some funding for high-risk pools. The House bill may face a tough political battle even with President Trump's support. Four GOP senators have already spoken out against several pieces of the House ACA replacement plan, most notably ending Medicaid expansion. The GOP has barely any room for vote leakage in the Senate. Fiscal conservatives in the House are also

complaining. The key highlights from the bill: 1) Ends Medicaid expansion after 2019, but allows states to continue w/o current enhanced federal match; 2) Ends Medicaid DSH reductions, 3) Repeals cost-sharing subsidies and premium tax credits starting 2020; 4) Introduces advanceable monthly tax credits beginning 2020; 6) Makes several expansions to health savings accounts (HSAs) including expanded contribution limits starting in 2018; 7) Allows insurers to charge a penalty of 30% of monthly premiums to individuals who decide to re-enroll after failing to maintain continuous coverage starting in 2019; 8) Expands age rating bands to 5:1 (vs. 3:1) starting in 2018; 9) provides \$100 bln for high-risk pools.



Making the most of Social Security could significantly boost your retirement income. When should you begin to take benefits. There are a number of considerations when it comes to Social Security, so learn to apply the rules in a way that makes sense for *you*. Your "full" retirement age benefit starts somewhere between 65 and 67, depending on the year you were born. Your benefit is based on an inflation-adjusted average of your 35 highest-earning years. You can start taking Social Security benefits as early as age 62. But, your monthly benefit will be reduced by about 30% from the full benefit amount. You can delay benefits. If you wait until age 70, your monthly benefit will grow to about 135% of your full benefit. The choice depends on your individual situation. While there's no one-size-fits-all solution, there are ways of thinking

about benefits that can help you find the right answer for you. Capitalize on Spousal Benefits. If you are married (or were married for more than 10 years and did not remarry), you may be eligible for spousal benefits. The maximum amount you can receive is 50% of your partner's full retirement age benefit. It typically makes sense to use a spousal benefit if one person earned significantly more than the other. Plan for low interest rates. Every year you delay taking benefits "earns" you 8% in additional Social Security income in the future. It could be a larger rate of return than you would earn on many investments. In addition, Social Security benefits are indexed to inflation, once you start receiving checks, they'll keep pace with the rising cost of living. Before deciding to delay consider your financial needs. If you need the income, it's difficult

to justify hardship in exchange for higher income later. Similarly, if you're chronically ill or in poor health and concerned about lifespan, it might not make sense to delay. These are tough questions, and the right answer is unique to each individual. The math can point you in the right direction; it can't address all the qualitative issues that make up your life. To help with the decision go to the Social Security Administration's Benefits Planner website. You can learn about the benefits you might be eligible for and use the SSA's free calculators to help optimize your own Social Security plan. For personal help and advice, consider making an appointment with your local Social Security office. At the end of the day, the important thing is to educate yourself about Social Security and have a plan.



The Case for Japanese Equities

We remain bullish on Japan. Our positive investment case stems for several factors. The Japanese government has a GDP target of 600 trillion yen for t2020, (a 13% increase vs. 2016). Second, there is movement towards addressing labor market inefficiencies. Currently, approximately 40% of workers are paid below-market salaries as contract and temporary part-time workers. We also believe Japanese stocks have excellent earnings prospects and are currently trading at reasonable valuations. To meet its growth target the government is engaged in initiatives including incen-

tives to increase birth rates and improve senior services. Under the industrial policy banner initiatives are underway including; creating new markets focused on health care, housing reforms and energy-related investment. Infrastructure spending for the 2020 Summer Olympic games has increased and tourism is up. The most important factor to influence Japanese stocks in 2017 will be corporate earnings growth. In addition to local initiatives, earnings can be influenced by US Federal Reserve policy. As US interest rates rise the Japanese yen is likely to weaken,

boosting earnings for Japanese exporters, which account for a large portion of the Japanese market. Earnings are estimated to grow at a double-digit rate and analysts expect upward revisions. Compared with other markets, Japanese equities do not look expensive. As of year-end 2016 the TOPIX was trading at 16x forward earnings. The S&P 500 was trading at almost 19x. Even though the TOPIX has roughly doubled over the last four years, earnings per share have also doubled leaving the price-to-earnings multiples at 2012 levels, near the low end of their historical range.



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We also understand the relationship between risk and return and seek to reduce risk through targeted asset allocation among numerous asset classes. Each asset class has separate and distinct characteristics, including returns and risk that can be measured over time. While all classes are cyclical, they often trend in different directions. Two portfolios, each having similar return prospects, may have substantially different short-term risk characteristics. Clearly, the lower risk portfolio would be the choice of most investors.

Of course, all investments contain risk and there is no guaranty of positive returns; losses can occur. For additional information and a complete performance history, please visit www.starkadvisers.com.

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The Outlook for Commodities

We remain Underweight commodities. Early in 2016 the DBIQ Optimum Yield Diversified Commodity Index recorded what may have been the bottom. Since then the asset class has been building a base. The outlook appears to be improving. There has been a reduction in capacity in the energy and metals areas. Low prices have fueled lower capital spending, industry consolidation, and the removal of inefficient production sources, causing supplies to fall. At the same time, the combination of stronger global growth and low interest rates has led to a stabilization of demand. While the implementation of President Trump's proposals remains an area of uncertainty, the US appears to be on track for a more growth-oriented policy direction. These factors may cause the balance of supply and demand to move from a surplus to a deficit, which would be an important source of support for prices. However, in the energy area, new supply can quickly enter the market suggesting that while prices may firm, upward movement may be modest. According to the USDA, agricultural grain prices continue to adjust to lower prices. Reduced energy prices have decreased production costs. Nonetheless, lower crop prices have resulted in reduced planted acreage. Projections suggest a tapering of price declines and the beginning of modest increases. The demand for meats and dairy products is expected to remain strong. One negative is that despite the US being a strong global competitor of agricultural products, a stronger dollar is a short-term barrier to exports and prices.

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