Pinnacle Capital Management, LLC

January, 2017

COMMENTARY

If we had written a year ago that in 2016 Britain would decide to exit the European Union (EU) and that a real estate magnate best known for barking, "You're fired!" on a reality TV show would win the U.S. presidency, you would have thought us mad. Had we added that the Federal Reserve (Fed) would begin to tighten U.S. monetary policy (if just slightly) and that Russia was ascendant in the Mid East; and after all of this U.S. stock markets would register double digit returns, you'd probably stop reading. We never predicted these events, but were nonetheless optimistic for most of 2016. It's worth asking then, to what extent do these write-ups add value.

Simply put, we want the world to make sense. The nature of pieces such as this Commentary is that much space is devoted to events that have occurred in the last quarter or year, which is then followed up with prognostications as to what events and trends are expected going forward. This is followed by discussions of their expected impacts on investments. In the end, we finish with a warning to not get caught up with these near term factors, and instead continue to focus on the long term. Here are some snippets from concluding paragraphs of prior Commentaries: "So while we're still bullish for the long term...", "... we advise investors not to panic", and "... we'll continue to focus on the fundamentals and long term results". Despite their insertions towards the tail end of our write-ups, these are often the most important words we write!

Recognizing this importance, we will break with our own conventions and insert our conclusions here. With respect to equities, we are still quite bullish for the long term. However, in the short term we do have some concerns and wouldn't be surprised if we saw some volatility. Not the least of our concerns are that valuations are not particularly cheap - though not overly expensive either - and business results will need to be positive for stocks to continue upward. Also, after a strong bull run in the market where every positive hope has been placed on the new Trump administration (who would have predicted that!?), reality may disappoint some. With respect to bond markets, we may be at the end of the long bull market - or we may not. We still like fixed income with shorter maturities, and we still believe it's best to take on some credit risk. With that out of the way, let's get on with a discussion of 2016!

2016 witnessed the continuance of a sluggish, economic expansion that began in 2009. As the year wore on, excess labor began to be absorbed by the markets. Unemployment fell, and the Fed, having promised up to four rate increases during the year, mostly found a reason to wait. Of course there were several shocks that gave them reason for concern. The first shock was the Brexit -

Britain's vote to exit the European Union. In the immediate aftermath of the June vote, the British pound plummeted, stocks fell globally, and the stocks of any companies that either sold into the British market or had operations in Britain fell even further. As we wrote in July, we felt this was an overreaction; and indeed the British economy has held up remarkably well since then, while stocks had rebounded even prior to the U.S. general election.

The bigger shocker came in November, when Donald Trump beat Hillary Clinton to become President Elect. Of equal significance, though less headline grabbing, was the strength of Republicans in both Congressional and state wide elections. While there are wide divergences within the Republican Party, they now have the ability to vastly impact the agenda on a national scope. Nowhere might this have a more significant and lasting effect than in the shaping of the Supreme Court. With one vacancy in place and potential others to follow, we expect the Justices selected to adhere more to original intent and precedent than the current Court. From a practical investing perspective, this will likely lead to a Court more skeptical of expansive government control of business in general. But be forewarned. This does not mean an end - or even a massive rollback - of business regulation. And while the Trump administration, at this point, is perceived to be more business friendly, the President elect has already demonstrated his willingness to interfere in the business decisions of individual companies.

Returning to 2016, consumer optimism seemed to remain fairly strong during the year. Auto sales in the U.S. sustained record levels. And after the election, consumer optimism continued. Meanwhile, with energy prices having apparently bottomed - for now at least - overall corporate profits lost the drag of a negative energy sector. With strong consumer sentiment and the economy still advancing upward, the Fed in December decided to raise its benchmark Fed Funds target. As of this writing, U.S. markets had little problem with this move. Of course, with the U.S. pursuing a tighter (by recent standards) monetary policy and much of the rest of the world still easing monetary policy, the dollar advanced upward. This does put a headwind in front of some of the expected corporate profit growth and is part of the reason why our expectations, though positive, are somewhat muted in the near term.

As 2017 progresses, we are convinced that the new Administration will at times take steps to encourage economic growth and at times take steps that we are convinced will yield little that is positive. In the former category there is the possibility of tax reform. In the latter category is Mr. Trump's protectionist attitude. Of course, the President can only do so much without the help or consent of Congress.

We expect that consumer sentiment will not collapse in the New Year, and that spending will remain strong, notwithstanding higher interest rates. Energy prices have edged up over the course of the last year, and they've made significant advances recently with OPEC and other major producers agreeing to production caps. We think that some of the optimism of oil bulls is premature. Still, we seem to have reached some base level of oil prices. We'll keep a sharp eye out in 2017 for OPEC cheating and levels of production elsewhere. And finally for 2017, we even have a glimmer of hope that the rest of the world will watch the recent move of interest rates in the U.S. and discover the folly of low to negative interest rates in their own countries. That, for us, would be the real shocker in 2017 should it come to pass.

As we close this Commentary, we wish to update you on a few happenings here. In 2016 we reached a record level of assets under management, restructured our marketing efforts, added some exciting new products and services, and added to our staff. We're particularly happy to welcome Paul Tryon, CFA as our newest portfolio manager. Paul will be based out of Boston, and has already proven to be a major contributor to our firm. Happy New Year, and we wish you a healthy and prosperous 2017!

PINNACLE
Capital Management, LLC

100 Limestone Plaza • Fayetteville, NY 13066
(315) 234-9716 • Fax (315) 637-0090 • www.pcm-advisors.com