HENNESSY FUNDS

December 2016

2017 OUTLOOK: FUNDAMENTALS SUPPORT A CONTINUED BULL MARKET

Over the past year investors here in the U.S. and around the world have weathered a great deal of turmoil, especially in the political arena. Foremost, the bitterly divisive and all-consuming U.S. Presidential election, with its unanticipated outcome, is finally behind us. While the equity markets were jittery at first, they now appear more comfortable with the prospect of a Trump presidency and seem to be looking forward to diminished government regulation and intervention.

The Brexit vote in the U.K. cast a shadow over the European Union's future. There remains uncertainty over the details and timing of the break and the economic consequences for both Britain and Europe, but early signs suggest the impact on growth in Britain will not be as severe as initially feared.

Additionally, uncertainty over whether the Federal Reserve would raise short-term interest rates has hung over the economy for well over a year now. The effects that higher rates could have on growth, the strength of the U.S. Dollar, corporate profits and loan supply and demand seem to have weighed heavily on investors, causing paralysis and money to remain on the sidelines of the market.

Despite all these concerns, U.S. equity markets have pushed higher, and the U.S. economy grew at a respectable annual rate of about 2% with corporate profits starting to move higher. Today, as of mid-December, bond and Treasury yields have risen a bit from record lows just this summer, and the bond market is finishing the year on slightly rocky footing. Bond yields are still very low relative to historical averages, while the prospective PE multiples for the Dow Jones Industrial Average and S&P 500 Index are just above long-term averages at 18.0x and 18.9x, respectively. We believe that equity valuations could go considerably higher and still be at appropriate levels relative to bond yields. And, while we do expect the Fed to raise interest rates in the coming year, we believe that inflation will stay under control, so that short-term interest rates will not have to rise too fast or too far.

As I reflect over the past twelve months, what I realize is that many of the worries this year are not new. For the past several years, American businesses have operated in an environment characterized by highly partisan politics, mounting regulations, uncertainty over interest rates, and a lack of clarity regarding taxes and healthcare costs. Despite all these headwinds, U.S. corporations have been incredibly resilient and found ways to impress investors. If the newly elected administration follows through on campaign promises of reigning in regulation, lowering taxes for corporations and individuals, or reforming healthcare to drive down costs, then companies, which are already lean, should be able to post higher profits. And, that growth should lead to more jobs and a stronger economy, potentially creating a very positive cycle going forward.

With the bull market in U.S. equities entering its ninth year, many believe the economy is due for a recession and the market is due for a downturn. But, the euphoria that usually accompanies a peak in the market is absent. Since the recovery began after the financial crisis, I have found myself pondering the bull run of 1982 to 2000, powered, in part, by a significant increase in valuations. I believe today's market displays the fundamentals to sustain a similarly strong and lengthy bull market. Meanwhile, companies are largely profitable and many corporate balance sheets are cash-rich, with relatively little debt. Unemployment is low and real wages are rising, helping to drive consumption. We are hopeful that these factors will provide support for positive market returns in the year to come.

Best regards,

Neil J. Hennessy
President and Chief Investment Officer

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Past performance does not guarantee future results.

Mutual fund investing involves risk. Principal loss is possible.

Opinions expressed are those of Neil Hennessy and are subject to change, are not guaranteed and should not be considered investment advice.

The Dow Jones Industrial Average and S&P 500 Index are unmanaged indices commonly used to measure the performance of U.S. stocks. One cannot invest directly in an index.

PE, or price to earnings, is calculated by dividing a company's market price per share by its earnings per share.

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