With the market reaching new all-time highs after the surprising election results, we offer our two-pronged outlook on the future. First, we will outline our thoughts on what a Trump presidency might mean for each sector. It's too early to know specifics of his policies at this point or when they may be implemented. Given his comments to date, however, we can at least discuss potential implications and how they differ by sector. Second, with 2017 almost here, and several sectors trading at all-time highs, we will share our outlook by sector on key investment themes in the coming year.

Since the election, longer-term interest rates (represented by 10-year Treasury bond yields) have risen significantly. Investors believe President-elect Trump's agenda will translate into more robust economic growth, which will lead to higher rates. While this may materialize, major change often occurs more slowly than expected, and with difficulty.

Any new policies will impact sectors of the economy in varying ways. Certain programs might not have an obvious or direct impact on publicly traded companies, while others have already driven particular stocks or sectors higher or lower. We believe there are several key changes that could have the most impact. While other leaders have stressed infrastructure spending before, Trump seems keenly focused on this initiative to create jobs and spur the economy. Any incremental spending would benefit businesses that supply the materials, the labor, and the machinery involved - chiefly materials and industrials companies, but also certain midstream energy companies.

The market seems to believe that infrastructure growth will occur, which has led to predictions of faster economic growth, and a corresponding selloff in government bonds. This has driven the 10-year Treasury bond yield to nearly 2.5%, a threshold not seen since early this year. The stock market has performed well since the election, as investors have become more comfortable with Trump's pro-growth policies. Financial firms have been yearning for higher interest rates for years, as they benefit from an increasing spread between the rates they must pay savers and the rates they can realize on investments. Not surprisingly, financial services has been the best performing sector since the election. In contrast, sectors known for paying healthy dividends, such as utilities, consumer staples, real estate, and telecom tend to suffer with rising rates. That has, for the most part, occurred as well.

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Another important issue is the Affordable Care Act (ACA), enacted under President Obama. It represented an overhaul of the U.S. health care system, and led to winners and losers within the health care sector. Now, Trump has vowed to repeal the ACA. Again, if accomplished, this will likely lead to fresh groups of health care companies that benefit and those that suffer. The most exposed, in our view, would be hospitals and insurers. We do not recommend any companies in these subsectors.

In the wake of the election, there are many investing nuances that will reveal themselves over the ensuing months and years. We continue to recommend, however, that investors stay the course (not making rash decisions or changes), and remain invested in a diversified portfolio of high-quality stocks for the long haul.

**Sector Commentary:** The market is forward-looking, so investors are already speculating on the impact of different Trump ideas on various sectors. Certain equity sectors (those labeled “defensive”) are more sensitive to changes in interest rates than others. These would include consumer staples, real estate, utilities, and telecom. These stocks tend to pay above-average dividends, and therefore tend to underperform when market interest rates rise. This is because the income they generate becomes less favorable when compared with bond yields. Over time, there has been an inverse relationship between these sectors and interest rates. When rates rise, the stocks tend to fall, and vice versa. We have seen that borne out in the market in the weeks since the election (Please see figure 1 below).

**Figure 1**

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<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Financials</td>
<td>5.1%</td>
<td>10.9%</td>
<td></td>
</tr>
<tr>
<td>Industrials</td>
<td>10.6%</td>
<td>7.0%</td>
<td></td>
</tr>
<tr>
<td>Telecom</td>
<td>9.4%</td>
<td>6.7%</td>
<td></td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>2.1%</td>
<td>4.7%</td>
<td></td>
</tr>
<tr>
<td>Materials</td>
<td>10.2%</td>
<td>4.6%</td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>16.9%</td>
<td>2.0%</td>
<td></td>
</tr>
<tr>
<td>Health Care</td>
<td>(3.9)%</td>
<td>1.4%</td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td>12.5%</td>
<td>0.8%</td>
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</tr>
<tr>
<td>Real Estate</td>
<td>1.4%</td>
<td>(1.0)%</td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td>16.5%</td>
<td>(1.9)%</td>
<td></td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>6.6%</td>
<td>(2.7)%</td>
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Sources: FactSet.

**Consumer staples**, which is one of the highest yielding sectors in the S&P 500, has declined since the election. However, valuations for the sector remain slightly above average. We continue to see some attractive opportunities, but we recommend a selective approach. Buy-rated stocks in this sector include PepsiCo (PEP) and Kraft Heinz (KHC).

**Utilities** stocks have also underperformed the market since the election, and there are certain policies Trump has discussed that could have a negative effect on the sector. However, we believe the group is suffering more from the selloff in Treasury bonds than anything else.

Heading into the election, utilities were trading near all-time highs. We continue to believe that if interest rates continue to rise, it will not bode well for utilities stocks. Therefore, our outlook remains cautious on the group. Utility stocks rated Buy include Fortis (FTS) and Duke Energy (DUK).

Similarly, we expect a challenging 2017 for the **real estate** sector in the face of potentially higher interest rates and moderating growth in rental revenue. Record-high commercial property prices may also be due for a correction. That said, ongoing economic growth and low unemployment rates could continue to drive demand. Over the long term, in our view, increased earnings and dividend growth will mitigate risk from interest rates. Real estate companies rated Buy include American Tower (AMT) and Highwoods Properties (HIW).

**Telecom** stocks have reacted in various ways since the election. Shares of traditional telecom stocks have been pressured due to the spike in 10-year Treasury yields. In contrast, cable-TV stocks have risen. Despite the pressure on telecom shares, we believe that a Trump presidency will be positive for the sector because Trump has stated that he would like to decrease government regulations. Some investors are speculating that the Trump administration will seek to repeal the FCC’s recent net neutrality ruling in which Internet services are fully regulated like a traditional telephone service. We believe that such reduced regulation would be positive for the sector.

For 2017, we estimate low growth across the industry as data-services growth offsets declines in traditional telephone services. We expect that data usage on wireless and wireline networks will continue to increase, contributing to modest industry growth. Regulatory relief would be positive for the sector, positioning companies to generate more revenue from areas such as targeted advertising and faster Internet connections. Buy-rated stocks include
Verizon (VZ) and Comcast (CMCSA).

The technology sector has many questions that remain unanswered regarding Trump’s stance on numerous issues. At this time, there is a fear that the administration’s policies could have a negative impact on technology firms due to their reliance on overseas manufacturing, foreign workers using the H1-B visa program, and pro-tech regulations such as net neutrality that were fostered under the Obama administration. On the positive side, technology firms stand to benefit significantly from a tax holiday, which would allow repatriation of cash trapped overseas. While we have become more cautious in the near term under a Trump administration, we remain optimistic longer-term because we believe the technology sector provides many growth opportunities for investors and for the overall U.S. economy.

In 2017, we believe the potential for accelerated spending exists, especially in light of growing market opportunities like cloud computing and mobile, as well as the possibility of a tax holiday, but we again are remaining cautious until we have more clarity regarding Trump administration policies. Longer-term, we expect global spending to return to historical norms, in line with GDP growth. In our view, pockets of outsized growth in software and services should offset slower growth in subsectors such as hardware. Technology stocks rated Buy include Facebook (FB) and Microsoft (MSFT).

Other sectors with different drivers have fared better since the election. Not only are other groups less sensitive to increases in long-term interest rates, but we believe some of them are positioned to benefit from potential policy changes brought about by the new administration.

Energy stocks have risen, but much of this may be due to the rise in oil prices. Initially, there were expectations of a production freeze by OPEC, and now OPEC has announced a production cut. In addition, there has been increased optimism concerning the global economy and the potential for demand to continue to increase. We do view the election results as supportive for the energy sector because we see reduced federal regulation and oversight. The biggest beneficiaries in the nearer term would likely be pipeline companies and refiners, as pipelines requiring federal approval should receive these approvals easier and faster, while environmental rules would likely be lightened for refineries. Oil and natural gas producers could benefit over time from lighter regulation, but this area is mostly regulated at the state level, so the impact will likely be limited.

We believe energy stocks in 2017 will continue to be driven primarily by oil prices, reflecting the global balancing of oil supply and demand. Oil prices have recently moved closer to our long-term price outlook of $55-$70 per barrel as production has been significantly reduced in the U.S. and OPEC has announced its intentions to cut production. Combined with reduced investment by producers around the world and expectations for an improving global economy, we expect higher oil prices in 2017 relative to current levels. Buy-rated energy stocks include Pioneer Resources (PXD) and EOG Resources (EOG).

Health care stocks have increased modestly since the election. The results make it less likely that state and federal governments will be focused on drug prices in the near term. However, we believe that we are entering into a period of increased uncertainty for health care. While we believe that notable changes to the health care system could occur under the new administration, we cannot say with any certainty what those changes will be. There has already been discussion of a repeal of the Affordable Care Act, which could have a major impact on many health care companies. We believe that with a closely divided Congress, substantial political compromises will be made. However, we think it will take time to reach those compromises, and even longer to enact any changes.

We continue to view pricing pressure as a long-term risk for the biopharmaceutical industry. Going forward, we believe payer consolidation, pharmacy benefit managers, and self-policing by drug companies will each play a role in containing drug prices. As a result, we believe biopharmaceutical companies will be less likely to take significant annual price increases as they have in the past. Medical device companies have already seen modest pricing pressure for several years now, which we think will continue. We believe that innovative companies with a diverse geographic presence, product portfolio, or payer mix appear better-positioned to navigate the new landscapes profitably. Health care stocks we rate a Buy include Johnson & Johnson (JNJ) and Abbott Laboratories.
Several sectors have had particularly positive reactions to potential Trump administration policies.

**Consumer Discretionary** stocks may be significant beneficiaries of the election if the new administration is able to jumpstart growth and accomplish specific agenda items such as a lower corporate tax rate. Retailers in particular could benefit from lower taxes since these companies generally are domestic-focused and have higher tax rates. Additionally, if there is a tax cut for individuals, consumers would have more discretionary income and most likely higher confidence that could lead to additional spending on goods and services. Buy-rated stocks in the sector include Tractor Supply (TSCO) and Lowe’s (LOW).

**Industrials** and **materials** stocks reacted positively, outperforming the S&P 500 on the premise of higher infrastructure and defense spending. The most direct beneficiaries of a potential fiscal stimulus from the new administration would be companies within the infrastructure and aerospace/defense subsectors. We see a less meaningful impact for many materials stocks. We have a mixed view of that sector, favoring agriculture and chemicals, while remaining cautious on miners. While any kind of stimulus would be positive, the actual benefit as well as the timing is unknown. In reality it will take a while after any spending package is announced for it to materialize and show up in sales, but nonetheless it should support sentiment. A wildcard for industrials involves regulations and trade restrictions. It is difficult to know the impact because it would depend on the timing and the scope of the change, as well as the specific business of affected companies. For instance, relaxing emissions and mileage regulations could be positive for car manufacturers but negative for suppliers of these technologies. Additionally, changes to trading policies with Mexico would be expected to be negative for companies manufacturing products there.

Regardless of the election implications, 2017 should mark a return to growth for industrials and materials after an earnings recession that spanned most of 2016. Valuation is elevated, but that is normal when the earnings cycle is turning positive. We see select opportunities across our coverage. Our buy rated stocks include Wabtec Corporation (WAB) and United Technologies (UTX) among industrials and FMC Corp. (FMC) and Praxair Inc. (PX) in the materials sector.

The best-performing sector since the election has been **financial services**. These stocks should benefit from higher short- and long-term interest rates, the prospect of a less-burdensome regulatory environment, and the potential for faster economic growth. An improvement in economic growth would likely lead to better loan growth and greater capital markets activity. Overall, we are optimistic that higher interest rates and some regulatory relief will result in an improved backdrop for financial services stocks. However, uncertainties remain. A sluggish global growth environment could slow the upward path of long-term interest rates, and the easing of regulations will likely take time and are still unknown.

Overall, valuations are in line with historical averages for this sector. Performance in 2017 will depend not only on the policies of the new administration, but also on global economic growth and consumer spending levels. We believe U.S. consumer confidence could remain elevated as home prices continue to rise, the stock market stays strong, and employment and wage trends keep improving. Buy-rated stocks in financial services include U.S. Bancorp (USB) and Alliance Data Systems (ADS).

As with most macroeconomic events, the election results will have different perceived, as well as actual, impacts on different equity sectors. Post-election stock performance has differed significantly by sector as investors have tried to digest the results and predict future implications. We do believe that some sectors will benefit from potential changes brought about by the Trump administration, while others will likely struggle. In our view, though, many investors have a longer time horizon than four or even eight years. Recent market volatility could provide an opportunity to rebalance portfolios to ensure proper diversification. We recommend positioning portfolios to meet long-term goals, which means staying invested in a well-diversified group of quality stocks through the ups and downs of the market cycle.

**Valuation** - Methods used to evaluate the stocks in the sectors mentioned in this report include price-to-earnings (P/E) ratios; P/E relative to the summation of our earnings growth outlook and the dividend yield (PEGY ratios); enterprise value to earnings before interest, taxes, depreciation and
amortization (EV/EBITDA); net asset value (NAV); price to book value; price to tangible book value; and price to sales (P/S), along with a discounted cash flow analysis.

Please see the individual company opinions for more information on each company, including valuation and risks particular to each stock.

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Andy Smith, CFA

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