Market News

The first half is in the books! The S&P is up % YTD. Every year since 1988 that has had a 6% gain in the first half has led to a full year of double digit performance. Is this what we will see in H2? Hard to say with any certainty but recent history sides with H2 continuing upwards.

Yield curves steepened across the board this week off hawkish tones from the various central bankers. Both Carney at the BoE and Draghi at the ECB struck markedly hawkish tones and more or less have begun planting the seeds of tightening in the marketplace. The Fed backed similar ideas as well in our own economy. Bill Dudley noted earlier in the week that easy policy was allowing for the Fed to begin tightening.

Fins caught a nice break from the CCAR results. For the first time since the beginning of the stress tests 7 years ago, all banks passed their capital distribution plans. XLF gapped up to their post-election highs on at the open on Thursday morning, but has not held that level. If anything, XLF looks like it failing at its March highs. Consumer Discretionary was essentially flat this week and Staples were down. Energy rallied most of the week, though it has beaten up badly recently. Health Care gave back everything it made up prior to last week's gap up. Industrials were uninspiring and flat – however Tech was down and appears to be rolling over. Utes continue their two week slide.

QQQ fell below its 50 day on Tuesday, regained it easily on Wednesday, and consequently lost it again on Thursday. The record is broken, and the following months are typically weaker following similar streaks. Ultimately, the NASDAQ still appears to be rolling over – maybe I am the contrarian signal though so take it with a grain of salt! SPY & QQQ failed to regain their 20 day all week – while it is a small moving average, they both got rejected a few times at those levels.

Dennis the Menace (Gartman) said on Friday morning this, "As the stock markets around the world, one after another, are breaking trend lines and closing below important longer term moving averages, we are convinced that the time… finally… has come to err bearishly on equities…". Prepare yourselves for takeoff, this market is about to rip!!

Index Performance:

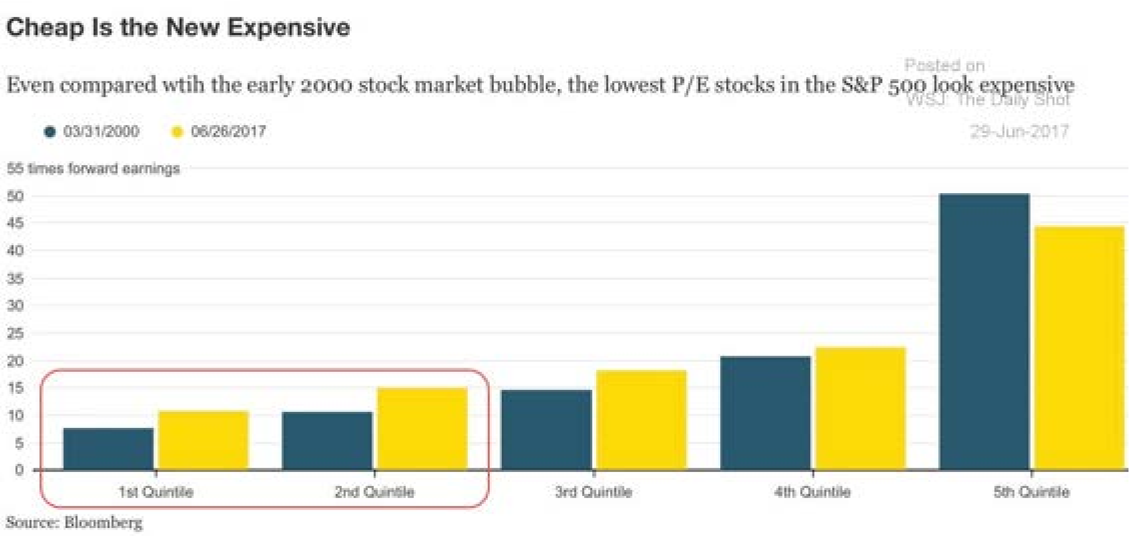
- Month-to-date: Dow +1.62%, S&P +0.48%, Nasdaq (0.94%) Russell +3.29%
- Quarter-to-date: Dow +3.32%, S&P +2.57%, Nasdaq +3.87% Russell +2.12%
- Year-to-date: Dow +8.03%, S&P +8.24%, Nasdaq +14.07% Russell +4.29%

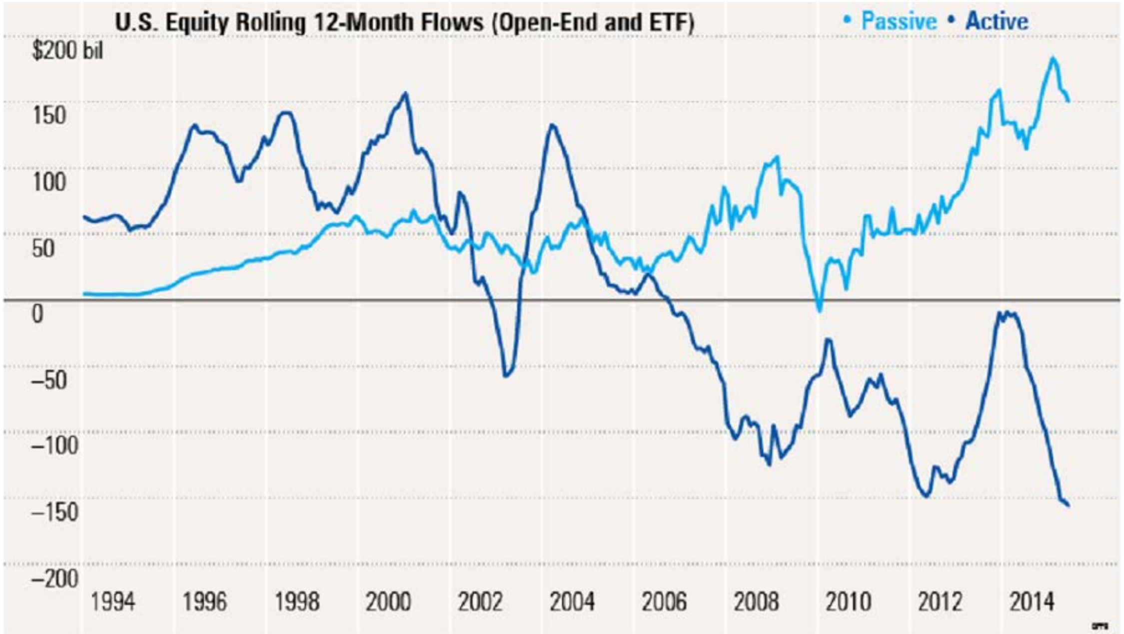
Macro Bits

Last week we touched briefly on crude and how its flight lower could lead to a rollover in the energy sector and junk bonds, which would ultimately trickle its way into the broader stock market. Well, BoA came out with a call for oil to see the 30s – which obviously means it will do the opposite. However, the oil market now finds itself in the middle of contrarian signals. On the one hand, Bank of America is calling for $30 crude, BUT none other than the Gartman himself said oil will probably see upside to ~$48 over the next few weeks. Regardless of the calls, oil has so far sustained its dead cat bounce from the middle of last week.

The dollar traded lower for most of the week as well. The DXY broke post-election lows on Thursday around 3am which led to a commodities rally. Oil (as we already stated) helped commodities rally, as did industrial metals.

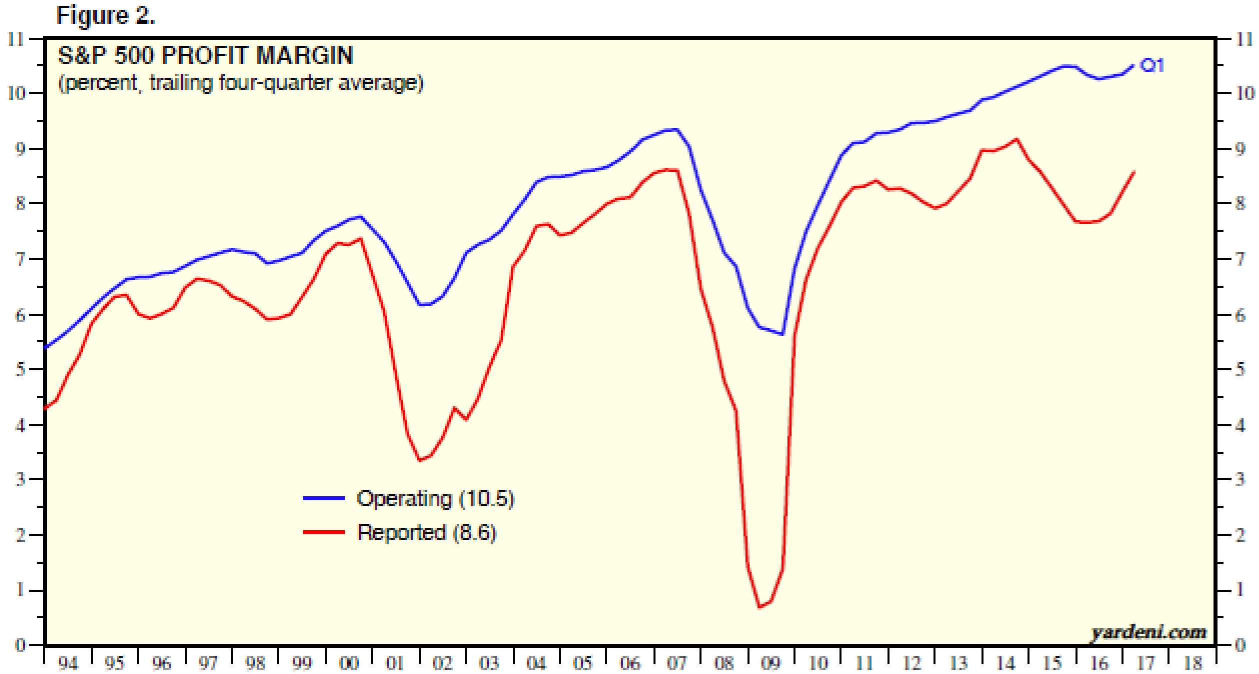
Not to beat a dead horse or anything, but stocks are expensive if you guys didn't know…, but pasted in below is just one more measure for how expensive stocks are relative to the tech bubble. I find this graphic to be interesting. We all know how expensive things were in 2000. Coke was traded at 50x, Microsoft at 65x, and Cisco got all the way up to 130x. The most expensive stocks in 2000 were incredibly expensive – way more expensive than stocks are now. It's interesting to me though that the bottom of the market is now more expensive than the greatest valuation bubble we have ever seen. We bought AMAT at 12x and TROW at 18x during the tech bubble. There was still value to be found – just not at the top. Unfortunately for active investors, the rising tide of passive investing has lifted all boats. Everything is expensive now and value is harder to find. The second chart just highlights the sheer volume of the inflow of funds in passive strategies, though it is a little outdated.





Margins are worth watching as an indicator. A rollover in margins has preceded the last two recessions. We have not experienced this rollover yet. It's worth keep an eye on it though over the next few quarters. The margin chart below is similar to the late 90s. Margins dropped momentarily in 2016, as they did in 98. They then continued upwards till the peaked in 2000 – will we see that peak soon?

Figure 2.

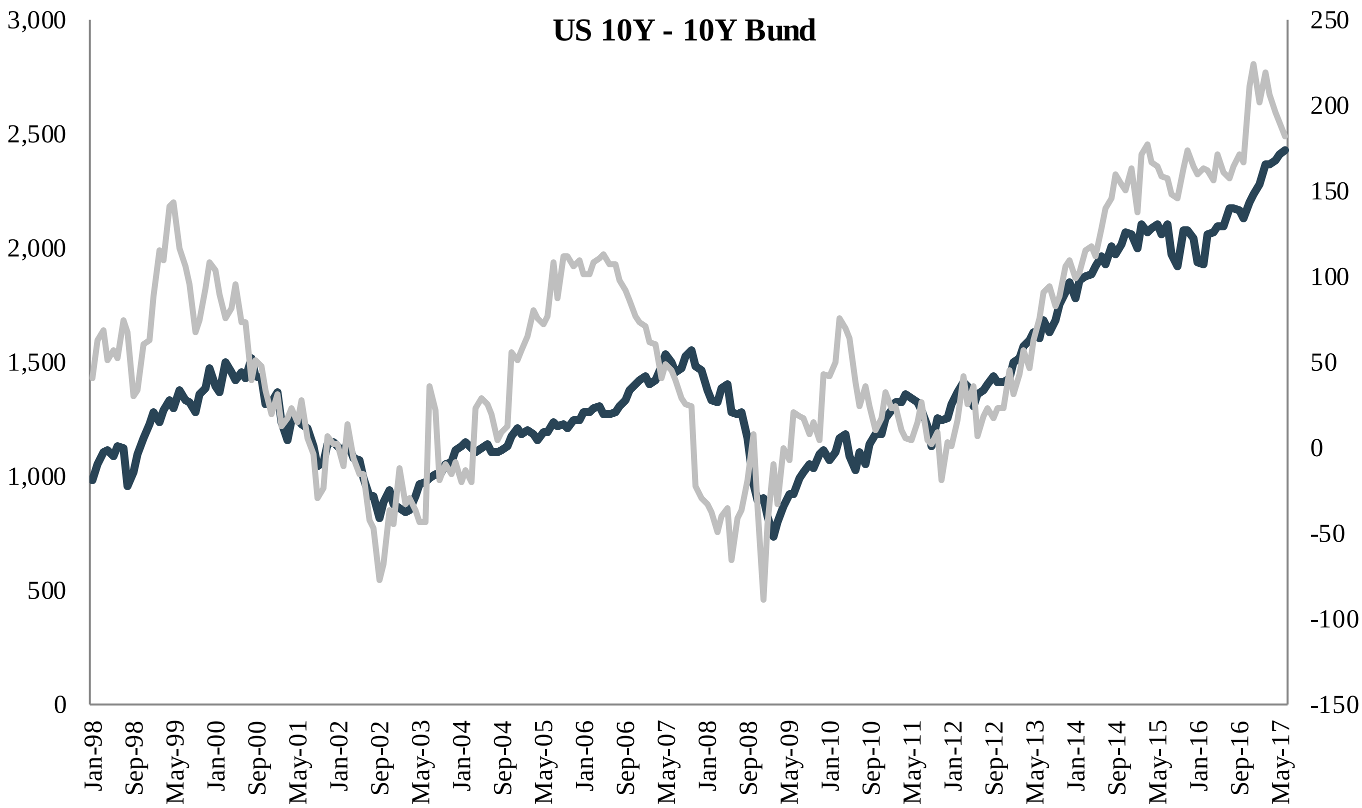


Source: Standard & Poor's Corporation (revenues and reported EPS) and Thomson Reuters I/B/E/S (operating EPS).

Things to Consider

Though not related to our portfolio, just an interesting tidbit I came across with regards to the age old economic debate with regards to minimum wage. The Seattle Minimum Wage Study, which was funded by the city and was led by economists from the University of Washington, looked at the impact of increasing Seattle's minimum wage in a two-step process. The first increase took place in 2015 and raised minimum wage from ~$9.50 to $11. The first increase had little impact upon hours/employment. The second increase took minimum wage from $11 to $13 in 2016. This second-step reduced hours for lower-wage jobs by 9% and ultimately lowered lower-wage jobs monthly income by $125. Now if anyone wants to discuss minimum wage, you have a little ammunition…

Next, the spread between the US 10 year and the 10-year Bund is starting to tighten. Since the fall of the Berlin wall, the tightening spread has occurred ~12 months prior to each market top. A similar pattern is also seen in US-Gilts and US minus whatever the Frenchies call theirs. A similar pattern is also seen in 10s – 2s in treasuries. Regardless of which fixed income indicator you use, it looks like the market is starting to signal something. The spread peaked 10 months prior to the market top in 2000 and 15 months prior to the market top in 2007; the spread hit a record high December of 2016 – this would put us on par for a correction early in 2018.



Portfolio News

June 26, 2017:

- **Scana** and Santee Cooper had to amend their interim agreement with Westinghouse Electric concerning the nuclear construction project through August 10th – subject to bankruptcy court approval

June 27, 2017:

- **FactSet** reported their Q3 numbers
  - Revenue and Earnings were roughly in line
  - Their Annual Subscription Value showed organic growth of 5.7% sequentially, but was a deceleration from the last quarter
  - Guidance given was in-line with prior estimates
  - Analysts noted that FactSet continues to outperform their peers with regard to market share, however there has been a continued deceleration in their organic numbers
  - FactSet began the week as a 3.2 in the model, as of 6/29 they were a 3.0 – however their sales and earnings numbers are continuing to decelerate

June 29, 2017:

- **Walgreens** and Rite Aid terminate their merger
  - **Walgreens** and Rite Aid however did enter into an asset purchase agreement
    - **Walgreens** will acquire 2,186 stores, distribution assets and inventories from Rite-Aid for $5.2B on a cash-free, debt-free basis

June 30, 2017:

- **Nike** beat last night and traded up +10%
  - It was by no means a stellar earnings report – they guided in line for FY18 and had soft Q1 guidance, however analysts are optimistic given that **Nike** is seemingly reversing some negative trends it has seen in the past few quarters
    - R&D is up and Inventory was in a better position than it otherwise has been
    - Future orders –which has been hurting Nike in the past – had less emphasis from analysts given **Nike**'s growth in their direct to consumers sales
- **Dominion** acquired a solar facility in Virginia and plans to purchase another

Upgrades/Downgrades:

- **Abbott** was initiated buy at Guggenheim with a target of $58
  - **Abbott** was also rated a buy at Jeffries with the same target
- **Becton** has been upgraded to strong buy from outperform at Ray Jay with a target of $226.
- **Costco** has been upgraded to outperform by Ray Jay with a target of $173
- **Republic** intiated outperform with a target of $71 at BMO Capital Markets
- **Stryker** was initiated a hold at Cantor Fitz with a price target of $153
- **Walgreens** upgraded to buy from hold at Needham

Portfolio Performance

I've pasted our portfolio performance in below… I am shortcutting this section a little this week as I have to help someone move…. We did not purchase anything on the composite level, though we did sell ½ of our **TMO** holding and all of four **Qualcomm.**

			Relative Performance				
Tick	52 Wk High	52 Wk Low	1 Yr.	YTD	QTD	MTD	WTD
ABBV	-1.6%	31.7%	0.4%	7.7%	8.8%	9.5%	-0.2%
ABT	-2.0%	30.0%	9.5%	18.8%	7.3%	6.4%	-1.0%
ACN	-3.7%	13.6%	-6.8%	-3.1%	0.2%	-1.5%	0.8%
ATR	-1.2%	23.5%	-4.1%	9.7%	9.9%	1.4%	0.1%
BDX	-0.5%	21.0%	-1.9%	8.6%	2.9%	1.8%	0.0%
BF.B	-18.6%	11.2%	-15.3%	0.4%	3.2%	-6.5%	-0.6%
BRO	-5.9%	20.3%	2.6%	-11.0%	2.0%	0.0%	0.3%
CERN	-4.1%	41.4%	-1.8%	31.5%	10.0%	0.9%	-2.7%
COST	-12.7%	12.5%	-15.8%	-9.0%	-7.8%	-12.4%	1.8%
CTSH	-2.6%	46.1%	-1.0%	10.0%	8.7%	-1.5%	-1.5%
D	-6.1%	10.2%	-16.0%	-7.5%	-3.1%	-4.9%	-2.2%
DLTR	-30.0%	6.5%	-43.0%	-17.7%	-13.5%	-10.6%	5.0%
EBAY	-4.3%	50.2%	31.2%	8.2%	0.4%	0.3%	-1.8%
ECL	-1.6%	20.0%	-4.3%	4.1%	2.5%	-1.4%	0.8%
EXPD	-2.2%	19.6%	-0.6%	-2.4%	-3.3%	4.5%	2.0%
FDS	-9.5%	10.1%	-9.0%	-4.3%	0.4%	2.0%	-0.4%
FISV	-3.7%	31.8%	-2.6%	6.3%	3.1%	-3.3%	-2.0%
GWW	-31.3%	7.1%	-35.2%	-31.0%	-25.5%	3.5%	2.4%
HRL	-14.7%	3.7%	-20.7%	-10.5%	-4.3%	0.7%	-2.4%
ICE	-1.2%	31.4%	13.4%	8.6%	7.6%	9.1%	2.6%
ITT	-8.7%	33.7%	8.1%	-5.1%	-5.6%	4.2%	3.3%
KO	-2.6%	12.5%	-16.0%	0.0%	3.2%	-1.7%	-0.9%
MD	-21.6%	12.2%	-32.1%	-17.2%	-15.1%	11.2%	0.7%
MSFT	-5.4%	36.8%	18.7%	2.1%	1.6%	-2.3%	-3.2%
NEE	-3.3%	26.8%	-7.3%	9.1%	6.6%	-1.4%	-2.1%
NKE	-2.2%	20.4%	-20.4%	-3.5%	-7.0%	0.0%	11.6%
NNN	-27.0%	7.3%	-39.9%	-18.8%	-11.9%	2.5%	2.5%
ORLY	-25.3%	1.4%	-37.9%	-30.5%	-22.3%	-11.1%	-0.6%
OZRK	-17.6%	39.9%	11.8%	-18.5%	-11.8%	6.3%	3.1%
QCOM	#N/A	#N/A	-14.0%	-23.6%	-6.4%	-4.2%	-3.0%
RMD	-2.0%	37.6%	7.4%	16.2%	4.7%	8.1%	-0.7%
ROST	-17.3%	4.5%	-14.1%	-20.7%	-15.4%	-10.7%	2.6%
RSG	-2.5%	29.6%	9.0%	2.8%	-1.7%	-0.9%	0.0%
SBNY	-12.6%	26.4%	0.3%	-12.2%	-5.3%	0.4%	5.5%
SCG	-12.3%	4.4%	-25.4%	-15.8%	1.0%	-1.2%	-3.5%
SJM	-24.8%	0.5%	-37.7%	-15.9%	-12.4%	-8.0%	-2.0%
SNI	-18.1%	15.2%	-4.4%	-12.0%	-15.0%	3.2%	1.4%
SYK	-4.7%	30.3%	0.0%	7.8%	3.0%	-3.2%	-1.4%
TJX	-13.7%	5.8%	-23.7%	-13.5%	-12.5%	-5.8%	4.2%
TMO	-1.4%	25.5%	2.9%	15.2%	10.8%	0.3%	0.0%
TROW	-6.0%	17.8%	-13.1%	-9.7%	6.2%	4.8%	0.6%
TSCO	-42.7%	4.1%	-61.1%	-38.1%	-25.5%	-4.1%	3.0%
UTX	-0.8%	25.1%	4.2%	2.9%	6.0%	0.0%	-0.1%
VRSK	-3.5%	11.6%	-11.5%	-5.4%	0.3%	2.7%	2.4%
WAB	0.7%	39.6%	12.5%	0.7%	13.3%	10.1%	3.4%
WBA	-11.0%	4.2%	-22.6%	-13.4%	-8.0%	-3.6%	2.6%
WCN	-3.9%	35.5%	16.4%	14.3%	6.6%	0.8%	-0.7%
YUM	-19.8%	23.8%	6.8%	7.9%	12.5%	0.8%	-1.4%