Notes from the Trading Desk

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Market Mover & Shakers

If the first week of August was the worst week for stocks in 2019, this past week was easily one of the wildest. The S&P 500 began the week where it left off the previous Friday, as it fell 3% on Monday. However, the index rallied into its Monday close and then proceeded to rally another 1% on Tuesday. The index fell 1.95% from Tuesday's close in the first 20 minutes of trading Wednesday before rallying more than 2% intraday and closing more or less flat. Markets entered rally mode again on Thursday, as the S&P 500 gained nearly 1.9%. Finally, on Friday, the S&P 500 fell more than 1.25% in the first half of the day, though it gained some of that back as it closed down 0.66%. For the week, the S&P 500 fell only 0.46%, while the Dow and the Nasdaq dropped 0.75% and 0.56%, respectively. The Russell 2000 underperformed its peers, as the small-cap index fell 1.34%. Gold continued its move higher. The precious metal is up nearly 18% this year (according to FactSet). Crude fell again last week and is down more than 20% over the last 12 months.

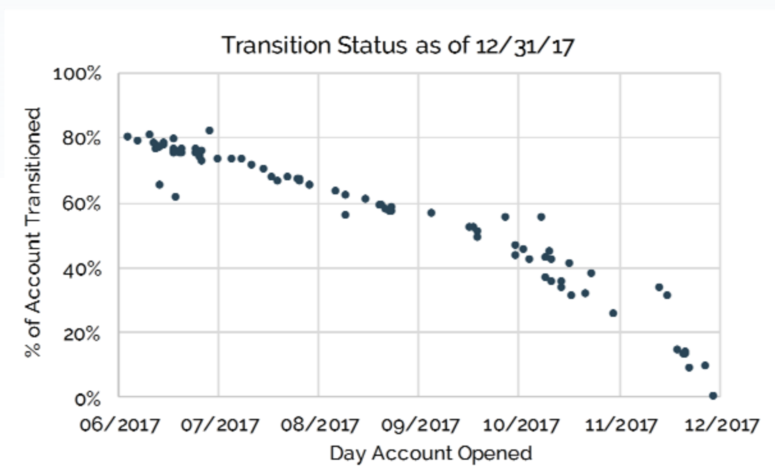
Last Monday's selloff actually began on Sunday night as a result of the overnight devaluation of the Chinese Renminbi. The exchange rate was allowed to push above 7 yuan per dollar for the first time since 2008. The depreciation of the Chinese currency sparked fears across Wall Street that the trade war would be escalating to a currency war. Further exacerbating this fear was Treasury's designation of China as a currency manipulator. Last week, we touched on how the trade war could end with a simple tweet from the President. However, consensus seems to be that a currency war would be more devastating and harder to roll back then any trade dispute. Furthermore, it would seem potentially unwise for the Chinese to allow their currency to devalue much more. According to the Wall Street Journal, nonfinancial companies in China owe $800 billion in dollar debt, while Chinese banks owe $670 billion in dollar debt. In other words, China's dollar debt adds up to 11% of their GDP. Since the debt is dollar denominated, a depreciation in the yuan relative to the dollar makes it increasingly harder to pay back their dollar debt. Thus, further devaluation of the yuan could cause China to surpass a currency crisis and enter a full-blown debt crisis.

The geopolitical shocks certainly roiled more than just the stock markets. Specifically, U.S. Treasury yields slipped at an alarming rate. The 10-year, which was above 2% at the end of July, fell as low as 1.60% on Wednesday. The spread between the 10-year and 3-month Treasury Bill got as low as –33 bps — meaning that the 10-year was yielding 33 bps less than the 3-month Treasury — which is the most deeply inverted it has been since 2007. Meanwhile, the race to cut rates amongst global central banks seems to be at full tilt. In response to the further deterioration in global growth, the central banks of India, New Zealand and Thailand all cut rates this past week. Within the last month, Europe has hinted at fresh stimulus from the ECB. And, following our Fed's 25 bps cut at the end of July, markets have now priced in a 100% chance of another 25 bps in September, and a 24% probability of 50 bps.

Transition Analysis

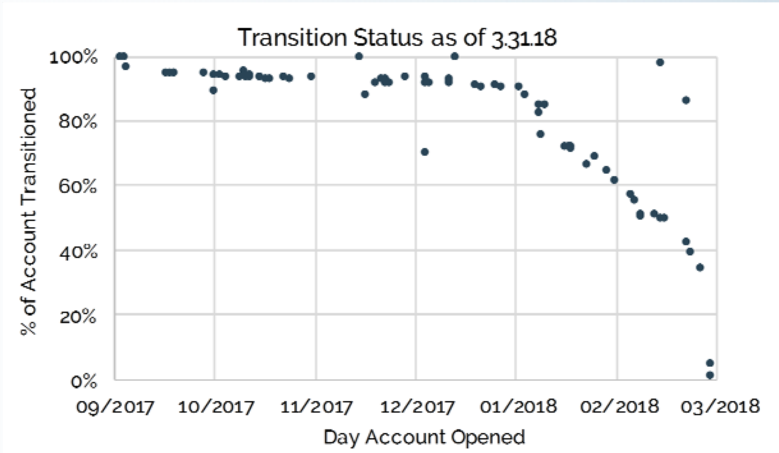
All of these macro events have caused volatility to come back with a vengeance. The VIX, which was at one point below 12 within the last three weeks, spiked all the way to 25 on Monday. Quick jumps in volatility often cause indiscriminate selling as high-quality and low-quality names alike are sold off as investors rush into safe havens. However, investors scrambling for the exits presents the perfect opportunity for us to be rather aggressive with new money in getting into our strategies. As such, spurts of volatility often coincide with an increase in activity on the transition level.

Typically, when left to our own devices, new accounts are transitioned over approximately 3-6 months. However, extremes in the greater marketplace environment can often affect the speed at which we transition new accounts. For example, 2017 was a historical year due to the complete lack of volatility — a topic which we discussed extensively at the time. Just to quickly rehash though, 2017 saw a record low on the VIX, only 8 trading sessions resulted in a move greater than ±1%, and the S&P 500 didn't have a single down month for the first time on record. It was truly a remarkable year. As a result of the complete dearth of volatility, it was much harder to put money to work on the transition level. The graph to the right charts the progress of accounts transition given their start dates. As one can see in the chart, accounts that had been here for 6 months were only

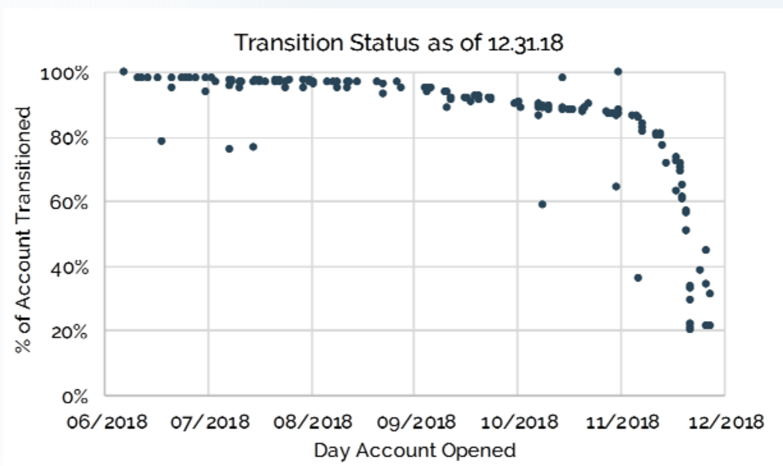


80% invested in our strategy. Accounts that had been with us for three months were roughly 60% of the way through their transition.

However, at the start of February 2018, a few volatility-linked products imploded, which caused a 10+% pullback in the S&P 500. While we had been rather slow in 2017 to put money to work, the reintroduction of volatility allowed us to be more aggressive. As such, and as one can see below, money was being invested much more quickly. The opportunity from the market selloff, allowed us to get accounts that had been here for 2 months more than 90% invested. Accounts that had been here for one month were 60% invested.



The difference in speed at which we transition accounts was evident again in Q4 of 2018. Markets fell 20% in nearly 3 months due to global growth fears and central bank miscues. As such, accounts were being transitioned at an even quicker rate than they were during the first quarter of 2018. Accounts that opened at the end of November were nearly 90% invested within one month opening.



In fear of being misunderstood, it is worth iterating that the rate at which we transition accounts is without a doubt totally independent of what the market is doing. The market is something we often discuss in *Notes from the Trading Desk*. However, in reality, it plays little to no part in how we invest money. The transition process, as well as our investment process as a whole, is done on a stock-by-stock basis, regardless of what the S&P 500 is doing. However, the brief spurts of volatility do provide opportunity in individual names to implement our strategies. As such, in weeks like the last two, we have had the opportunity to invest, on the transition level, in plenty of our names. If volatility within the marketplace continues in the coming weeks, it would not be surprising to see us continue to be aggressive on the transition level and take advantage of quality names being sold-off indiscriminately alongside lesser quality names.

Portfolio News & Notes

For the most part, earnings season is beginning to wind down. Consumer Staples such as Brown Forman, Hormel, and J.M. Smucker all are still yet to report, as well as discount retailers TJX, Ross Stores, Dollar General, and Dollar Tree. Last week, BDX, HSIC, EXPD, and CVS all reported. All four companies beat their EPS estimates. However, BDX, HSIC, and EXPD all disappointed on the topline coming in just shy of estimates sales numbers. Becton raised the low end of their FY 2019 guidance while reiterating the rest of their numbers. BDX rose 2.5% following their earnings report. Henry Schein on the other hand, fell 4.3% by the end of the day following their numbers release. EXPD, who does not release guidance, traded up nicely following their numbers. However, EXPD — along with many of the transports — has been trading in lock step with the trade war headlines. Lastly, CVS had a nice 7.5% pop following their beat and guide higher.

	WTD	MTD	QTD	YTD
Dow Jones	-0.75%	-2.15%	-1.17%	12.69%
S&P 500	-0.46%	-2.07%	-0.79%	16.43%
Nasdaq	-0.56%	-2.65%	-0.59%	19.95%
Russell 2000	-1.34%	-3.91%	-3.42%	12.20%
Comm. Svcs	-0.64%	-1.91%	1.04%	19.57%
Con Disc	-0.01%	-2.21%	-1.33%	19.39%
Con Staples	0.01%	-0.36%	1.96%	16.70%
Energy	-2.22%	-5.73%	-7.50%	2.80%
Financials	-1.67%	-4.16%	-1.96%	13.65%
Health Care	0.41%	0.29%	-1.43%	5.59%
Industrials	-0.62%	-3.22%	-2.64%	17.02%
Info Tech	-0.81%	-3.00%	0.16%	26.33%
Materials	0.72%	-1.07%	-1.50%	14.22%
Utilities	1.04%	2.12%	1.73%	14.77%
REITs	1.82%	2.82%	4.52%	23.63%

Upgrades/Downgrades & Dividends

DG — Upgraded to buy from neutral at Goldman Sachs, price target increased to $152 from $142 (8/8).

DLTR — Downgraded to hold from buy at Deutsche Bank, target of $99 (8/5).

HSIC — Downgraded to market perform from market outperform at William Blair (8/7).

RSG — Initiated neutral at JPMorgan with a price target of $94 (8/7).

WCN — Initiated overweight at JPMorgan with a price target of $98 (8/7).

Earnings Calendar		
Date	Time	Ticker
8/13	Pre-Market	CVET
8/20	Pre-Market	TJX
8/22	Pre-Market	HRL
8/22	Post-Market	ROST