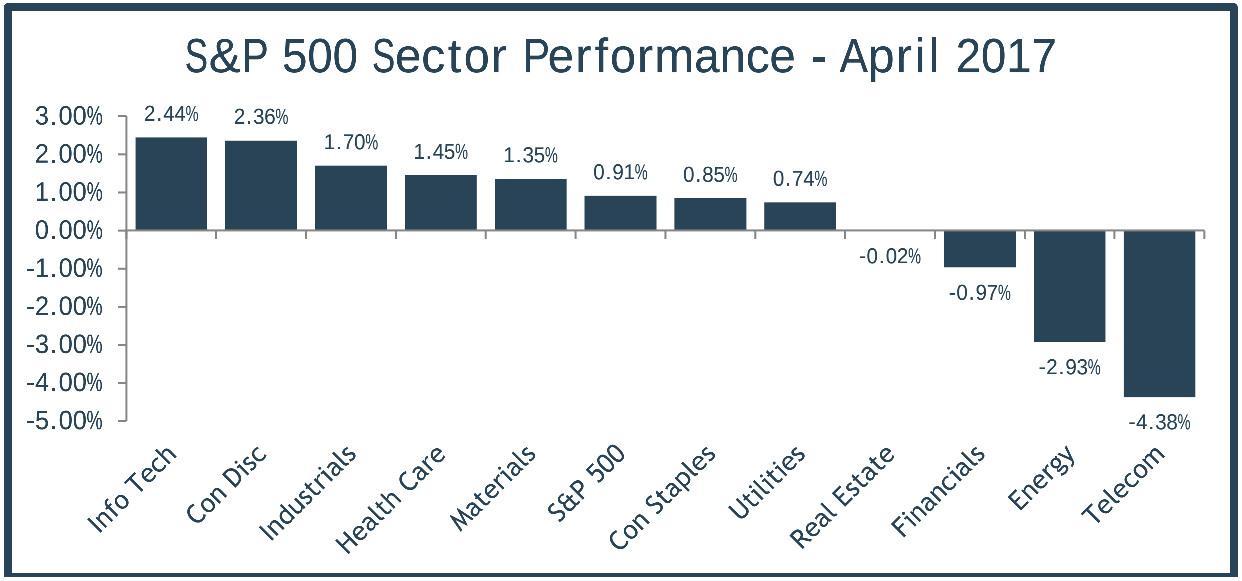
Financial Markets Review

April ended up being a tale of two halves. The U.S. equity markets trended lower in the first half mainly due to geopolitical concerns – North Korea and the French election. The concerns were reflected in the VIX, as it increased by 49.3% from April 5th to April 17th. The U.S. Treasury market was also a benefactor of the "fear" trade. The 10-year U.S. Treasury yield troughed on April 18th at 2.16%, which was 24 basis points lower than its monthly high of 2.40%, set on April 1st.

Once the first round of the French presidential election concluded without any major surprises, equity markets around the world rallied. The European equity markets rebounded the most with France leading the way up over 4% on the Monday after the election. Over the last two weeks of the month, the VIX fell 36% and the 10-year U.S. Treasury yield bounced back toward previous support of 2.30%.

The Nasdaq Composite was able to crack 6,000 and set a record intra-day and closing high. This tech-laden index is now up 12.34% year-to-date. The S&P 500 managed to erase the losses in the first two weeks of April by rallying nearly 3% over the last two weeks to close the month with a gain of 0.91% and just shy of all-time highs. The following graph shows the sectors of the S&P 500 that led the way in April.



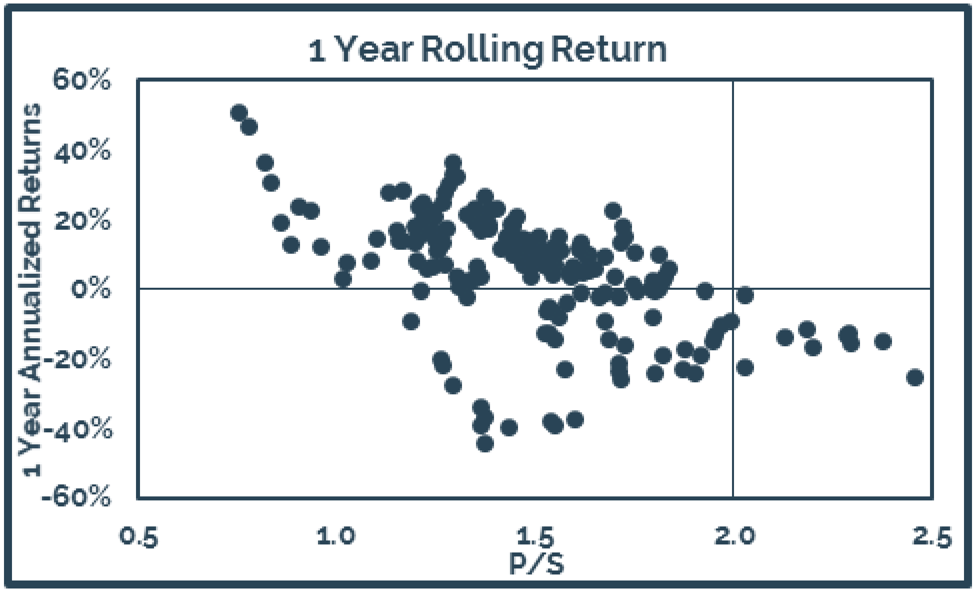
Source: Standard & Poor's

Earnings and Valuation Updates

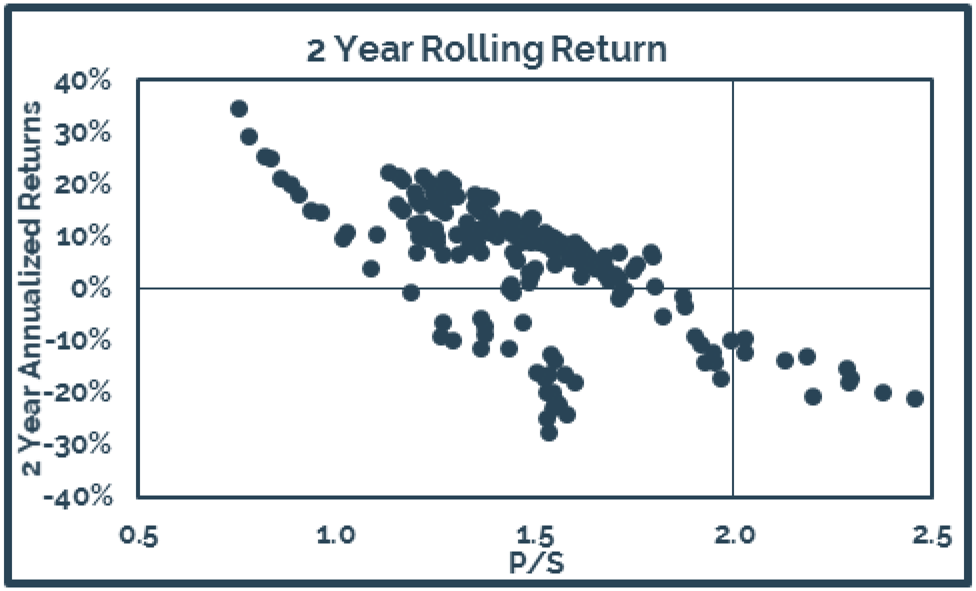
Earnings season really didn't get going until the third week of April. And, there is good reason to believe the strength in earnings was a major contributor to the rally in the back half of the month. Currently, we are a little over half way through quarterly earnings announcements for the S&P 500. According to Factset, the year-over-year sales growth is 8.66% and earnings per share growth is 13.1%. This growth has been led by a recovery in the Energy sector with 30.84% sales growth and 237.77% earnings growth. Since the start of the quarter, Q1 earnings per share has come in better than the expected 9.6% growth.

Looking forward, estimated earnings per share for Q2 continue to come down from a forecasted growth rate of 9.1% to now 8.5%. For the full year, earnings per share estimates have inched slightly higher over the past month. Growth for 2017 is now expected to come in at 10.4% vs. 10.1% expected at the start of this quarter.

Traditional valuation metrics, such as P/E and P/S, continue to stay elevated relative to historical readings. The good news is we are now clear of the earnings recession experienced throughout 2015 and into 2016. However, at these valuation levels much of the growth currently being reported and expected for quarters to come is very much priced into the U.S. equity markets. At this point, there is very little room for monetary/fiscal policy error, major geopolitical conflict, or a broad based economic slowdown. Based on the past 20 years, the S&P 500 is trading in the 93rd percentile for P/S at 2.04. The following three charts show the annualized return experienced over the past 20 years at different P/S levels. The important thing to note is at the current P/S level, the S&P 500 has never experienced a positive return over a one, two, or three- year period. Hopefully, this time is different!



Source: Factset



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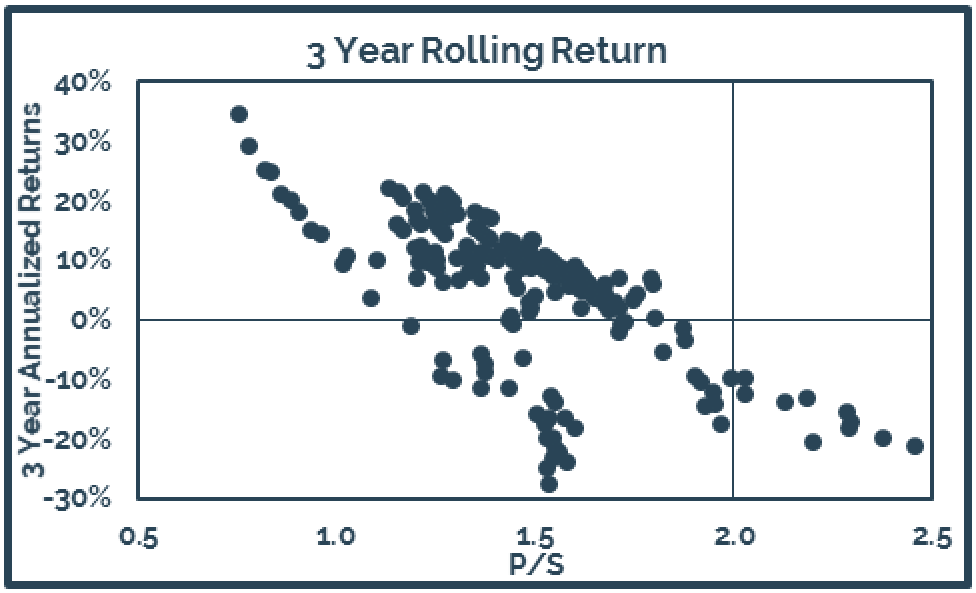


Source: Factset

Tandem Strategy Updates

We took two new positions in our strategies this month – Verisk (VRSK) and Factset (FDS). VRSK is a decision analytics and risk assessment company. They serve customers across industries such as insurance, financial services, and energy to help them make informed decisions and evaluate their risks. VRSK specializes in using their proprietary data to provide predictive analytics to aid in their clients' decision making. The company has managed to grow sales and operating earnings on a 5-year compounded annual growth rate at 8 – 10 %. VRSK is currently being added to our Equity and Mid-Cap strategies.

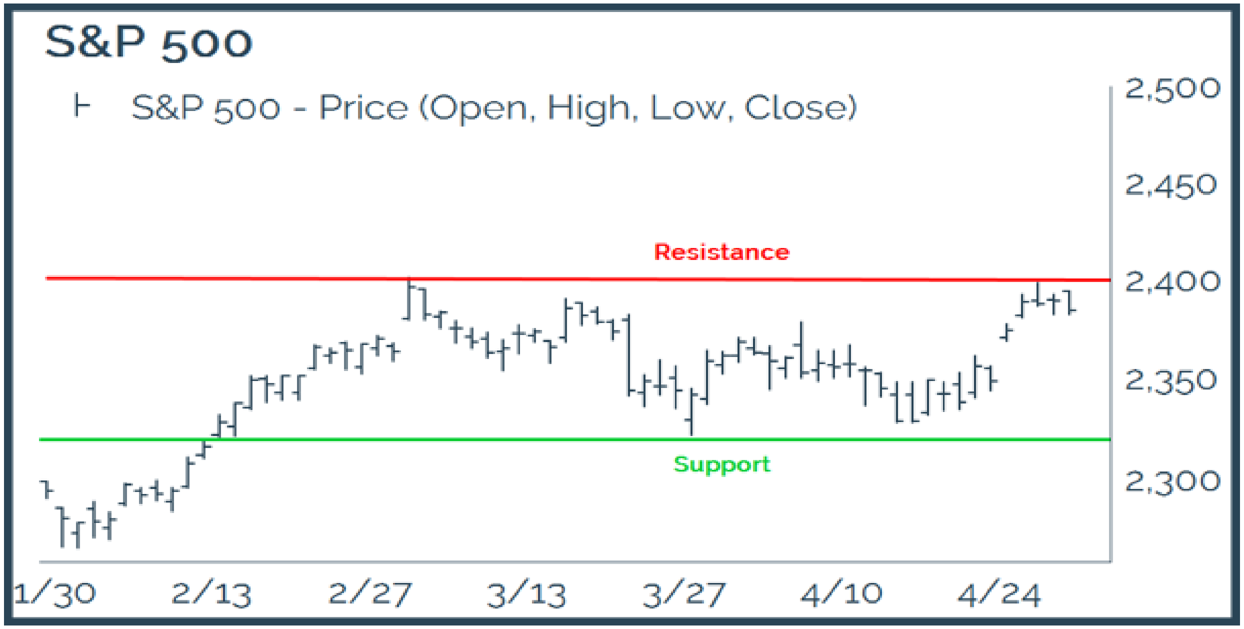
Factset (FDS) provides financial data and analytical tools to investment professionals through sales of their software. FDS has increased sales and net income every year since the company became public in 1996. In addition, the company has increased its dividend every year by at least 12%, since FDS started paying a dividend 18 years ago. FDS is currently being added across all our strategies.

We continue to add incrementally to Signature Bank (SBNY) in our Equity strategy after taking profits at a higher level in November of last year. We have also nearly completed liquidating Aptargroup (ATR) and ITT Corp (ITT) across all our strategies. ATR recently hired a new CEO from outside of the company, which violates one of our fundamental principles of hiring from within. ITT no longer passes through our quantitative model due to its lack of growth on both the top and bottom line over the past several years.

Things to Watch

May is upon us and you will most likely hear a lot of "sell in May and go away" talk. It is easily one of the more popular Wall Street adages. There is some truth to it, but not nearly enough to base an investment thesis around. However, currently there are a few headwinds worth noting.

- Flattening yield curve - the spread between the 10-year U.S. Treasury and 2-year U.S. Treasury is 102 basis points, which is down from a high of 134 basis points in December right after the election.
- Citi Economic Surprise Index is breaking down – measures how economic data is being reported relative to expectations.
- S&P 2,400 level – current overhead resistance for no other reason than the market is expensive on most traditional valuation metrics and it is a round number. If the market can sustain a break above 2,400 and close above it, stocks should be off to the races. Otherwise, the S&P 500 will likely remain range bound and test the 2,325 level of support.



Source: Factset

- Deteriorating market breadth – fewer stocks are leading the market higher. The beginning of March was the last time the S&P 500 was trading at current levels. At that time, 82% and 79% of stocks were trading above their 200-day moving average and 50-day moving average, respectively. Currently, 73% and 56% of stocks are trading above these moving averages. The last time we saw deterioration in stocks underlying the index, while the headline index level was in earshot of all-time highs was during the summer of 2015. If you remember, August and September were not too kind to equity investors.

Events on Tap

- FOMC meeting (May 3rd) – market is pricing in a 5% chance of an increase in the Fed Funds Rate. An interest rate increase would be a shock to the market, as it would be considered a huge surprise.
- Non-farm payrolls report (May 5th) – consensus is looking for a gain of 187,500 jobs. After last month's disappointing report of a 98,000 gain, anything greater than consensus and a revision higher of last month's report would come as a big sigh of relief.

--Billy Little, CFA

"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it." ~ Ralph Waldo Emerson