Notes from the Trading Desk

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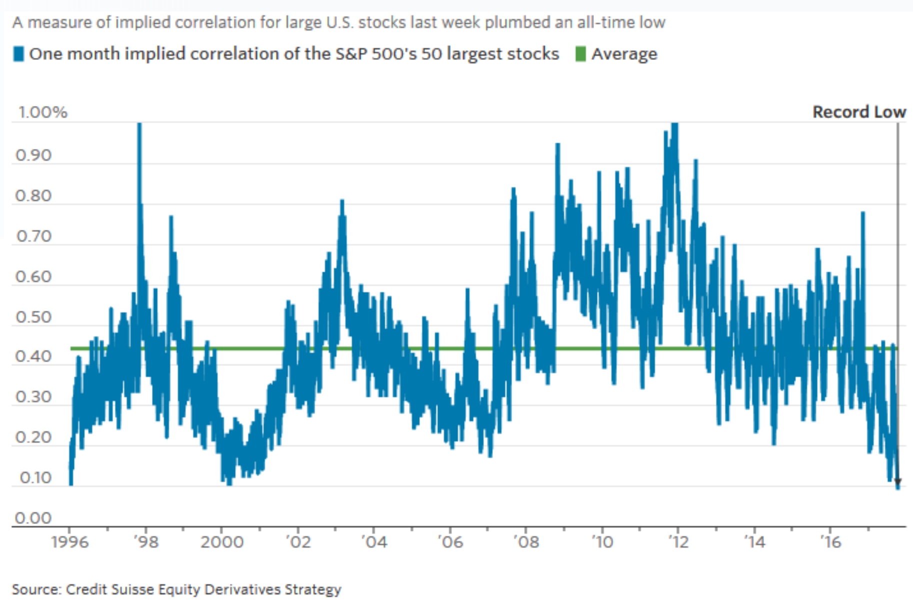
Market Movers & Shakers

Another week is in the books and a rather muted week it was. The S&P closed up 15 bps, the Nasdaq was up a quarter of a percent, and the Russell was down 50 bps. Sector performance was mixed with defensive sectors largely leading the way. REITS and Consumer Staples were both up at least 150 bps, while Utes added to the defensive theme — up 133 bps. Tech also made a material move, closing up 1 and 1/3 percent. Telecomm took a beating on the back of a bad report from AT&T. Fins, Healthcare, and Discretionary were all off at least 1/2 percent as well. Gold was bid higher, closing up 2%, the dollar was weaker, and Crude had a nice week — up 4.5%. The yield curve continued to flatten, though an inversion still seems quite a ways away. However, we are once again nearing cycle lows on the spread between 10s and 2s. We've talked a lot about the yield curve here in the past, and I still hold that a continuation in the flattening of the curve is bad news for the stock market.

The Wall Street Journal put out an interesting article this past Tuesday. According to Credit Suisse's equity derivatives strategy team, the one month implied correlation for the 50 largest US stocks hit an all-time low. Last week's one month implied correlation printed a reading of 9%, well below the average of 44% for the data stretching back to 1996 (chart below). The Journal went on to tout this a surefire sign of a "Stock Pickers" market. I am not arguing against their point, however I do think they missed the point most obvious to me when looking at the chart. Correlations reached 12% in February of 2000, a cycle low at that point. At the start of 2007, correlations again hit cycle lows with a correlation of 18%. To be sure, correlations head towards 100% when times get tough, however distinct lows in the implied one month correlation seem to also prelude a clear spike in correlations, which is typically seen as being negative.

On the flip side of the Journal's active management coin, the rising tide of passive investing seems to be hitting on all cylinders. This past week, The Financial Times pointed out that the 10 largest stock ETFs in the US, all weighted by market cap, have taken in $65B of new cash from investors YTD. Additionally, fund flows from Lipper and EPFR show that a record amount of money poured into global equity funds this past week — $6.6 billion in new cash entered these funds, the highest ever weekly inflow according to Jones Trading. However, the rush into these, largely passive, funds could potentially add to the frothiness in the marketplace. Invesco's CEO, Martin Flanagan, recently warned that investors have been blindly pouring money into highly concentrated indexes. Flanagan expressed concern that investors were unaware of the high concentration in funds that many perceive as being broad and diversified. The head of the fourth-largest ETF provider (Invesco) is warning that investors are blindly rushing into investments, totally unaware of what they might be buying. This seems like it could be potentially problematic.

Last bit of food for thought for this week. The spread between BoAML's US High Yield and the US 10Y is really beginning to compress. Going back to 1997, the average spread is 5.25%. Today, it is slightly above 3 at 3.16. A widening of these spreads could lead to a more turbulent ride. Spreads widened into the 2000 top, as well as the 2007 top. Spreads also widened throughout much of 2011 and on the back half of 2015 into the start of 2016. All periods witnessed a double digit pull back, something the marketplace has been devoid of for quite some time now.



Upgrades & Downgrades

ABBV — upgraded to outperform from market perform at Cowen. Price target increased to $105 from $95 (10/10).

DLTR — downgraded to hold from buy at Loop Capital Markets, target remains $88 (10/13).

EBAY — target increased to $33 at Morgan Stanley, up from $29, though it remains underweight (10/11).

ITT — upgraded to buy from hold at Deutsche Bank with a price target of $55 (10/9).

PYPL — upgraded to overweight from equal-weight at Morgan Stanley. Their price target was increased from $66 to $72 (10/11). **PYPL** also had their price target increased from $70 to $80 at Jeffries, their rating remains a buy (10/13).

SBNY — assumed neutral at Piper Jaffray with a price target of $140 (10/13).

YUMC — initiated buy at Nomura/Instinet with a price target of $51.60 (10/9).

Dividend News

Brown & Brown is increasing their quarterly dividend over 11% year over year to $0.15— payable 11/8/2017.

Dominion Energy is increasing their quarterly dividend 10% year over year to $0.77 —payable 12/20/2017.

Earnings Calendar

Date	Time	Ticker
10/16/17	Post-Market	BRO
10/18/17	Pre-Market	ABT
10/18/17	Post-Market	EBAY
10/18/17	Post-Market	PYPL

Portfolio News

The average Tandem holding fared no differently than the S&P 500 this past week, both were up 20 bps. However, the dichotomy between the top and bottom of our portfolios was stark. At the bottom, many of this past Summer's themes resurfaced. Amazon once again wreaked havoc, this weeks target was pharmacies. Walgreens was off 7.7% and CVS was down 5.6% . These downward moves were mostly driven by a news report last week stating Amazon's decision as to whether or not they will attempt to move into the pharmacy space will come before Thanksgiving. Let's rehash this real quick — Amazon is deciding *IF* they will move into the pharmacy space, and as a result, CVS and Walgreens are down double digits quarter-to-date. Apparently, we will all wake up one day and Amazon will be providing anything and everything we could ever need — there will be nothing, except Amazon.

However, let's not dwell too much on the negative. We had a couple names continue some impressive runs. PayPal was up 4% this week, over 7% for the quarter, as it continues higher. For those keeping score, its up 74% YTD. Cerner, though it had a rather quiet week news wise, was up nearly 3%, and is up over 55% this year. Yum! China reported some good numbers last Friday and hasn't looked back since — they're up nearly 7.5% since last Thursday's close.

On the portfolio front, we rounded out CVS to 3% on Monday, taking advantage of the Amazon induced selloff. Other than that, it was a rather quiet week on the news front and the portfolio front. However, earnings season is set to ramp up and there is certainly going to be a slew of news coming the next few weeks. While we have a couple of names on deck reporting this week, the following week has 15 Tandem companies set to report. The busy season is ready to begin!

	WTD	MTD	QTD	YTD
Dow Jones	0.4%	2.1%	2.1%	15.7%
S&P 500	0.2%	1.3%	1.3%	14.0%
Nasdaq	0.2%	1.7%	1.7%	22.7%
Russell 2000	-0.5%	0.8%	0.8%	10.7%
C.D.	-0.6%	1.2%	1.2%	12.0%
C.S.	1.5%	1.2%	1.2%	5.7%
Energy	0.1%	-0.4%	-0.4%	-9.0%
Fins	-0.9%	1.0%	1.0%	12.2%
H.C.	-0.7%	0.7%	0.7%	19.6%
Ind.	-0.1%	1.3%	1.3%	13.7%
I.T.	1.3%	2.8%	2.8%	29.6%
Mats	0.7%	2.7%	2.7%	17.1%
Utes	1.3%	2.0%	2.0%	11.2%
REITs	1.8%	2.2%	2.2%	6.8%