

SUMMER NEWSLETTER

The US Stock Market continued its record run to close out the first half of 2017, despite the increasing turmoil both here and abroad. **Earnings are the biggest driver for stock prices, and earnings growth has accelerated for the first time in a couple of years.** The US economy continues to chug along while the global economy has actually strengthened. These are really important events and provide strong support to the Bull rally. Emotions remain high with a great deal of angst and skepticism from investors. It's been the case for 8 years. This Bull Market has charged higher in the face of fear and confusion its whole life.

THE FAB 5



There is very little investor euphoria out there, but there is some that's been brewing. We saw signs of it in Tech, where some stocks have been soaring while the broader Market has not. The Top 5 stocks in the

S&P 500 have had a huge impact on this Market rally. They are: Apple, Google, Microsoft, Amazon and Facebook, also referred to as the Fab 5. These 5 stocks represent a mere 1% of the 500 S&P companies, however, they represent 13% of the weighting of the index.

Tech is by far the largest sector in the S&P, representing 24% of the index. **The Fab 5 have been the biggest drivers for the US Stock Market, accounting for 1/3 of the gains.** It's even more pronounced in the Tech-heavy NASDAQ. The same 5 stocks represent over 40% of the weighting of the NAS 100 index and 55% of the gains. Amazon, Apple and Google were up 30%, 25%, and 18% respectively for the first half of the year. It's been a handful of stocks that are driving the rally.

IT'S ALL ABOUT GROWTH

Innovation reigns supreme and investors have been aggressively throwing money at companies that are exposed to **driverless cars, artificial intelligence and the internet of things.** Make no mistake, these investment themes are real and they're sustainable in our minds. They've just gotten a little too excited and ahead of themselves.

Despite higher valuations, it isn't anything like the dot.com bubble of 2000. The Fab 5 companies are all very profitable and are much cheaper than Tech during the bubble days. But stocks do get overbought, which is the case today.

THE AMAZON EFFECT



Amazon shook things up with the bid to buy Whole Foods. The news sent shockwaves throughout the retail industry and has investors re-thinking everything about how

we're going to shop. Nearly 30% of retail sales are coming online today. For perspective, it was less than 10% when Amazon IPO'd 20 years ago. But Amazon is showing that physical stores are needed and relevant. **Balancing the convenience of delivery with in-store experience for quality is the focus,** and retailers are scrambling to compete and stay relevant.

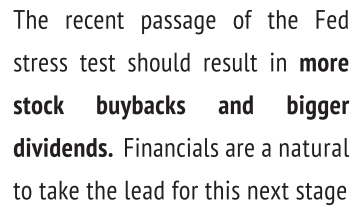
UNSTABLE RELATIONSHIP BETWEEN ENERGY & TECH

It was an extremely challenging first half of the year for American Energy stocks. After leading all sectors last year, Energy has been the worst performer in 2017. **Healthy Bull Markets usually see Tech and Energy play leadership because they both tend to reflect growth.** With the new administration, we anticipated a very supportive Energy policy and increased US oil and gas production. Oil prices fell as US producers continued to produce at record rates. Innovative Energy companies are high-tech. We don't believe we will see \$100 oil for the rest of the decade. But we do see more opportunities to grow your money in the space.

BANKS & BIOTECH

Financials came alive at the end of last year after struggling mightily since the crisis in 2008. Bank balance sheets are the strongest they've been in decades and the prospects for higher interest rates and pro-growth policies from Washington kick-started their stocks. Interest rates fell in the first half, which was good for Bonds, but not for Banks. We see a reversal coming.

GROWTH OVERSEAS



Despite the massive moves for Tech stocks, it was the broad-based Health Care space that performed the best for the first 6 months. Biotech erupted higher in June for a fantastic finish. **Biotech stocks have spent the last 2 years in correction mode, something that we think comes to an end.** This is a positive development for this Market, and an area that we believe will provide leadership for the second half of 2017. We see tremendous opportunity for investment in the treatment of cancer, Alzheimer's and chronic pain, among others.

For the Bull Market to continue, new leadership is needed. Sector rotation has been a theme throughout this Bull's cycle. Money continues to flow to new areas, which has kept this rally alive. We still like Tech long-term, but think it's due for a breather. **We see new leadership coming in the form of Financials and Health Care. We see Energy stabilizing while Emerging Markets continue the catch-up.**

"History doesn't repeat itself, but it often rhymes." - MARK TWAIN

The Twain quote captures a critical reason why charts provide context and a great aptitude to help us anticipate what lies ahead. The Tech-heavy Nasdaq has had a tremendous run in 2017, performing the best of the major market indices. Generally, when a group of stocks outperform by a wide margin in a narrow window, they attract a lot of attention. It often leads to performance chasing. We call the late stage buyers “weak hands” as they were late and are the first to jump ship when the trend turns against them. We think that is in play with the Nasdaq, a great performing index, that simply got ahead of itself. In our work, it does not mean this market is done going up. It just shows the probabilities point towards a quick and healthy correction into the summer to wash out those “weak hands”.

Once this happens, another base will form, and the Nasdaq can regain its footing and reemerge as a leader and charge higher into the end of the Year. We are now underweight Tech in our portfolios, but plan to get back in later in the Summer or Fall. **The chart below depicts what we anticipate ahead.**

