

FALL NEWSLETTER

The Energizer Bull keeps going and going... This Market just does not want to go down. The path of least resistance has absolutely been higher. Three quarters through 2017, the Bull Market continues to reach fresh, new highs in the face of so many challenges. Many of said challenges are political, geopolitical and social in nature. The one constant in 2017 has been strong earnings growth, and it is indeed earnings that drive stock prices.

ALL ABOUT GROWTH



For much of the year, it was a very narrow segment that was leading the Stock Market higher. The Technology sector has been the best performer in 2017. For the first half of the year,

Tech was responsible for the majority of the gains on the S&P 500. In fact, just 5 stocks accounted for 40% of the S&P gains. Those stocks were Apple, Google, Facebook, Netflix, and Amazon. No surprise, these are also the innovative companies that are leading this Digital Economy and are experiencing rapid growth. They have also become mammoth companies with dominant business models.

The investment themes are sustainably strong and long-term in nature. The innovations with smart-phones and smart devices, electronic commerce, Robotics and Artificial Intelligence and automation will continue to provide growth for the foreseeable future. Cyber-security is back on everyone's radar and has been a growth theme for a few years. The future prospects are compelling for the cops in the cloud. It is very investable.

MEGA-CAP DOMINANCE

The Stock Market has become pretty top-heavy. Within the S&P 500, the top 5 stocks account for over 13% of the index. The top 300 stocks represent over 90%. Put another way, if the 200 smallest companies in the S&P 500 went to zero, it would result in less than a 10% correction for the US Stock Market!

This Bull Market is incredibly resilient and has found a way to stay up under any circumstance this year. Fortunately, the rally broadened out a bit over the Summer and into Fall. Growth stock leadership transitioned to Value. Tech and Health Care strength switched to Energy and Financial leadership. This rotation triggered fresh new highs to close out September. It's been truly remarkable.

LOWER TAX AND GLOBAL GROWTH



Tax-reform has been on the Market's Washington Wish List all year. A formal Bill has been drafted but will face tremendous heat on Capitol Hill. Lower tax rates for corporations and individual

Americans would certainly be celebrated by Wall Street. There is a pile of corporate cash sitting offshore that could come back to American soil and pragmatically be put to work. Our sense is a tax deal will get done, but not in current form and not in 2017.

A key factor this year has been the broadening participation of global markets. International stocks, led by Emerging Markets, have come alive in 2017, after 3 years of declines. Faster growing economies with strong demographics like India have accelerated. That has been a significant positive, and something we see continuing in the next couple of years as international stocks play catch-up to the U.S.

INTEREST RATES = PRICE OF MONEY

Stronger economic growth naturally leads to higher interest rates. With unemployment at multi-decade lows and the global economy picking up speed, the Federal



Reserve indicated more rate hikes are on the way. The Fed also plans to unwind its inflated balance sheet, a result from aggressive monetary policy to combat the Financial Crisis. That means borrowing costs will climb. We don't see interest rates skyrocketing anytime soon, but we do see them moving enough to hurt long-term Bond prices and help Financial stocks.

INTEREST RATES = PRICE OF MONEY CONT.

The low interest rate environment has been positive for stock prices and supportive of a higher Market valuation. The S&P 500 is currently trading at 17.5X next year's earnings estimates. This is on the expensive side of history, but not excessively. The average multiple of earnings historically is 15.5X. When you factor in the low interest rates, it appears much cheaper. The result, money has flowed to stocks over bonds and other asset classes.



BULL TO BULL

There have been many comparisons to the current Bull and the Dot.com Bull, which eventually burst in the year 2000. It's understandable to draw the comparison. This current Bull, born in 2009, is now the second longest in time and second largest in price in American history, trailing only the Dot.com Bull. Both Bulls were driven by innovative Tech companies. The Dot.com bubble was inflated with pricey young Tech companies, many of which had neither profits nor plans to be profitable. That is a major difference where the vast majority of Tech today is very profitable and not nearly as expensive. Today's Tech leaders are innovators and have captured customers the world over and have strategic advantages that are sustainable. It is a solid foundation on which they operate. Investor sentiment is showing some signs of exuberance, but not necessarily irrational. The consecutive new highs seem to be sucking people in. We just believe certain stocks are a little ahead of themselves and are just overdue for a healthy correction.

WHAT'S THE CHART SAYING?

In our 2017 Outlook Newsletter in January, we gave our projection for the upcoming year and next part of the bull cycle saying, "2500+ on the S&P 500 this year is well within the realm of possibilities." As we enter the final quarter of 2017, the S&P 500 sits at 2537. Our high probability price objective has been achieved. The last 10% correction the S&P 500 witnessed was February of 2016. This year brought the lowest volatility in decades. The Brexit vote in the Summer of 2016 brought a 6% decline followed by a 5% sell-off ahead of our Presidential Election, which set up the current rally. There was a minor 3% sell-off this Summer. That's it. A correction is overdue.

There are a number of analytical inputs we have been reviewing recently which give us an indication that what happened in late 2014, would be a good analog for what may be coming our way. Highlighted in the yellow box on the chart below, you can see the 2014, quick, sharp 4th wave drop in the S&P 500. It dropped almost 10% in 18 trading days. That 2014 correction re-set valuations, triggered some fear, tested proper technical support and allowed for prices to have the energy required to rally and achieve much higher levels into the summer of 2015. Make no mistake we still see higher S&P 500 prices well into 2018. A quick sell-off would correct the excesses, before resuming the uptrend. The setup is there for a well needed breather. We're prepared.

