EQUITY STRATEGY

EQUITY COMMENTARY
3nd Quarter 2017

The bull market continued its unabated run during the third quarter, despite the anticipated seasonal effect. Historically the third quarter contains the worst months of a year's performance, and many market professionals thought this year would be especially likely to witness a correction. But not even President Trump's tweets, nor "Rocketman's" North Korean missile launches, nor even the Federal Reserve's continued tightening pace seems to be able to stop the uniform melt upward in price levels of this bull market.

Watching the daily news on the antics of North Korea in its latest round of missile launches and atomic tests is far more entertaining and awful to think about than the direction of inflation, interest rates, and the Fed's shrinking of its balance sheet. Yet for serious long-term investors, which we count ourselves among, it is important to consider how national trends affect the market's bullish course just as much as international events.

The Federal Reserve controls short-term rates by the setting of the short-term Fed Funds Rate. This of course then sets the basis for the prime borrowing rate, which is generally 3% higher than Fed Funds. None of this, however, has an effect upon the longer end of the curve, other than psychologically. What remains to be seen is how removing the stimulus of the Fed's quantitative easing will now affect the market.

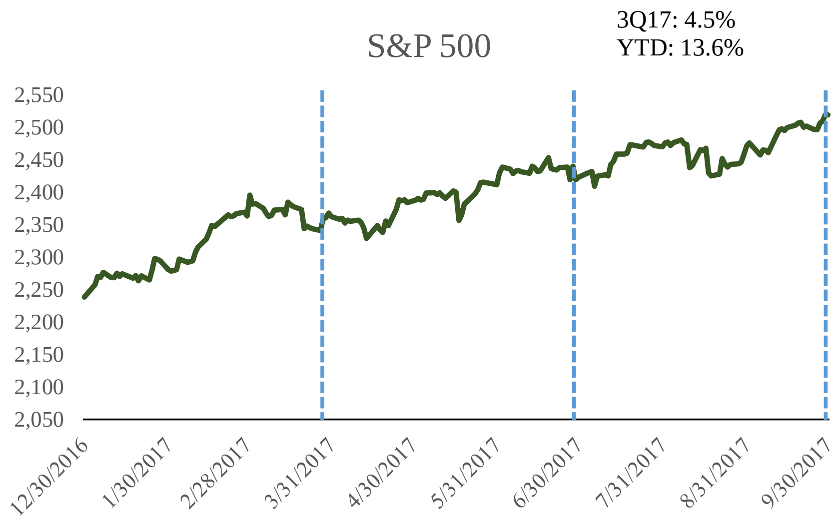
Having never experienced quantitative easing, it is difficult to gauge its results (although it did seem to work and help). We have also never seen the effect of a balance sheet run off or contraction of the prior quantitative easing cycle. We don't know how this will affect markets in the long run, but we do believe it may well have an effect upon the longer end of the yield curve in ways that the Fed Funds Rate does not. As long-term rates are the underpinning of how the market values other investments and these rates discount the value of future earnings into stock prices, we would hazard to guess that it could dampen, or at least sober up, the animal spirits.

The continued disruption caused by technology is also on our radar. The entire retail space, now including groceries, seems to face the prospects of becoming Amazombies. This has caused both us and other professional investors to adjust investment exposure to rapidly changing consumer preferences and purchasing patterns.

We have been excited to see the disruption of the automotive industry with the rapid approach of autonomous, self-driving vehicles and electric vehicles. This has been a tail wind for many of the companies that we have invested in given the inclusion of chips and advanced technology that they manufacture. But more importantly this makes us bullish on natural gas, for if the world shifts to electric vehicles, we will surely be using more electricity, and gas is the likely backbone of electric power, even as alternative energy builds market share.

The other bright spot we see is the energy complex. The supply-and-demand dynamics would suggest higher future pricing since the world has not replaced production at a rate sufficient to replace the decline, much less keep up with a growth in demand.

Low energy prices have also translated into low equity prices in both the common stocks of producers and in the pipelines companies in the MLP space. We would guess that the large amount of insider purchases in this space portends low valuations, attractive yields, and the potential for future returns. At least we believe that they represent one of the few true "value" bargains left in the public markets. If one is a believer in the concept of mean reversion, then energy as a sector and MLPs as an asset class bear the merit of consideration.



For the quarter the S&P ended up 4.5%, and 13.6% for the year to date. Though we think a brief pullback would be a healthy event, we do remain bullish till proven otherwise.

Source: Bloomberg L.P.

This may be one of the longest bull markets in history, but to us it shows no fundamental sign of ending, as supported by the chart to the left.

Source: Bloomberg L.P. and Strategas Research Partners

IMPORTANT DISCLOSURES

The past performance of the strategy is not an indicator of future performance and investment results may vary.

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