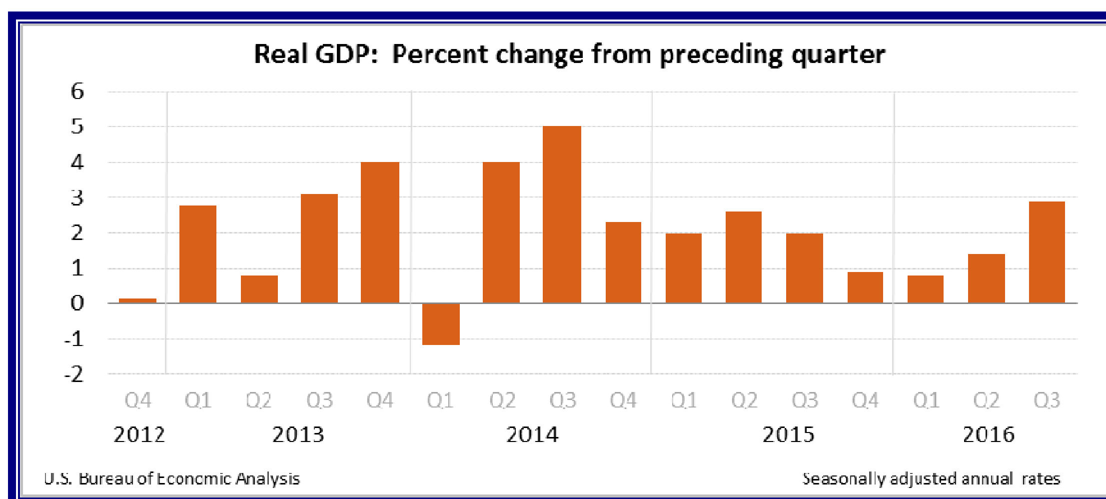
ALTMAN
INVESTMENT MANAGEMENT

EQUITY STRATEGY FOCUS

NOVEMBER, 2016

IN BRIEF: A Look at the U.S. Economy

GDP for Q3 increased at a rate of 2.9%, according to advanced estimates by the Bureau of Economic Analysis. The rise was due in part to stronger private inventory investment, exports, federal spending, and state and local spending. Larger import figures (which are subtracted from GDP) along with a smaller increase in personal consumption expenditures, detracted from the overall report. But even with this strong report, with only one quarter left in 2016, it appears that real GDP growth for the year will be closer to 1.9% and below our original forecast. This compares with average annual real growth of 2.6% and 2.4% for 2015 and 2014 respectively.



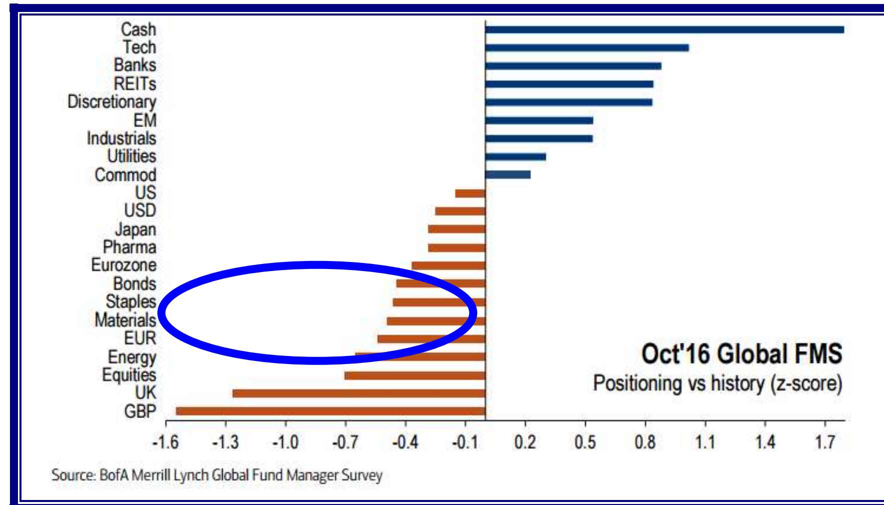
A rise in household wealth from higher stock market levels coupled with rising real-estate prices has continued to support the longevity of the U.S. bull market. In October, unemployment now stands at 4.9%. Improvements were evident in healthcare, business services and financial activities. The labor participation rate is little changed from last year. Average hourly earnings rose in October and are currently 2.8% higher than last year. Pending home sales for October rose modestly but were below analyst expectations. September readings were revised downwards to 1.5%. Household wealth as reported by the Federal Reserve saw an up-tick in Q2, supported by growth in financial assets and higher real-estate values. Personal Incomes rose in September, but were lower than anticipated by analysts. Consumer credit increased at 7% in Q3. As credit increases, generally it tells us that consumers are willing to take on more debt as their personal incomes rise. The savings rate tipped down slightly. Overall the U.S. consumer finished Q3 in good standing. Now that the elections are over, we may begin to see further improvement as we gain clarity on President-elect Trump's policies.

EQUITY LANDSCAPE:

Generally markets experience heighted volatility leading up to and throughout an election year. Specifically the uncertainty surrounding defense spending, tax levels, budgets, and labor costs are a few of the issues impacting the markets. On average, in these volatile months high beta stocks tend to underperform while defensive stocks outperform.

According to Merrill Lynch's Fund Manager Survey, cash balances have increased to 5.8%, up from 4% levels in 2013. A negative reading greater than -0.4 standard deviation, as identified in the chart below, is considered a contrarian buy signal for equities. Contrarian indicators are also pointing to an emphasis on commodities. The survey is pegging Treasury bond yields as the more influential driver of equities over the next 6 months than the direction of the U.S. Dollar. This new data supports our discussion from our previous equity strategy piece which highlighted a bullish Contrarian Sell Side Indicator.

<u>Fund Manager Positioning Indicates Opportunities in Equities and Commodities</u>



Growth in emerging markets (EMs) as projected by the International Monetary Fund is forecasted to increase by 4.3% this year and 4.7% in 2017. The forecast takes into consideration the slowdown in China, the recession in Brazil, steady growth in Emerging Europe and Asia along with the Middle East. Despite the expectation for slower growth in emerging regions, money has shifted away from Developed Markets in favor of EMs as reported by the Merrill Lynch Global Fund Manager Survey.

We often discuss the benefits to staying fully invested in the stock market throughout the ups and downs of market cycles. It makes sense now to revisit this notion as some analysts are warning we are reaching peak levels in the market and we have yet to have a 10% market correction in 2016. There are risks inherent in attempting to time the market in anticipation of a "would be" market correction or worse, a long term bear market. The key risks are: 1) the market correction may never materialize; and 2) it's incredibly difficult to accurately time an exit point, as well as the market re-entry point. Merrill Lynch Research has conducted a recent analysis of market returns in comparison to returns one would realize if in fact they missed the 10 best performing days in the period. As we would expect, performance is substantially reduced when excluding those top performing days.

<u>S&P 500 Price Returns Exceed Those</u>
<u>Attempting to Time the Market</u>

Decade	Price Return	Excluding best 10 days per decade
1930s	-42%	-79%
1940s	35%	-14%
1950s	257%	167%
1960s	54%	14%
1970s	17%	-20%
1980s	227%	108%
1990s	316%	186%
2000s	-24%	-62%
2010s	95%	34%
Since 1930	10055%	31%

Source: S&P; BofA Merrill Lynch US Equity & Quant Strategy

CLOSE-UP: Equity Investment Overview

➢ Performance Highlights

AIM Performance Attribution as of September 2016

	Sector Wgt. as % of Portfolio as of 9/30/2016	Relative Wgt. versus S&P 500 Index	3rd QTR Total Return of AIM Composite	3rd QTR Total Attribution of AIM Composite	YTD Total Return of AIM Composite	YTD Total Attribution of AIM Composite
AIM Composite			3.0	-0.9	10.3	2.4
Consumer Discretionary*	8.7	-3.8	-6.9	-0.5	-2.8	0.0
Consumer Staples	11.0	1.1	-0.8	0.1	13.0	0.6
Energy	11.5	4.2	1.5	-0.1	17.3	0.4
Financials	15.6	2.8	5.9	-0.1	-1.9	-0.8
Health Care	15.3	0.6	0.2	-0.2	4.2	0.4
Industrials*	9.3	-0.4	2.8	-0.1	16.1	0.7
Information Technology	19.4	-1.8	11.6	-0.3	19.3	1.2
Materials	2.5	-0.4	6.0	0.1	5.3	-0.2
Telecommunication Services	2.4	-1.2	-5.0	0.0	22.3	0.1
Utilities	2.3	-1.0	-6.4	0.1	24.4	0.1
REITS	0.0	-3.1	--	0.2	--	0.0

*Philips Electronics (PHG) is categorized as a consumer discretionary stock in our AIM Core Value Composite, but remains an industrial company within the S&P 500 index.

- The AIM composite out-performed the benchmark S&P 500 on a year to date basis by 240 basis points.
- Small caps out-performed large caps by over 350 basis points. Value out-performed growth, 9.36% to 6.38%.
- The leading market sectors were: Energy, Telecom, Utilities and InfoTech.
- Our best performing holdings: Applied Materials, Devon Energy, Halliburton, Marathon Oil, and Baxter.
- Our worst performing holdings: Express Scripts, Wells Fargo, Cardinal Health, Bank of America, and Met Life.

➢ Equity Strategy

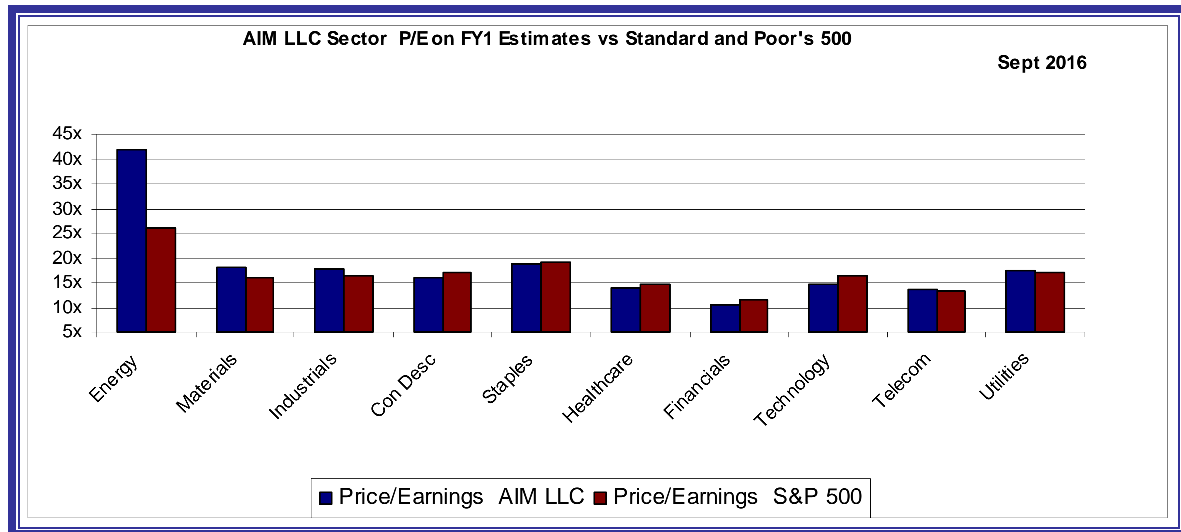
Companies holding the greatest amounts of foreign cash are in line to benefit, should a repatriation holiday take effect under the new administration. Under this "tax holiday", corporations would be subject to a one-time reduced tax rate on foreign profits as encouragement to repatriate cash back into the United States. This initiative would help spur capital spending and job creation as well as stimulate stock repurchases and debt reduction. Technology companies and Healthcare are the sectors with the greatest amount of foreign cash. Microsoft, Cisco, Oracle, and Johnson & Johnson are just a few of our holdings with sizeable amounts of foreign cash.

Lower corporate tax rates would help corporations as a whole, but will obviously benefit those in higher brackets to a greater degree. Telecommunications, Healthcare Providers and Diversified Financial Companies are among those in the highest tax brackets. REIT's, Energy Equipment Services, and Semiconductors are among the lowest brackets.

Stocks that are targeted for tax loss selling (down more than 10% year to date), have historically outperformed in November-January as tax loss trades unwind. In the past, stocks that were candidates for tax losses selling rebounded approximately 5% on average during that period. This year however there are a number of uncertainties surrounding U.S. elections, ECB quantitative easing and OPEC decisions. These issues in conjunction with macroeconomic releases could muffle this phenomenon in 2016, as stocks react more to macroeconomic trends. But so far, through mid-November Express Scripts (ESRX) and Wells Fargo (WFC) are each up 13% since Sept 30th. Lowes (LOW) and Cardinal Health (CAH) are up 3.4% and 2.3% respectively.

While the average stock multiple is 18.5x earnings on a forward year basis, it is important to highlight a few notes to the effect. Ex-energy the multiple is closer to 17x. Energy stocks account for 7% of the S&P 500 index. Growth in Energy earnings has been depressed since Q1 2015, inflating multiples above their historical norms. We are invested in areas in which we believe to be out of favor, underappreciated, and directly tied to commodities prices which we believe are headed to stabilize above the $50 range. We should also take a look at valuations on a sector level. The largest segment of the index is Technology which shares on average sport a multiple of 16x forward earnings. In our composite, we tighten up that multiple to approximately 14.7x through our stock selection process. Healthcare, the next largest segment in the index, hosts a multiple of 14.7x compared to our AIM composite healthcare multiple of 14.1x.

Our Stock Selection Process Enables Us to Tighten our Sector Multiples in our Over-weighted Sectors



With 97% of S&P companies having reported for Q3, it's probably safe to say that the S&P 500 will deliver positive earnings growth for the first time since Q1 2015. Earnings growth is coming in around 1.6% with revenue growth figures approximately 2.6%. Gains were spurred by a stronger dollar and rising oil prices along with reduced share counts. Ex energy, earnings growth is tracking at 4.8%. All sectors beat on earnings expectations except for REITS. Consumer Discretionary, Financials, and Information Technology also beat on the revenue side as well. Overall earnings are beating expectations by 5% with sales reporting in line.

IN SUMMARY:

Economic conditions are improving and we expect them to continue doing so. We received a strong Q3 GDP report at 2.9% growth, U.S. consumer data is encouraging, inflation is in check, and there is evidence that manufacturing and industrial production are improving. Real GDP will likely finish the year near 1.9% growth. We expect corporate profits to continue at a 5.0% growth rate with a shift to higher revenue growth against a backdrop of rising costs. We anticipate another Fed interest rate increase in December. The markets will likely reflect the expectation of higher rates even before they occur, lifting the long end of the curve.

The opinions expressed in this commentary are those of Altman Investment Management, LLC as of the date appearing on this material only and are subject to change. The material is based upon information we consider reliable but we do not represent that it is accurate or complete and should be relied upon as such. This material does not take into account the particular investment objectives, financial situation or needs of the individual client and should not be viewed as an endorsement of any particular investment. Certain investments give rise to substantial risk and are not suitable for all investors.