EQUITY STRATEGY FOCUS

NOVEMBER, 2017

IN VIEW: The Equity Landscape

The Standard and Poor's 500 ended the third quarter at an all-time high. The stock market was able to shrug off a plethora of uncertainties - ranging from the failed attempts at healthcare reform, the challenges facing comprehensive tax reform, the potential that the Fed's reduction in the balance sheet is the beginning of a tightening cycle, and the prospect of war with North Korea. In addition, investors remained cautious against a back drop of multiple devastating hurricanes, Special Council Mueller's ongoing investigation, continued Middle East unrest, and disturbing events in Charlottesville and Las Vegas. In the final analysis, the market participants overlooked these headwinds, and instead focused on the fundamental drivers of the current economy. One of the key drivers is corporate profits that continues to improve at an estimated double-digit growth rate. The acceleration has been bolstered by both a recovery in the Energy sector as well as the expectation that the Financial sector will benefit from interest rate normalization, a favorable regulatory environment, and an economy picking up steam.

Real GDP for the third quarter was reported at 3.1% and is expected to accelerate to 4.0% in the fourth quarter. Despite hurricanes negatively impacting results in the short term, recent quarter GDP growth was quite respectable bouncing off the 1.2% rate from the prior quarter. This reconfirms a positive change is underway, raising the U.S. economic growth rate to an estimated 3.0%. This compares to the 2.0% growth trend that has occurred since the Great Recession. The combination of tax cuts and reform, in conjunction with significant reductions in business regulation and potential infrastructure builds, could speed up economic growth as envisioned by the Trump Administration's legislative agenda above the current 3.0% rate.

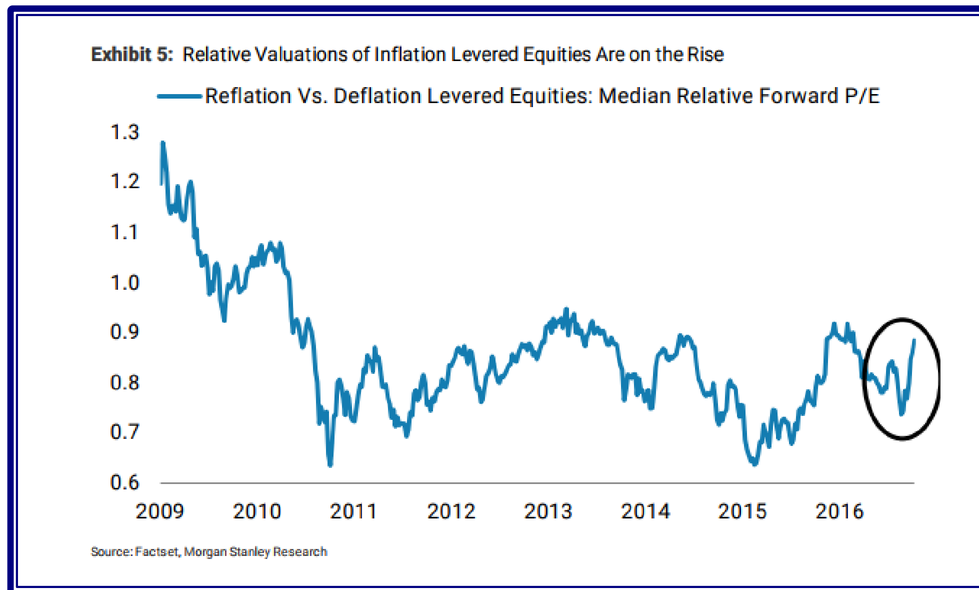
Despite the fact that the fiscal federal deficit estimated for 2017 remains an impediment against long term growth prospects, as it nears 3.5% of GDP, we remain supportive of equity exposure. As the nine-year expansion approaches the longest on record, most economic statistics are doing quite well with little sign of recession on the horizon. Inflation pressures remain contained, with market indicators pointing to less than 2.0% inflation over the near to intermediate horizon. Subdued wage pressures, despite unemployment at 4.4%, reinforce this view.

Continued U.S. economic growth and global momentum are keeping the monetary authorities on a cautious path towards higher rates. In contrast to the Fed's rapid response in late 2007 and through 2008, that brought the Fed Funds rate from 5.25% to near zero in ten moves, movement to the upside has been sluggish. Despite inflation remaining historically low, we believe that it is prudent that the Federal Reserve maintain its policies of interest rate normalization, with an interest rate hike expected in December, and continue shrinking the Federal Reserve's balance sheet of $4.5 trillion.

Outlook for Financial Markets:

A reflation of the economy is underway as evidenced by rising leading CPI figures and improving earnings revisions across multiple sectors. The consumer is also strengthening due to loose financial conditions. lower unemployment, rising confidence, and low relative household debt. The U.S. dollar's decline in 2017 was met with a more coordinated global monetary policy. This contributed to a strong and broad earnings recovery. This recovery in global markets in coordination with a bottoming in emerging markets helps explain why the multiples of more reflation levered stocks are expanding. In 2018, we are expecting a modest slowdown overseas, but we expect growth to remain above trend.

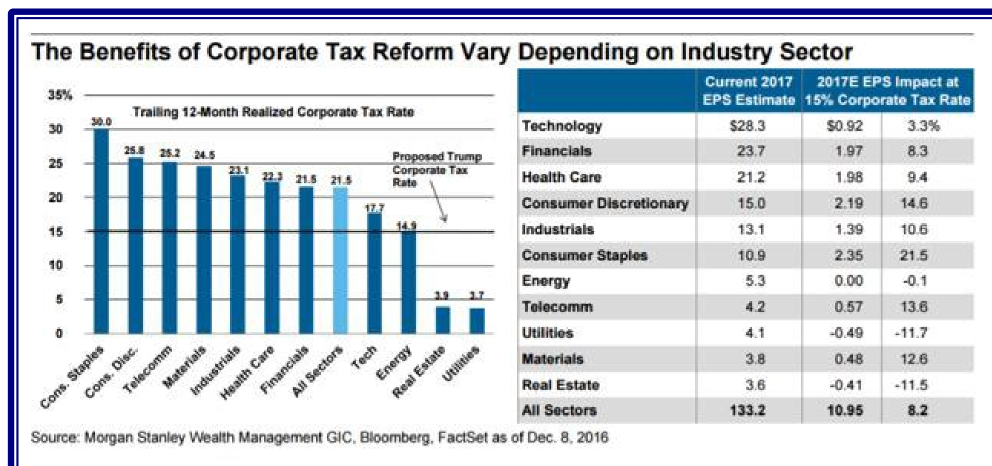
Multiples of Reflation Levered Equites are Moving Higher



Despite tight labor markets in some economies, inflation remains soft. We think global factors such as labor mobility and technological innovation are subduing inflationary pressures. In the U.S., we think recent soft data may have only interrupted, not derailed, a gradual rising trend in core inflation and wages. However, in overseas economies, we think structural challenges will continue to constrain wages and core inflation, holding U.S. rates down longer than most expect.

Although we are a bit skeptical that the proposed corporate tax cut to 20% from the current 35% could add another 10% to corporate earnings next year, we are mindful that should Congress pass this legislative goal the effect could be quite muted. This is based on the fact that many companies employ various accounting loopholes and already pay a materially lower rate, and the complexity of passing tax reform is fraught with considerable challenges.

An analysis of 2016 corporate tax rates help us put into perspective which sectors will benefit the most from potential tax reform. At the time this study was conducted, the proposed tax rate was 15%, not the current 20%, however the resulting beneficiaries should not be all that different. As we observe, Consumer Discretionary, Consumer Staples and Telecom stand to benefit the most - whereas Real Estate, Utilities, Energy and Technology fair the worst. While tax cuts are bullish for stocks, concern over potential set backs are causing tax cut levered names to underperform.



	Current 2017 EPS Estimate	2017E EPS Impact at 15% Corporate Tax Rate	
Technology	$28.3	$0.92	3.3%
Financials	23.7	1.97	8.3
Health Care	21.2	1.98	9.4
Consumer Discretionary	15.0	2.19	14.6
Industrials	13.1	1.39	10.6
Consumer Staples	10.9	2.35	21.5
Energy	5.3	0.00	-0.1
Telecomm	4.2	0.57	13.6
Utilities	4.1	-0.49	-11.7
Materials	3.8	0.48	12.6
Real Estate	3.6	-0.41	-11.5
All Sectors	133.2	10.95	8.2

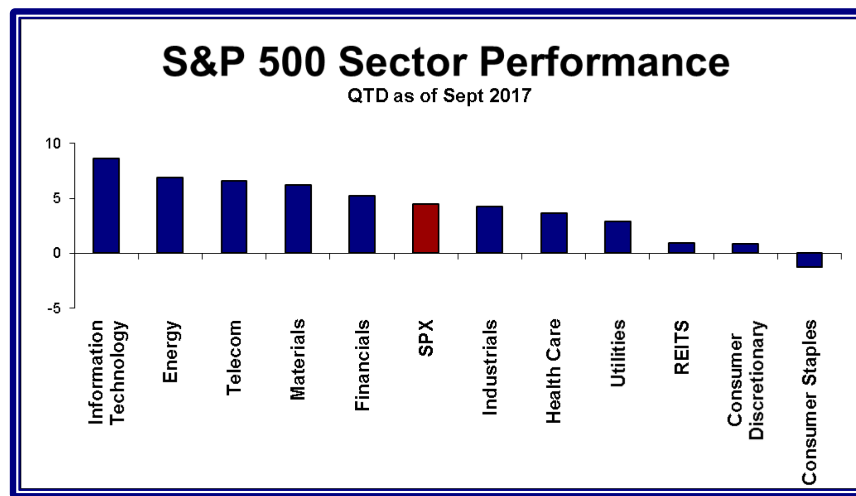
Source: Morgan Stanley Wealth Management GIC, Bloomberg, FactSet as of Dec. 8, 2016

In this latest cyclical rotation, we make the observation that the market has been primarily consumer driven. Supply-side sectors (commodities or industrials) relative to consumer-oriented sectors (healthcare, discretionary) were stronger throughout 2016. However, since the beginning of 2017, it has been the consumer sectors that have gained ground, as the supply side corrected after nearly a year of outperformance. In more recent months, we have seen a broadening out of performance. Perhaps both sectors are positioned to move more in unison going forward in response to stronger economic activity, global growth, and moderate inflationary expectations.

A short-term correction in the stock market is possible, depending on how smoothly tax reform progresses. Right now, there are two versions of a tax bill, one submitted by the House and one by the Senate with considerable differences. Both passed their respective chambers and are proceeding to conference. The corporate tax relief, that the markets seemingly have priced in already, may be delayed and any concrete developments in that direction could cause a short term pull back in the markets. Additionally, Jerome Powell has been newly appointed to the Federal Reserve Chairman post. In the past, he has voted in support of Janet Yellen's strategy to slowly raise interest rates. That being said, we expect the current strategy to continue. However, should economic growth or U.S. dollar strength change materially in direction or magnitude requiring a change in Fed policy, the markets could react adversely.

CLOSE-UP: Equity Investment Overview

➢ Performance Highlights



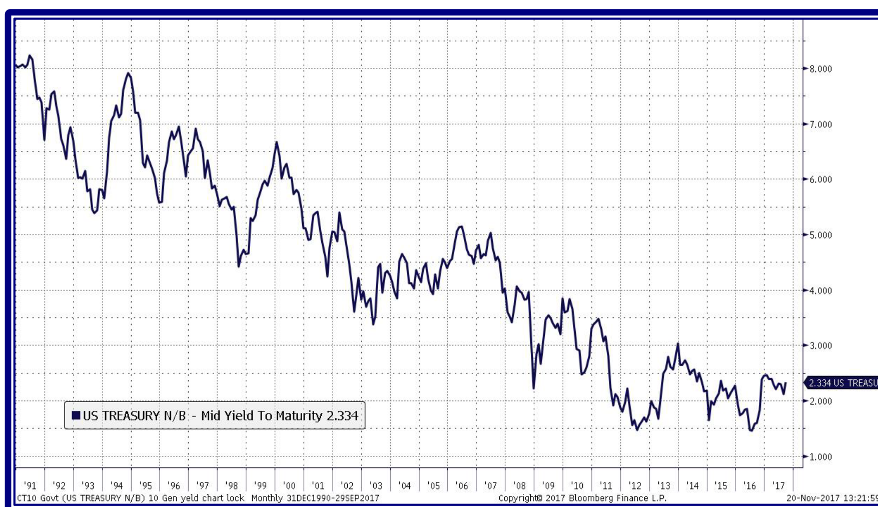
- Information Technology had another strong quarter up over 8%. Semis carried the sector with a total return of 13.7%, almost double that of software and hardware. Information Technology continues to lead on a year to date basis.
- The FAANG stocks - *Facebook, Apple, Amazon, Netflix and Google A & B* - were up 13%, 7.5%, -.69%, 21.4%, 4.7% and 5.5% respectively. These stocks make up over 10% of the market index.
- Not all FAANG stocks are considered Technology stocks; Amazon and Netflix fall under the Consumer Discretionary category. Autos were strong, up 10%, but negative results in Consumer Durables and Apparel, Services, and Media dragged the sector down.
- Energy also posted strong results up nearly 7% for the quarter. Energy, however, continues to be the laggard on a year-to-date basis.
- Applied Materials, Northrup Grumman and Philips Electronics contributed most to our composite attribution.
- Cardinal Health, Oracle and Johnson Controls were the largest negative contributors towards composite attribution.

With nearly 85% of companies having reported, earnings during Q3 are trending above forecasts with overall earnings beat of 2.2%. Beats on a sector basis are strongest in Technology and weakest in Telecom and Utilities. Earnings and revenue growth are up 6.2% and 5.5% respectively. Energy and Technology are reporting the largest earnings and sales growth figures. While Financials, Utilities, and Telecom were the weakest year over year. Multinationals continue to beat earnings expectations at a greater pace than domestic companies, assisted by a weaker U.S. dollar and strengthening global growth.

➢ Equity Strategy

Markets are looking expensive on a historical basis, especially when comparing the forward P/E of 19.3x for the S&P 500 to its 25 year average of 17x. A 10% growth expectation for next year should bring valuations back within historic ranges. Therefore, we continue to prefer stock investment over bonds.

Although Rates Have Backed Up since mid 2016…
Bond Markets Look Expensive



Also favoring stock ownership is the strong economic data that reflects the continuing expansion of the U.S. economy. Most data remain supportive of the economy at current levels. Consumer strength, Fed confidence, corporate revenues growth, and unemployment levels, all point to a growing economy.

We recognize current valuations levels and believe that it is critical to identify areas of the market where value still exists. For example, Consumer Discretionary stocks look expensive as a whole, however, after a closer examination at the industry level we find that multiline retailers offer some opportunity. The insurance industry, pharmaceuticals, and communications equipment are other industries that offer attractive valuations. Excessive risk associated with market corrections should be reduced, by avoiding higher priced equities in favor of value opportunities.

The AIM Composite is Structured to Yield Favorable Relative Characteristics

	AIM LLC	S&P Index
# holdings	39	500
Beta	1.08	1.00
P/B	2.47	3.22
P/E cur	18.00	19.17
P/E FY1	15.84	17.28
P/S TTM	1.59	2.11
Div yield	2.31%	1.98%
P/CF	13.14	13.53
Mkt Cap Wgt	118,449	175,375
Equal Wgt	97,869	46,917

Source: Bloomberg and Altman Investment Management

Characteristics are Measured on Multiple Levels - They are Not Simply a Bird's Eye View Snapshot
(Characteristics of S&P 500 Market Sectors)

	Energy	Materials	Industrials	Con Desc	Staples	Healthcare	Fincl	Tech	Telecom	Utilities	REIT
# holdings	32	25	68	84	34	61	86	68	3	28	33
Beta	1.0	1.0	1.0	1.2	0.6	0.9	1.4	1.2	0.6	0.3	0.7
P/B	1.9	5.3	4.7	5.0	4.7	4.0	1.4	5.3	2.7	2.0	3.3
TTM P/E	35.4	29.1	21.1	22.0	20.9	21.1	15.7	22.9	15.0	18.5	44.2
P/E cur	30.6	20.2	19.7	20.8	20.0	17.6	15.5	19.4	13.1	18.3	37.3
P/E FY1	24.0	17.3	17.8	18.8	18.6	16.2	13.6	17.4	12.9	17.6	38.2
P/S TTM	1.7	2.6	1.8	1.6	1.3	1.8	2.3	4.3	1.5	2.1	6.8
Div yield	2.8%	2.1%	2.1%	1.4%	2.8%	1.6%	1.9%	1.4%	5.0%	3.5%	3.3%
P/CF	11.6	16.9	15.5	12.1	14.4	15.8	11.8	15.4	6.9	8.0	18.5
mrt cap wgt	151,721	60,672	75,497	143,723	130,232	122,502	152,347	359,785	218,008	34,587	27,842
EQ wgt	42,473	26,371	33,965	34,499	60,526	51,944	50,738	87,947	150,927	24,042	20,032

Source: Bloomberg and Altman Investment Management

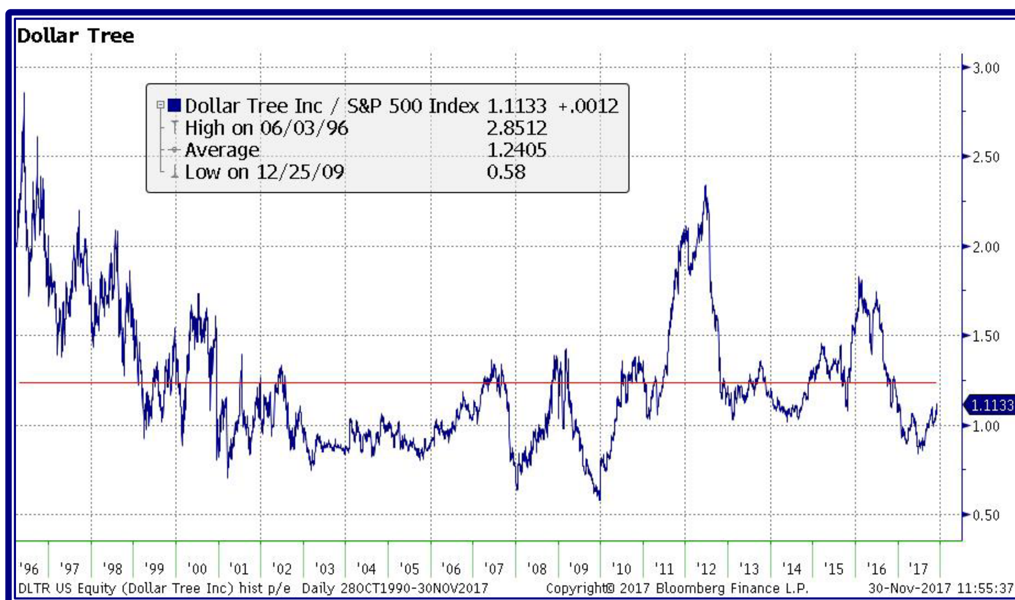
Energy and Financials are our largest sector over-weights, as compared to the benchmark S&P 500 index. Financials look attractive on most metrics. In Energy, the inflated multiples are somewhat misleading as they coincide with the dramatic drop in energy prices which cut into profits substantially.

In light of growing consumer strength, and the potential for further rotation into cyclicals, we made the following trades in the composite portfolio at the end of October. We shifted from Consumer Staples in favor of Cyclicals by taking gains in The Kraft Heinz Company (KHC) and establishing a position in Dollar Tree, Inc. (DLTR). Dollar Tree is one of the largest discount retailers in the U.S., operating two distinct retailing platforms as they merge the Family Dollar and Dollar Tree stores acquired in 2015, offering merchandise such as cleaning supplies, food, and party decorations. As a defensive participant in the retail market, the businesses have proven to be countercyclical during periods of economic downturns, as consumers tend to trade down and look to stretch their discretionary spending with lower priced purchases.

Despite the headwinds that traditional retailers have faced, especially against the growth of on-line shopping, Family Dollar and Dollar Tree have successfully addressed both the value and convenience attributes. Investor skepticism surrounding the turnaround of Family Dollar, as well as heightened competition in the grocery market, creates an attractive entry point and is reflected in current low valuations relative to its peers. In their regular analysis of debit card spending, the Bank of America Merrill Lynch discussed spending growth amongst low income consumers and found that lower income growth has been outpacing middle to upper income consumers.

Spending trends along with a strengthening consumer bode well for low end retail businesses. A traditional dollar store customer prefers to pay in cash for immediate/point of service products shielding it from the competition of online retail giants such as Amazon. For these reasons DLTR is considered to be relatively defensive or counter cyclical in nature. Although Consumer Retailing is expensive on most valuation metrics, trading for example at over 1.5x the S&P Index multiple, the Dollar Tree does offer exposure to this industry at significantly lower valuations.

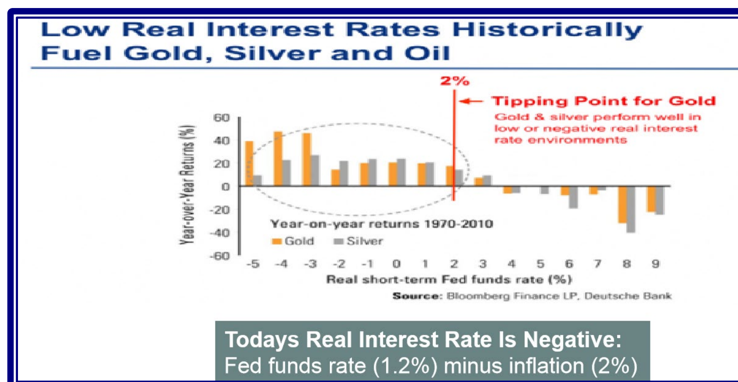
The Dollar Tree is Trading Below its Historical Value



Source: Bloomberg and Altman Investment Management

Precious Metals Revisited

Historically, precious metals perform better in periods with low interest rates. Low rates thwart off demand for the U.S. Dollar and hence weaken its value. Generally, a low interest rate environment leads to inflation, and gold outperforms, because precious metals are negatively correlated with the U.S. dollar. The argument for owning precious metals here is for an inflation hedge. Real rates (interest rates minus inflation) are historically low and are signaling that room remains for precious metals to benefit – take a look at the chart below. However, for the past 3-4 years this has not been the case. Inflation has remained subdued, keeping gold and silver in somewhat of a trading range. Therefore, at this time despite what may be a friendly interest rate environment, we prefer opportunities in other industries at least until inflation looks to be more of a possibility.



Technology Comment

Our Technology exposure, while underweight versus the S&P 500, is our largest sector weight in the composite. Within the sector, however, we are overweight semis which by comparison are trading at lower valuations to software and service companies. Ignoring the collapse in earnings after the financial crisis, semis are trading on the lower to mid side of valuations. On a forward basis, the SOX looks even more attractive as we anticipate multiples contracting with earning growth to the upside.

IN SUMMARY:

We are forecasting economic growth of 3.5% real GDP for 2018, accompanied by 2.7% CPI and 10% Corporate Profits led by growth in developed markets. The U.S. economy is supported by a strengthening labor market, strong consumer trends, as well as loose monetary policy. We also anticipate renewed support from growth in emerging economies.

Overweighting equities in balanced portfolios remains our preferred strategy. After the run-up in stocks this year, we expect moderate but positive returns next year, supported by the continuing expansion and earnings.

Our portfolios are constructed with investments that trade at a significant discount to their intrinsic value, which help to mitigate risk during market volatility. As has been the case over the past several years, market performance has been dominated by a few stocks with relatively higher valuations. We are now just beginning to see signs of breadth which we find encouraging. By avoiding higher priced equities in favor of value opportunities, the excessive risk associated with market corrections should be reduced.

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Any performance reference represents a hypothetical composite compiled from actual equity, fixed income or balanced client portfolios and includes cash. These three composites reflect aggregated returns that address differing objectives. As such, the performance of each composite does not reflect the actual total portfolio returns earned by our clients. The investment performance records are compiled from a capital weighted average of the equity, bond and cash components of a broadly representative group of discretionary accounts that meet certain minimum size thresholds.

No gross performance returns that are referenced that are calculated after brokerage commissions but before investment counsel fees are presented without the comparable net performance figures after both commissions, investment counseling fees and other custodial charges. The net counseling fees are the actual average counseling fee calculated across all the portfolios included in the composite. All performance figures are presented on a time-weighted total return basis and assume all income is reinvested. The investment advisory fees are disclosed in Part II-A of the Investment Form ADV. Some clients may benefit from available discounting in the management fee schedule associated with the overall size of the portfolio. Management fees will reduce overall returns to the client.

The composites were created in 2001 and the inception dates start on August 17th, 2001.The composites include only discretionary fee-paying accounts managed in the strategies, and additional information associated with the composites are available such as: dispersion in individual portfolio results as well as the % of the firms AUM in the strategy. All performance calculations are presented within the GIPS® guidelines of the CFA Institute. The CFA institute does not endorse or promote this organization nor does it warrant the accuracy of the content herein.

Investing entails inherent risks and results may be altered by material market or economic conditions. Investment returns and principal values may fluctuate, and losses are possible. Past results are not a guarantee of future comparable results or trends. Our process benchmark is the S&P 500 Index with dividend reinvestment, and our performance benchmark is the Russell 1000 Value Index with dividends reinvestment.