February 2018

The correction's postmortem will have to wait, as the pounding stocks suffered on the last 2 days of February continued on Thursday, with an assist from Trump. From Friday's WSJ lead story, **Trump's Tariff Vow Rattles Markets**: "President Donald Trump's pledge Thursday to impose stiff tariffs on steel (25%) and aluminum (10%) imports sparked worries of a looming global trade war, sending stocks tumbling, drawing protests from a broad swath of American industries dependent on the metals, and prompting threats of retaliation across Asia, Europe, and North America. ... The Dow Jones Industrial Average tumbled more than 500 points, or 2%, after the announcement, as shares of big steel users, including auto makers Ford and General Motors, dropped even further."

From Bespoke:

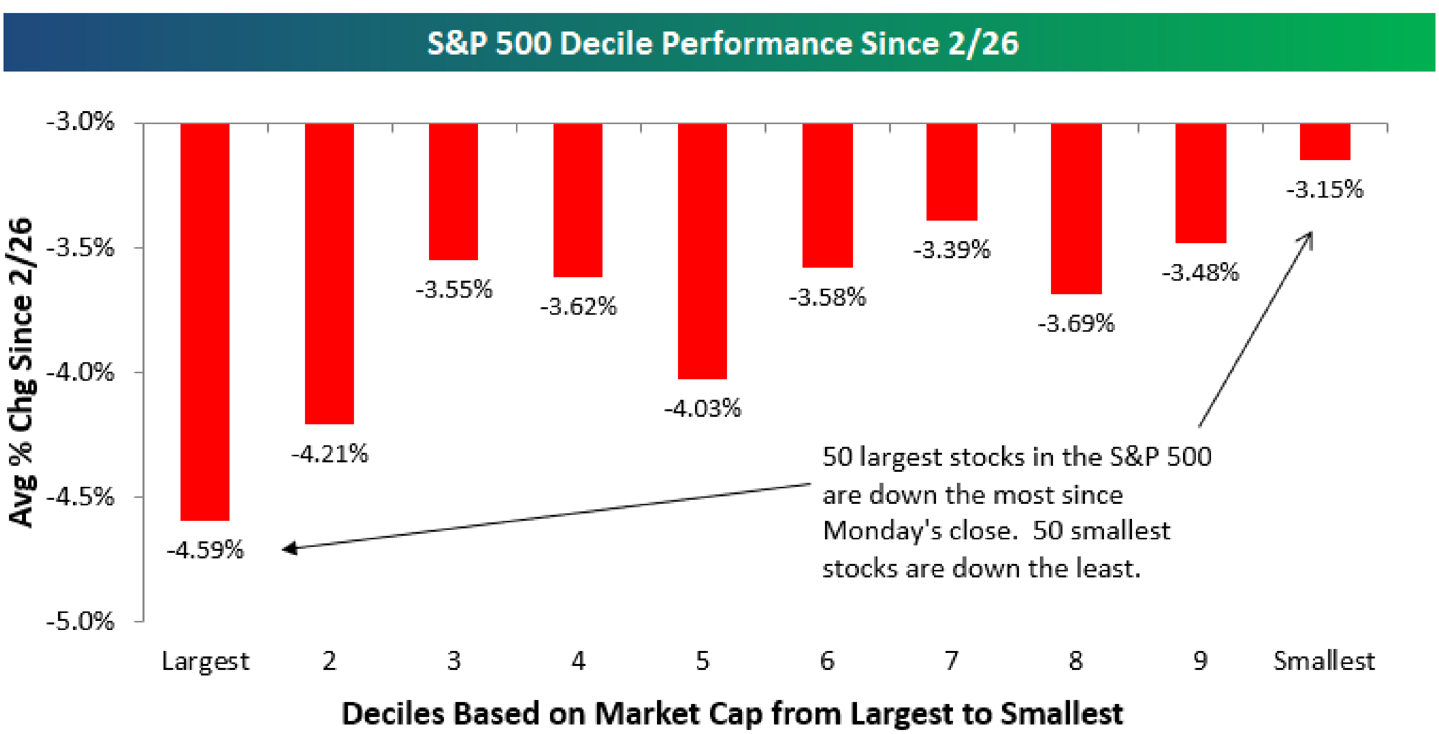
Mega Caps Underperforming on Trade War Sell-Off

Mar 2, 2018

Trump's tariff announcement yesterday sent US equities reeling on trade war fears. A trade war would presumably impact the largest global companies much more than smaller cap, more domestically-oriented ones. In terms of stock price performance, it seems that investors agree with this presumption.

We ran our decile analysis on the S&P 500 based on market cap to see how the largest vs. smallest stocks in the index have performed during the sell-off that began on Tuesday. To run the analysis, we broke the index into deciles (10 groups of 50 stocks each) based on market cap, and then we calculated the average performance of the stocks in each decile since Monday's close.

As shown below, the 50 largest stocks in the S&P 500 are down an average of 4.59% during this sell-off, which is easily the worst performing decile of the group. The average stock in the S&P 500 is down 3.73% since Monday's close, so the 50 largest stocks are underperforming the average by 86 basis points. Conversely, the 50 smallest stocks in the S&P are down just 3.15% during the sell-off, which is the best performing decile of the



group.

Given that the S&P 500 is a market cap weighted index, the largest stocks have a bigger impact on its price movement. When the largest stocks get hit the hardest as has been the case on this trade-war sell-off, it weighs heavily on the S&P. But on an equal-weighted basis, things don’t look quite as bad.

Best synopsis we saw:

From CNN Money:

February was an insane month for the stock market

by Matt Egan February 28, 2018

A profound inflation scare. Not one but two 1,000-point plunges for the Dow. And a powerful comeback that almost went straight back up.

February was easily one of Wall Street's wildest months since 2008.

The Dow plummeted more than 3,200 points, or 12%, in just two weeks. Then stocks raced back to life, at one point recovering about three-quarters of those losses.

Fittingly, February ended with more drama. The Dow tumbled 680 points during the month's final two days, leaving it down about 1,600 points from the record high in late January.

The market insanity was even more startling because it followed a period of extreme calm. And it arrived during a roaring economy. ...

In early February, the runaway train stock market ran smack into spiking bond rates that were pricing in the threat of inflation. Investors suddenly became worried the economy, boosted by huge tax cuts, could overheat and force the Federal Reserve to raise interest rates. (The Fed was already signaling 3 rate increases this year. The markets' concern is that the pace of increases will accelerate.)

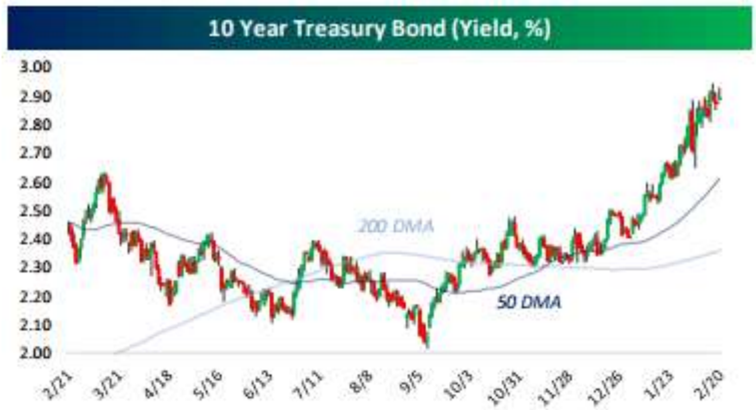
It certainly didn't help that the post-election surge had left stocks relatively expensive — and vulnerable to a sharp pullback. ...

Inflation fears have caused the Dow and S&P 500 to do something they haven't in 11 months: decline. Both indexes had their worst month in two years.

And yet it took very little time for the market to storm back off the lows as investors, emboldened by the strong economy and soaring profits, jumped into the fray to buy stocks. All three major indexes are up again for the year, and the Nasdaq is down just 1% for the month. ...

Even though the market has bounced back, the recovery is fragile — and remains subject to the whims of the bond market.

Just look at how the Dow dropped 299 points on Tuesday after the 10-year Treasury rate crept closer to 3%. (We added the Bespoke chart.) The sell-off, driven by Fed chief Jerome Powell's upbeat outlook on the economy and inflation, sent the VIX (VIX) volatility index spiking again.



The fear is that a sudden inflation spike will cause the Fed to cool the economy off by aggressively raising rates, ending the party on Wall Street. ...

Wall Street is glued to the 10-year Treasury rate because it helps set the price on virtually all other assets. When rates are low, like they had been, it means bonds aren't returning much money, and it encourages investors to gamble on riskier assets like stocks. (At these levels, Bonds are the riskier asset.)

Higher rates make bonds look a bit more attractive and raise the cost of borrowing on mortgages and other loans.

Rates have been on the rise because of the strengthening economy and a spending splurge by the federal government that will force it to borrow more money.

The market turmoil started with inflation and bond market concerns. But the early February nosedive may have been exacerbated by the implosion of little-known investments used to bet that markets will stay calm.

When the markets were placid, as they were for months, those bets were lucrative. When the Dow plummeted 1,175 points on February 5, they blew up.

Some analysts believe the breakdown of these complex volatility instruments may have caused the selling to snowball. ...

The question now is whether the market is out of the woods or whether stocks will head back down to the lows of February 9.

If inflation really is heating up or bond yields spike, more turmoil could follow.

But if not, investors have a lot to smile about. The outlook for the U.S. economy remains robust. Consumer confidence hit a new 17-year high in February.

And corporate profits, the real driver of stock prices, are booming. Fourth-quarter S&P 500 earnings are up an estimated 15% and are on track to be the best in six years, according to FactSet. Thanks to the corporate tax cut and improving economy, 2018 profits are expected to surge by 18%. ...

Part of the postmortem should already be clear:

Funds That Are Built to Die

John Rekenthaler

23 Feb 2018

Disposable Funds
Tuesday's column about an exchange-traded fund, VelocityShares Daily Inverse VIX (henceforth to be called by its ticker, XIV), which lost 95% of its value before folding up shop this week, had me wondering: How common are catastrophic losses with ETFs? The possibility that a fund might collapse is a new thing for retail investors. Mutual funds do not melt down in that fashion, nor did the first wave of ETFs. However, the second and third waves of ETFs, often leveraged and/or investing in futures, are something different.

The answer: Over the trailing five years, 66 of the 1135 ETFs have annualized returns of less than negative 20%, meaning that their cumulative losses exceed 67%. In addition, more than 600 ETFs have expired. Since there were few ETFs before the year 2000, and fewer than 2200 ETFs now exist, that makes for a high and rapid death rate. Not all deceased funds were complete disasters—but most were bad at best, and some were much worse than that.

(If, at this point, you remain unafraid of fringe ETFs, consider this: 25 ETFs are down more than 40% *per year*. That translates to an almost 80% cumulative decline, cumulatively. Among that group, seven have annualized losses exceeding 60%. I once held an investment that fell by 60%, and that wasn't much fun. But it rebounded the following year, rather than losing 60% again and again and again and again.)

And the stakes are rising. First came leveraged ETFs, then double leveraged. Triple-leveraged followed. Now, there are quadruple-leveraged ETFs, courtesy of VelocityShares. (Technically, these new offerings are exchange-traded notes, meaning that the issuer guarantees the funds' payouts rather than place the proceeds into a segregated account, as with a conventional fund. However, Morningstar treats such notes as ETFs, which is good enough for me.) Mach 5 ETFs, no doubt, will soon be forthcoming.

Many of these funds won't make it. When leverage gets that steep, the probability of a bankruptcy (or near-bankruptcy) becomes high. Breaking such funds' bank doesn't require a perfect storm. A relatively ordinary crash can do the job. Such was the case with the XIV fund, which per Cliff Asness's analysis, expired because of a "3.3-sigma" leap in stock-market volatility. Untangling the jargon, XIV died because of a once-in-eight-years event.

Possible Uses
Such funds can't be bought and held, in the customary fashion of retirement accounts, and according to the principles of today's wealthiest investor, Warren Buffett. Even if they perform wonderfully well, compounding their gains so that they grow by several hundred percent over their first few years, these highly leveraged funds

are likely at some point to give it all back. After all, a fund that appreciates by 800% over its first six years, then falls 90% because of a 3.3-sigma event, is a fund that loses money for the buy-and-hold investor.

The question then becomes, Are there legitimate uses for funds that are built to die? Or, are they nothing more than abominations—Frankenstein monsters from fund providers who care not what havoc their creations wreak, as long as they can advertise that they offer something different?

My initial answer is, abominations. ... Back in the day, I had a colleague who immediately dismissed every high-concept fund as being not worth her attention. That drove fund companies mad. They would accuse her of being irresponsible by not delving into the details. But she was rarely wrong. ...

John Rekenthaler has been researching the fund industry since 1988. He is now a columnist for Morningstar.com and a member of Morningstar's investment research department. John is quick to point out that while Morningstar typically agrees with the views of the Rekenthaler Report, his views are his own.

More sage advice from Buffet, **"It is a terrible mistake for investors with long-term horizons ... to measure their investment “risk” by their portfolio’s ratio of bonds to stocks. Often, high-grade bonds in an investment portfolio increase its risk."**, appeared once again in this year's Annual Letter from Berkshire Hathaway:

Berkshire, itself, provides some vivid examples of how price randomness in the short term can obscure long term growth in value. For the last 53 years, the company has built value by reinvesting its earnings and letting compound interest work its magic. Year by year, we have moved forward. Yet Berkshire shares have suffered four truly major dips. Here are the gory details:

Period	High	Low	Percentage Decrease
March 1973-January 1975	93	38	(59.1%)
10/2/87-10/27/87	4,250	2,675	(37.1%)
6/19/98-3/10/2000	80,900	41,300	(48.9%)
9/19/08-3/5/09	147,000	72,400	(50.7%)

This table offers the strongest argument I can muster against ever using borrowed money to own stocks. There is simply no telling how far stocks can fall in a short period. Even if your borrowings are small and your positions aren’t immediately threatened by the plunging market, your mind may well become rattled by scary headlines and breathless commentary. And an unsettled mind will not make good decisions.

In the next 53 years our shares (and others) will experience declines resembling those in the table. No one can tell you when these will happen. The light can at any time go from green to red without pausing at yellow. When major declines occur, however, they offer extraordinary opportunities to those who are not handicapped by debt. ...

“The Bet” is Over and Has Delivered an Unforeseen Investment Lesson

Last year, at the 90% mark, I gave you a detailed report on a ten-year bet I had made on December 19, 2007. ... Now I have the final tally – and, in several respects, it’s an eye-opener.

I made the bet ... to publicize my conviction that my pick – a virtually cost-free investment in an unmanaged S&P 500 index fund – would, over time, deliver better results than those achieved by most investment professionals, however well-regarded and incentivized those “helpers” may be.

Addressing this question is of enormous importance. American investors pay staggering sums annually toadvisors, often incurring several layers of consequential costs. In the aggregate, do these investors get their money’sworth? Indeed, again in the aggregate, do investors get anything for their outlays?

Protégé Partners, my counterparty to the bet, picked five “funds-of-funds” that it expected to overperform the S&P 500. That was not a small sample. Those five funds-of-funds in turn owned interests in more than 200 hedge funds.

Essentially, Protégé, an advisory firm that knew its way around Wall Street, selected five investment experts who, in turn, employed several hundred other investment experts, each managing his or her own hedge fund. This assemblage was an elite crew, loaded with brains, adrenaline and confidence.

The managers of the five funds-of-funds possessed a further advantage: They could – and did – rearrange

their portfolios of hedge funds during the ten years, investing with new “stars” while exiting their positions in hedge funds whose managers had lost their touch.

Every actor on Protégé’s side was highly incentivized: Both the fund-of-funds managers and the hedge-fund managers they selected significantly shared in gains, even those achieved simply because the market generally moves upwards. (In 100% of the 43 ten-year periods since we took control of Berkshire, years with gains by the S&P 500 exceeded loss years.)

Those performance incentives, it should be emphasized, were frosting on a huge and tasty cake: Even if the funds lost money for their investors during the decade, their managers could grow very rich. That would occur because fixed fees averaging a staggering 21⁄2% of assets or so were paid every year by the fund-of-funds’ investors, with part of these fees going to the managers at the five funds-of-funds and the balance going to the 200-plus managers of the underlying hedge funds.

Here’s the final scorecard for the bet:

Year	Fund-of-Funds A	Fund-of-Funds B	Fund-of-Funds C	Fund-of-Funds D	Fund-of-Funds E	S&P Index Fund
2008	-16.5%	-22.3%	-21.3%	-29.3%	-30.1%	-37.0%
2009	11.3%	14.5%	21.4%	16.5%	16.8%	26.6%
2010	5.9%	6.8%	13.3%	4.9%	11.9%	15.1%
2011	-6.3%	-1.3%	5.9%	-6.3%	-2.8%	2.1%
2012	3.4%	9.6%	5.7%	6.2%	9.1%	16.0%
2013	10.5%	15.2%	8.8%	14.2%	14.4%	32.3%
2014	4.7%	4.0%	18.9%	0.7%	-2.1%	13.6%
2015	1.6%	2.5%	5.4%	1.4%	-5.0%	1.4%
2016	-3.2%	1.9%	-1.7%	2.5%	4.4%	11.9%
2017	12.2%	10.6%	15.6%	N/A	18.0%	21.8%
Final Gain	21.7%	42.3%	87.7%	2.8%	27.0%	125.8%
Average Annual Gain	2.0%	3.6%	6.5%	0.3%	2.4%	8.5%

Footnote: Under my agreement with Protégé Partners, the names of these funds-of-funds have never been publicly disclosed. I, however, have received their annual audits from Protégé. The 2016 figures for funds A, B and C were revised slightly from those originally reported last year. Fund D was liquidated in 2017; its average annual gain is calculated for the nine years of its operation.

The five funds-of-funds got off to a fast start, each beating the index fund in 2008. Then the roof fell in. In every one of the nine years that followed, the funds-of-funds as a whole trailed the index fund.

Let me emphasize that there was nothing aberrational about stock-market behavior over the ten-year stretch. If a poll of investment "experts" had been asked late in 2007 for a forecast of long-term common-stock returns, their guesses would have likely averaged close to the 8.5% actually delivered by the S&P 500. Making money in that environment should have been easy. Indeed, Wall Street "helpers" earned staggering sums. While this group prospered, however, many of their investors experienced a lost decade.

Performance comes, performance goes. Fees never falter.

The bet illuminated another important investment lesson: Though markets are generally rational, they occasionally do crazy things. Seizing the opportunities then offered does not require great intelligence, a degree in economics or a familiarity with Wall Street jargon such as alpha and beta. What investors then need instead is an ability to both disregard mob fears or enthusiasms and to focus on a few simple fundamentals. A willingness to look unimaginative for a sustained period – or even to look foolish – is also essential.

Originally, Protégé and I each funded our portion of the ultimate $1 million prize by purchasing $500,000 face amount of zero-coupon U.S. Treasury bonds (sometimes called "strips"). These bonds cost each of us $318,250 – a bit less than 64¢ on the dollar – with the $500,000 payable in ten years.

As the name implies, the bonds we acquired paid no interest, but (because of the discount at which they were purchased) delivered a 4.56% annual return if held to maturity. Protégé and I originally intended to do no more than tally the annual returns and distribute $1 million to the winning charity when the bonds matured late in 2017.

After our purchase, however, some very strange things took place in the bond market. By November 2012, our bonds – now with about five years to go before they matured – were selling for 95.7% of their face value. At that price, their annual yield to maturity was less than 1%. Or, to be precise, .88%.

Given that pathetic return, our bonds had become a dumb – a really dumb – investment compared to American equities. Over time, the S&P 500 – which mirrors a huge cross-section of American business, appropriately weighted by market value – has earned far more than 10% annually on shareholders' equity (net worth).

In November 2012, as we were considering all this, the cash return from dividends on the S&P 500 was 2 1⁄2% annually, about triple the yield on our U.S. Treasury bond. These dividend payments were almost certain to grow. Beyond that, huge sums were being retained by the companies comprising the 500. These businesses would use their retained earnings to expand their operations and, frequently, to repurchase their shares as well. Either course would, over time, substantially increase earnings-per-share. And – as has been the case since 1776 – whatever its problems of the minute, the American economy was going to move forward.

Presented late in 2012 with the extraordinary valuation mismatch between bonds and equities, Protégé and I agreed to sell the bonds we had bought five years earlier and use the proceeds to buy 11,200 Berkshire "B" shares. The result: Girls Inc. of Omaha found itself receiving $2,222,279 last month rather than the $1 million it had originally hoped for.

Berkshire, it should be emphasized, has not performed brilliantly since the 2012 substitution. But brilliance wasn't needed: After all, Berkshire's gain only had to beat that annual .88% bond bogey – hardly a Herculean achievement.

The only risk in the bonds-to-Berkshire switch was that yearend 2017 would coincide with an exceptionally weak stock market. Protégé and I felt this possibility (which always exists) was very low. Two factors dictated this conclusion: The reasonable price of Berkshire in late 2012, and the large asset build-up that was almost certain to occur at Berkshire during the five years that remained before the bet would be settled. Even so, to eliminate all risk to the charities from the switch, I agreed to make up any shortfall if sales of the 11,200 Berkshire shares at yearend 2017 didn't produce at least $1 million.

Investing is an activity in which consumption today is foregone in an attempt to allow greater consumption at a later date. "Risk" is the possibility that this objective won't be attained.

By that standard, purportedly "risk-free" long-term bonds in 2012 were a far riskier investment than a longterm investment in common stocks. At that time, even a 1% annual rate of inflation between 2012 and 2017 would have decreased the purchasing-power of the government bond that Protégé and I sold.

I want to quickly acknowledge that in any upcoming day, week or even year, stocks will be riskier – far riskier – than short-term U.S. bonds. As an investor's investment horizon lengthens, however, a diversified portfolio of U.S. equities becomes progressively less risky than bonds, assuming that the stocks are purchased at a sensible multiple of earnings relative to then-prevailing interest rates.

It is a terrible mistake for investors with long-term horizons ... to measure their investment "risk" by their portfolio's ratio of bonds to stocks. Often, high-grade bonds in an investment portfolio increase its risk.

Positions

DTEGY - 2% positions were bought for 5 clients on 2/5 @ 16.93.

Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
06/29/2017	1	ILLEK CHRISTIAN P		14,065
06/28/2017	3	HOETTGES TIMOTHEUS, D...		44,625
06/16/2017	1	VAN DAMME NIEK JAN		15,830
06/13/2017	1	NEMAT CLAUDIA		28,251
06/07/2017	1	NEMAT CLAUDIA		15,650
06/06/2017	1	DANNENFELDT THOMAS		6,969

From Morningstar:

Deutsche Telekom Reported In line 4Q Results; Maintaining EUR 17 ($21) FVE, Shares Undervalued

Analyst Note by Allan C. Nichols Updated Feb 23, 2018

Deutsche Telekom reported fourth-quarter results in line with our expectations and we are maintaining our EUR 17 fair value estimate for local shares and $21 for the ADRs, as well as our no-moat rating. The firm reported revenue fell 2% year over year in the fourth quarter, which brought its full-year revenue growth to 2.5%, spot on with our projection. However, this weak quarterly performance was primarily currency-related as T-Mobile US' 5.1% year-over-year revenue growth in U.S. dollars turned into a 4.1% revenue reduction when converted into euros that strengthened over the year. For more on T-Mobile US, please see our previously written note on its fourth-quarter results.

Deutsche Telekom produced net revenue growth in Germany of 1.9% over the prior year, which is its best result in almost three years. While, we don't think this growth rate is sustainable, we do think it can consistently grow at a lower rate as the firm benefits from the investments it has been making. Germany has been behind several other European countries at convergence, but DT laid 40,000 kilometers of fibre in 2017 and plans to lay another 20,000 in 2018. This fibre is enabling the firm to offer faster broadband speeds, which is helping attract customers to its MagentaEINS (converged fixed-line and mobile telephony) package. MagentaEINS subscribers increased almost 20% year over year to 3.6 million in 2017.

In the rest of Europe, revenue in the quarter was basically flat, but grew 1% for the year. We are pleased to see full-year revenue grow in the rest of Europe, which is the first time since 2010. Like in Germany, we think revenue growth in the rest of Europe is sustainable as it is also benefiting from the move to convergence. DT is also focusing on cost control and generated an adjusted EBITDA margin of 26.2% for the quarter, which brought its full year result again smack on our projection of 29.7%. The fourth quarter historically has lower margins due to special Christmas deals.

Investment Thesis by Allan C. Nichols Updated Mar 31, 2017

We are pleased with the strategic changes Deutsche Telekom is making. In January 2016, the company sold its stake in EE for a 12% stake in the enlarged BT Group and slightly more than GBP 2 billion in cash. This removes DT from directly competing in one of the most difficult markets in Europe, but leaves it as the largest shareholder in the only telephone company in the United Kingdom that fully owns and controls its own fixed-line and wireless telecom networks, leaving it well positioned for the movement to convergence.

In the United States, the merger with MetroPCS provided a listing for this business and reduced DT's stake to 74%. So far, we have been impressed by T-Mobile US. Its "uncarrier" strategy has performed better than we anticipated and allowed the firm to add 4.9 million contract customers in 2014, an additional 5.8 million in 2015, and 2.7 million in 2016. We anticipate continued revenue and subscriber growth in the U.S., but remain concerned regarding its scale disadvantage versus Verizon and AT&T. We think this is particularly an issue with the ongoing spectrum auction and the much lower free cash flow that T-Mobile US generates. Over time, we anticipate that DT will sell down its stake in the business.

DT has also been addressing its problems in its home market of Germany. The company completed its Save for Service program one year early and has reduced costs by EUR 4.5 billion. This enabled the German EBITDA margin to increase to above 39%, which is solid. However, competition has increased, making growth difficult, and the firm still has too many employees in Germany, especially on the fixed-line side. We anticipate that natural attrition will aid in this over time, as a significant portion of its employees are over 50.

While DT's other European revenue is likely to decline for the next couple of years, the firm continues to generate strong free cash flow. The firm has used cash to expand its operations in other countries, and international sales now outpace those in Germany. The firm still has room to grow in several markets, and we expect it will continue to invest in these areas.

Economic Moat by Allan C. Nichols Updated Mar 31, 2017

Despite Deutsche Telekom's inherent advantages, we believe the firm has no moat. DT is the incumbent telephone operator in Germany, the largest country by population in Europe, as well as one of the largest operators in Eastern Europe and one of the four national wireless operators in the U.S. DT has a large wireless subscriber base of 165 million, but it has not been able to use this scale to generate returns on investment above its cost of capital. In Germany, Deutsche Telekom has about 70% of the fixed-line market, holds 40% of the broadband market, and is the second-largest wireless provider in the country after the merger of Telefonica's and KPN's operations. Typically, an operator with this much market share would be able to generate high returns on capital, as its scale enables it to spread the fixed costs of its network over more people. However, Deutsche Telekom has so far failed to exploit its strong market position. While the firm has made major strides in improving its returns in Germany, it has been hampered by problems elsewhere, particularly in the U.S., Greece, and Romania.

Valuation by Allan C. Nichols Updated Feb 23, 2018

We are maintaining our fair value estimate for Deutsche Telekom's ADRs tat $21. T-Mobile US' "uncarrier" strategy continues to outperform our bullish projections. We anticipate strong subscriber growth and improving margins in the U.S. business to continue driving gains at the parent level. We estimate its U.S. revenue growth will average about 4.2% annually for the next five years in U.S. dollar terms. While Germany and the rest of Europe are showing signs of improvement, and we expect they can grow revenue about 1% annually, we remain concerned that price wars could break out and push revenue down again. However, this revenue growth is offset by much worse results at the Systems Solutions business. Because of the variability of possible outcomes in the U.S., we previously increased our fair value uncertainty rating to high from medium. While we anticipate some improvement in the U.S. operations' margins, they remain lower than the average for the rest of the firm. However, we expect DT's EBITDA margins to increase each year as the firm continues to cut costs. We expect its EBITDA margin to reach about 31% by 2022. We now use an exchange rate of EUR 0.8125/$1 as of Feb. 22, 2018, versus EUR 0.8153 previously. A 10% depreciation of the euro would lower our fair value estimate to $19, while a 10% appreciation would raise it to $23.

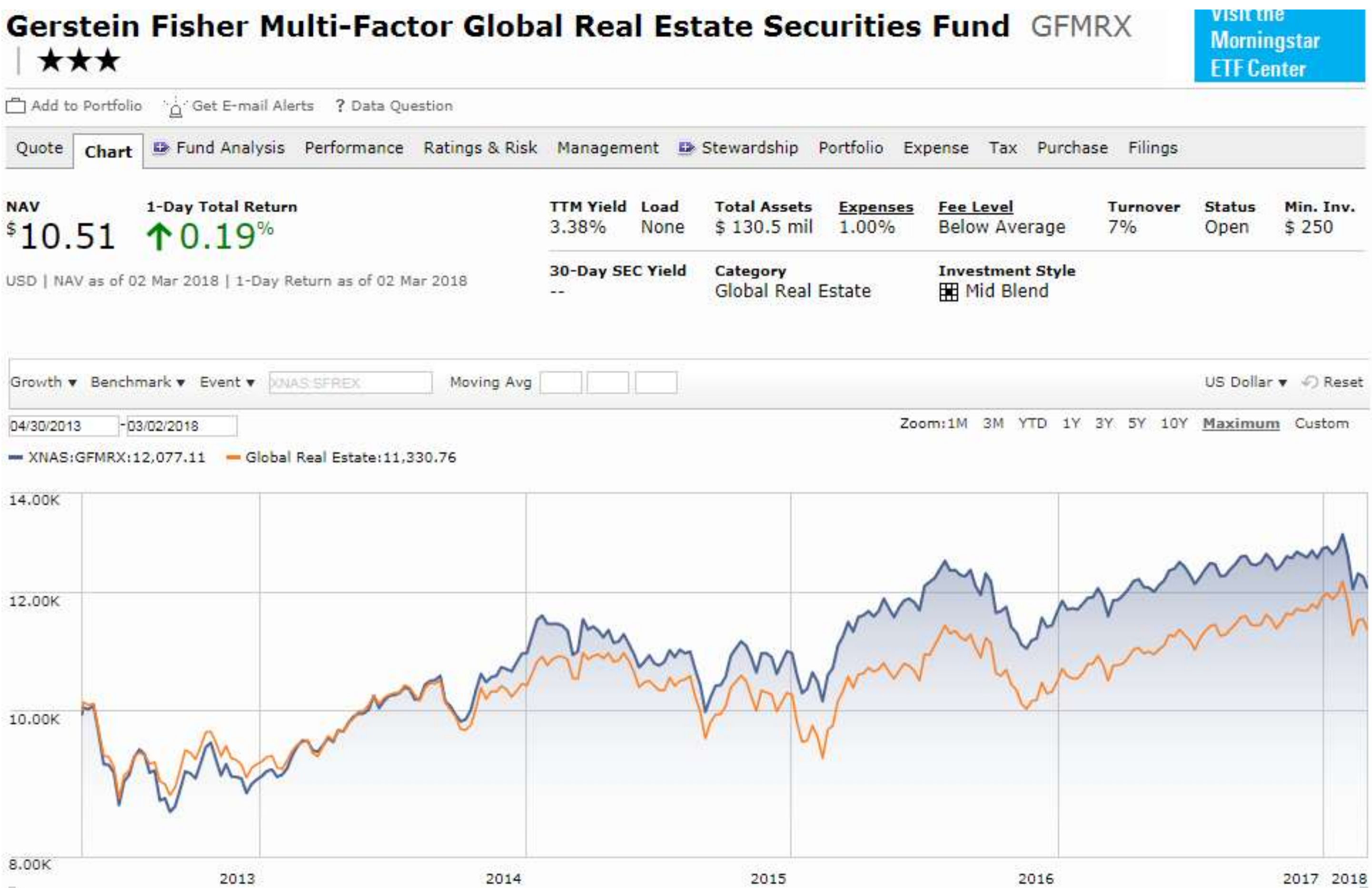
Risk by Allan C. Nichols Updated Mar 31, 2017

Competition is the biggest risk to Deutsche Telekom. With Telefonica's acquisition of KPN's E-Plus business in Germany, it has become the largest wireless operator in the country. Telefonica is also addressing its historically weak network by increasing capital expenditure in order to reduce the quality differential with DT and Vodafone. In the U.S., even after the merger with MetroPCS, T-Mobile US remains at a significant competitive disadvantage to the much larger Verizon and AT&T. We think T-Mobile US may need to spend much more than it expects if it is to gain the market share it desires. The secondary risk of competition is that Deutsche Telekom has had difficulty reducing staff fast enough to offset declining revenue. While the firm's success recently has been impressive, we are concerned about its ability to continue, particularly if the U.S. business starts to decline again. Another risk is Deutsche Telekom's toll-collection system, which is run in conjunction with Daimler. While the system is operational, the government continues to threaten lawsuits and fines amounting to more than EUR 5 billion, including interest. Deutsche Telekom could also overpay for other acquisitions. Rumours of an attempted tie-up with Sprint in the U.S. continue. The assumption in the past was that Sprint would buy T-Mobile US. However, given the improvements at T-Mobile US, it might instead buy Sprint and could overpay. The firm's Southern and Eastern European operations, particularly Greece, are struggling as a result of their weak economies and government austerity measures. We expect these countries' economies to continue struggling.

Management by Allan C. Nichols Updated Nov 09, 2017

Timotheus Hoettges became CEO in January 2014 upon the departure of Rene Obermann. Previously, Hoettges was the CFO; before that, he held various management positions at Deutsche Telekom. Thomas Dannenfeldt, who was previously managing director of finance for the German operations, replaced Hoettges as CFO. As a public German company, Deutsche Telekom has a supervisory board above the board of directors. The supervisory board has veto power over executive selection and some decisions, as well as the right to approve financial statements. It is made up of shareholder and employee representatives and sometimes seems more interested in saving jobs than increasing earnings, which adds to the difficulty Deutsche Telekom has in reducing head count. In addition, the government still owns 32% of the firm, and many employees have civil servant status. Deutsche Telekom has a mixed record with mergers and acquisitions. We believe it overpaid for T-Mobile US, but this business is now worth more than DT originally paid. Likewise, it overpaid for its stake in OTE. Strategically, this deal made lots of sense, but with Greece's credit crisis and ensuing recession, it turned out poorly in the short term. The firm also sold its stake in Mobile TeleSystems, Russia's largest wireless operator, much too early. This business has flourished since Deutsche Telekom sold its minority position. In our opinion, Deutsche Telekom sold its stake in EE at a good price. Additionally, with the pullback in BT's stock, we no longer think it is overvalued; given this, accepting a 12% stake in BT is no longer a concern.

FRIFX for **GFMRX** - While GFMRX continues to outperform its peers (orange line), we now consider FRIFX the better choice for Capital Preservation.



For a Funds only client seeking balance between Capital Preservation, Appreciation and Income, we substituted FRIFX, with its **Risk** ratio for maximum drawdown relative to the S&P 500 of **0.6,** for GFMRX, with a **Risk** ratio of **1.0**. FRIFX is currently higher rated for past performance (5 stars vs. 3 stars for GFMRX), has a higher Yield (4.51% vs. 3.38%), and lower Expenses (0.78% vs. 1.00%).

Fidelity® Real Estate Income Fund FRIFX | ★★★★★ | Bronze

FF Fund Family Data | Add to Portfolio | Get E-mail Alerts | PDF Report | ? Data Question

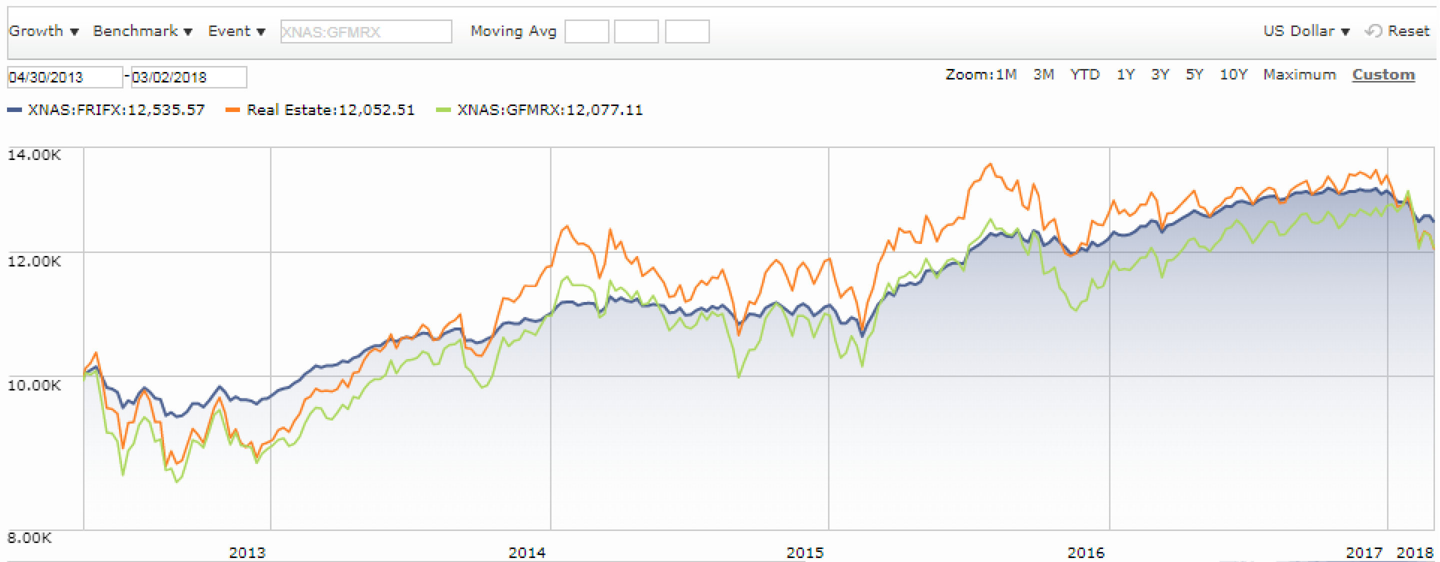
Quote | **Chart** | Fund Analysis | Performance | Ratings & Risk | Management | Stewardship | Portfolio | Expense | Tax | Purchase | Filings

NAV	1-Day Total Return
$11.45	↓ -0.17%

USD | NAV as of 02 Mar 2018 | 1-Day Return as of 02 Mar 2018

TTM Yield	Load	Total Assets	Expenses	Fee Level	Turnover	Status	Min. Inv.
4.51%	None	$ 5.0 bil	0.78%	Low	22%	Open	$ 2,500

30-Day SEC Yield	Category	Investment Style
4.20%	Real Estate	Mid Value



From Morningstar:

Real estate exposure, income, and low volatility.

by David Kathman, CFA, Ph.D. 11/03/2017

Fidelity Real Estate Income's distinctive income-focused approach makes it virtually unique within the Real Estate Morningstar category. It earns a Morningstar Analyst Rating of Bronze, thanks to its experienced manager, solid track record, and low price tag.

Manager Mark Snyderman's goal on this fund is to achieve a higher yield than pure real estate equity funds and investment-grade bond funds, but with less volatility and interest-rate sensitivity. To achieve that goal, he can invest in real estate securities across the capital structure, including common stocks, preferred securities, commercial mortgage-backed securities, and corporate bonds. He has access to Fidelity's deep analyst resources to find attractive real estate companies and evaluate macroeconomic conditions, but Snyderman makes all the decisions on which companies to invest in and which of those firms' securities are most attractive.

At first glance, the fund's returns appear to be all over the map, ranking near either the bottom or the top of the real estate category each year from 2007 through 2016. However, those numbers are misleading, since the fund's substantial holdings in preferred and fixed-income securities mean that comparisons to an equity-only real estate peer group are not especially useful. The fund has looked pretty good relative to a more appropriate custom benchmark consisting of 20% real estate common stocks, 40% REIT corporate bonds, and 40% REIT preferreds, beating that benchmark since the fund's 2003 inception. Over the past decade it has also beaten

Invesco Global Real Estate Income ASRAX, a global REIT fund with a similar approach drawing on the entire capital structure.

In line with its stated goals, this fund has been far less volatile than the equity-only FTSE NAREIT All REIT Index, while achieving a higher yield than the real estate category (4.04% versus 2.73% as of November 2017). Its 0.77% expense ratio also makes it one of the cheapest actively managed funds in the real estate category. It's a fine option for investors seeking real estate exposure combined with decent income.

Process Pillar: Neutral

This fund has a distinctive, income-oriented approach that's dependent on manager Mark Snyderman, earning it a Process Pillar rating of Neutral. It aims to achieve a better yield than pure real estate equity funds and most bond funds, but with less volatility and interest rate sensitivity. Snyderman tries to do this by investing in a diverse mix of commercial real estate security types ranging across the capital structure: common stock, preferred stock, commercial mortgage-backed securities, and real estate corporate bonds. Historically, 30% or less of the portfolio has been in REIT common stocks, with roughly 10%-30% in preferred stock, 15%-30% in CMBS, 25% to 50% in corporate bonds, and 0%-10% in cash and other.

With the help of Fidelity's research analysts and visits with company management, Snyderman keeps track of all the major real estate companies in the fund's universe, thinking about their entire capital structures. His fundamental research focuses on such factors as balance sheet strength, property quality, cash flows, quality of company management, growth rates, debt to property value, debt yield, and covenants. When he finds a fundamentally strong company, Snyderman determines which of its securities (common stock, preferred stock, bonds, and so on) is most attractive in terms of valuation, yield, or other fundamentals, before deciding what to add to the portfolio.

As of June 30, 2017, this fund's portfolio consisted of 31% common stocks (primarily REITs), 19% preferred stock, 18% commercial mortgage-backed securities, and 25% corporate bonds. The common stock weighting, 95% of which is in the real estate sector, is about as high as it has been since the fund's 2003 inception, and has stayed fairly steady since mid-2013. Manager Mark Snyderman thinks that real estate stocks are currently cheap relative to real estate bonds and the value of the underlying securities, even though they're somewhat expensive relative to the broader stock market. Conversely, the fund's 25% weighting in corporate bonds is about as low as it has been since the fund's inception.

The portfolio's preferred stock weighting is higher than it was during the 2008 financial crisis, when it got down to about 10% of funds assets, but it's lower than it was from 2004 to 2006, when it hovered around 30%. Snyderman has focused on higher coupon paying preferred issues, while being cognizant of their interest rate sensitivity.

The portfolio's 18% weighting in commercial mortgage-backed securities is similar to what it has been for most of the fund's history except from 2010 to 2012, when it swelled above 20%. Snyderman has focused on pockets of opportunity within this asset class, such as conservatively underwritten seasoned deals, and has avoided bonds containing mortgages dating from the pre-2007 bubble years.

Performance Pillar: Positive

This fund earns a Performance Pillar rating of Positive, thanks to returns that look solid once its unique exposures are considered. Through Sept. 30, 2017, its total returns ranked in the real estate Morningstar

Category's bottom quartile over the trailing three and five years, and in the bottom decile since the fund's 2003 inception; however, it ranked in the top decile over the trailing 10 years. These feast-or-famine results are also reflected in the fund's annual returns, which have ranked in either the category's top or bottom quartile each year from 2007 through 2016, including four years in the top 10% and two years in the bottom 10%.

However, the real estate category isn't a particularly good basis for comparison, given this fund's substantial holdings in preferred securities and fixed-income securities, which often perform very differently from real estate common stocks. Fidelity compares this fund's returns to those of the Fidelity Real Estate Income Composite Index, a custom benchmark consisting of 20% real estate common stocks, 40% real estate corporate bonds, and 40% REIT preferred securities. The fund has beaten that custom benchmark over the trailing three, five, and 10 years, and since inception.

The fund has been far less volatile than the average real estate fund. Its risk-adjusted returns have beaten the category's over all these trailing periods, as have its Sharpe and Sortino ratios, which account for both returns and volatility.

People Pillar: Positive

This fund earns a People Pillar rating of Positive, thanks to an experienced manager backed by deep resources. Mark Snyderman has been the sole listed manager since the fund's February 2003 inception. He has also managed Fidelity Strategic Real Return FSRRX and its Fidelity Advisor version since that fund’s September 2005 inception, and Fidelity Series Real Estate Income FSREX since its October 2011 inception. Prior to this fund, Snyderman managed Fidelity Real Estate High-Income, an institutional open-end fund, from 1995 to 2000, as well as institutional commercial mortgage-backed securities accounts from 1995 to 1999 and institutional REIT accounts from 1999 to 2002. He has been with Fidelity since 1994, managing real estate portfolios that whole time, and has been in the industry since 1988.

Snyderman works most closely with Fidelity’s high yield real estate debt team, which he has headed up since this fund’s launch in 2003. It includes seven investment professionals, including Snyderman, who analyze high-yield CMBS. He also makes use of Fidelity’s high-yield, investment-grade debt, and investment-grade CMBS analysts when necessary. Snyderman also uses Fidelity’s eight-person U.S. real estate securities research team led by Steve Buller, manager of Fidelity Real Estate Securities FRESX, as well as the firm's 380 U.S. & international equity research analysts, to provide research on key tenants and industries.

Parent Pillar: Positive | 04/18/2017

Long one of the industry's biggest asset managers, Fidelity has faced pressure as investors have pulled money from the active U.S. equity funds for which the firm is best known. While significant outflows could gravely impact some firms, Fidelity is shielded by its diverse mix across asset classes (including its own competitively priced index funds), success in other business lines, and private ownership that helps it escape quarterly earnings scrutiny.

The asset-management division remains well-staffed amid cost-cutting across the firm. Still, the firm could stand to rationalize its active-equity fund lineup: There are many redundant or mediocre funds alongside the standouts run by longtime star managers and up-and-comers. Retaining talent remains critical, particularly following the unexpected retirement announcement of a talented young small-cap manager. To its credit, Fidelity has handled equity manager transitions better than in the past. Meanwhile, Fidelity's fixed-income division remains among the industry's best, with a team-oriented approach assuaging key-person risk. Fidelity's target-date funds have improved, and the firm's technology and trading resources remain topnotch.

Even as it has raced to address competitive headwinds by unveiling a handful of factor-based exchange-traded funds, Fidelity remains capable on the actively managed side, earning a Positive Parent rating.

Price Pillar: Positive

This fund's 0.77% expense ratio ranks in the cheapest quintile of the Specialty No Load fee comparison group, earning it a Price Pillar rating of Positive. That expense ratio has come down from 0.81% in 2016 and 0.84% in 2013.

IRET - We bought this Apartment REIT for a client focused on Capital Appreciation that didn't have exposure to this sector for 5.60 on 2/1. On 1/17/17 we sold IRET for 4 clients @ 6.90.

Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
DANCE MICHAEL T Director	Purchase at $24.95 per share.	Indirect	49,900	Jan 17, 2018	2,000
DANCE MICHAEL T Director	Purchase at $5.50 per share.	Direct	55,000	Jan 03, 2018	10,000
DECKER MARK OKEY JR Officer	Purchase at $5.56 per share.	Direct	27,800	Jan 03, 2018	5,000
DECKER MARK OKEY JR Officer	Purchase at $5.58 per share.	Direct	139,500	Jan 02, 2018	25,000
KIRCHMANN JOHN Officer	Purchase at $5.68 per share.	Indirect	56,800	Jan 02, 2018	10,000
KIRCHMANN JOHN Officer	Purchase at $5.70 per share.	Indirect	5,700	Dec 26, 2017	1,000
KIRCHMANN JOHN Officer	Acquisition (Non Open Market) at $5.70 per share.	Indirect	43,206	Dec 14, 2017	7,580
CAIRA JEFFREY Director	Purchase at $5.79 per share.	Direct	260,550	Dec 13, 2017	45,000

ISCF for **IMOM** - For a Funds only client seeking balance between Capital Preservation, Appreciation and Income, we substituted ISCF (orange line), a multi-Factor Foreign Sm/Mid Blend ETF whose write-up we have previously shared, for IMOM (blue line). While we will continue to watch IMOM, it is no longer held by any clients.

TPVG - On 2/2 we added 2% positions in this Venture Capital BDC for 5 clients @ 12.59. An edited Summary from BDC Buzz's December 7, 2017 Projections:

- Yesterday, TPVG released a portfolio update that was included in its “2017 Wells Fargo Thought Leadership” presentation announcing robust originations in Q4 2017 resulting in reaching the lower end of its target leverage ratio.
- Due to the recently announced portfolio growth, maintaining its higher portfolio yield, and the potential for spillover income into 2018, there is a chance that I could be repurchasing shares depending on pricing (which he did on 1/31/18 @ 12.68).
- I am expecting a meaningful increase in NAV per share for Q4 ....
- On October 25, 2017, TPVG announced an accretive private placement by Goldman Sachs Asset Management (GSAM) raising around $22 million making GSAM the largest investor. ("The management team also invested an additional $1 million with an 18-month lockup" as detailed below under Insider Buying.)

Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
OLSON ANDREW Officer	Purchase at $13.65 per share.	Direct	100,818	Oct 24, 2017	7,386
SRIVASTAVA SAJAL Officer	Purchase at $13.65 per share.	Direct	604,872	Oct 24, 2017	44,313
LABE JAMES Officer	Purchase at $13.65 per share.	Direct	302,429	Oct 24, 2017	22,156

XSLV for **KNOW** - For a Funds only client seeking balance between Capital Preservation, Appreciation and Income, we substituted XSLV (blue line) for KNOW (orange line). We have previously shared our write-ups on both of these 5 star rated multi-Factor Domestic ETFs. XSLV has the lower **Risk** ratio (**0.9** vs. **1.0** for KNOW), Expenses (0.25% vs. 0.59%), and has outperformed since November of 2016. It should be noted that one of KNOW's Factors is Insider Buying, which has been limited with stocks at these valuation levels. While KNOW continues to be on our Buy/Watch list, it is no longer held by any clients.

PowerShares S&P SmallCap Low Volatility Portfolio XSLV | ★★★★★

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Quote | Chart | ETF Analysis | Distributions | Performance | Ratings & Risk | Portfolio | Fees & Expenses | Tax | Ownership | Filings

Last Price
$44.91

Day Change
-0.10 | -0.22%

As of Tue 02/20/2018 9:59 AM EST |USD

Intraday Indicative Value
$45.00 -0.02 | -0.04%

As of Tue 02/20/2018 9:54 AM EST |USD

NAV	Open Price	Day Range	52-Week Range	12-Mo. Yield	Total Assets	Expenses
45.02 USD	44.84	—-45.02	41.54-48.33	1.88%	1.22 bil USD	0.25%

Prem/Discount	Volume	Avg Vol.	SEC Yield%	Bid/Ask/Spread	Category
-0.20%	21088	142,179	—	44.81/ 44.86/ 0.11%	Small Value

Benchmark ▾ Event ▾ ARCX:KNOW Simple Moving Avg Reset

02/12/2013 - 02/19/2018 Zoom: 1D 5D 1M 3M YTD 1Y 3Y 5Y 10Y **Maximum** Custom