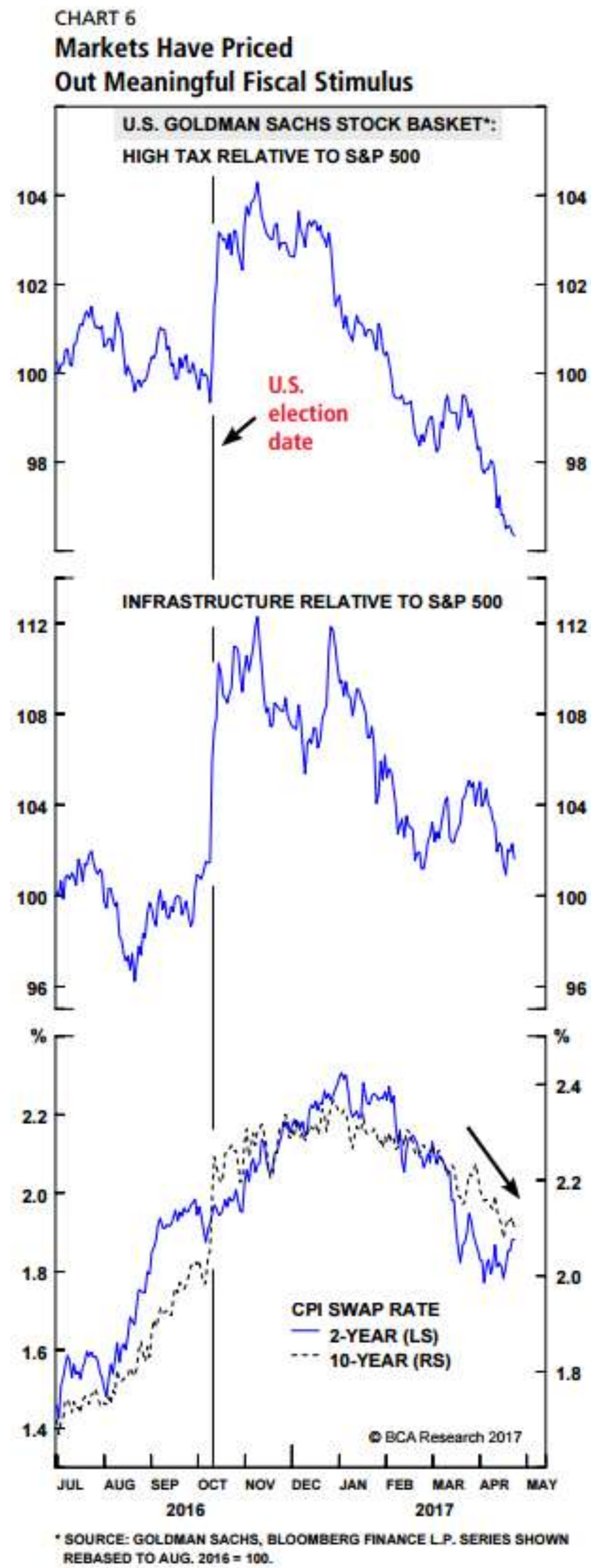
May 2017

Despite May 17th's "Trump Slump", which lasted all of one day, the S&P 500, Nasdaq and Dow ended the month near all time highs, which were then exceeded on both Thursday and Friday. However, Small Cap stocks, as represented by the Russell 2000, were down 2.2% in May. As noted by Bespoke on June 2nd, "Over the last few weeks there have been a lot of data points highlighting the "Trump fade," where asset classes that moved sharply higher immediately following the Election have given it all back." From BCA Research's Global Investment Strategy's May 26th Weekly Report: "After a wave of euphoria following the presidential election, the market has largely priced out meaningful fiscal stimulus. This can be seen in the flagging relative performance of infrastructure stocks and highly-taxed companies, as well as in the sharp decline in inflation expectations (Chart 6)."



Despite a weaker than expected Jobs report on Friday, the unemployment rate fell to 4.3%, the lowest in 16 years. The 10-year Treasury yield fell below 2.16%, the lowest since November 10th.

From the Washington Post this morning:

"No industry has experienced both the promise and peril of the Trump era more acutely than the financial sector. Stocks surged after the election on hopes that Republicans would deliver a massive fiscal boost from tax cuts and infrastructure spending. Share prices of the big banks themselves led the way, as investors expected the Trump team to slash post-crisis regulations on Wall Street. And the new president appeared primed to deliver, stocking his economic braintrust with big-name financiers.

Four and a half tumultuous months in, the industry is learning the hard way that it's easier to talk up big change in Washington than to deliver on it. Congressional Republicans remain stuck behind the starting line on tax reform, divided over basics. The deregulatory agenda is likewise flagging. The president launched his term by icing the massive Trans Pacific Partnership, and a question mark hangs over the future of free trade, another industry priority. As the window of opportunity for action closes, a cascade of headlines about the Trump team's Russia ties is keeping the administration off-balance."

Trump's downward spiral will likely accelerate with former FBI Director Comey's Senate appearance next Thursday, yet Mr. Market appears to be ignoring the growing Geopolitical risk.

Why There Is No ‘Trump Slump’ on Wall Street

By RUCHIR SHARMA MAY 30, 2017

After a brief stumble, the stock market returned to its upward march last week and hit another high. This optimism has left many people confused, even infuriated. Why isn’t Wall Street being affected by all the crazy news — including rumors of impeachment — coming out of Washington? Where is the Trump Slump?

So far, there isn’t one, and that’s good news for investors but also even for ideological opponents of the president. I’ve examined stock markets in countries around the world, looking at data over the past three decades. My research shows that a country’s stock market often outperforms its peers when a new leader comes to power in emerging countries.

But there is no such positive effect in developed countries. Countries like the United States have structural guardrails in place, like strong independent courts, central banks and other checks on power, that make it more difficult for a single leader to change the nation’s direction.

Compare political scandals, for example. In Brazil, the market is struggling to recover after falling nearly 15 percent in dollar value on May 18 perhaps in response to the blockbuster news of a cover-up that could cost the president his job.

In the United States, the stock market fell during the Watergate scandal but for reasons that had little to do with Richard Nixon and much to do with the stagnant economy and inflation. And stock prices rose steadily during the investigations and impeachment of Bill Clinton, until the 1998 collapse of the hedge fund Long-Term Capital Management threatened to trigger a global financial crisis. The same holds for other political scandals, like Teapot Dome and Iran-contra.

It is a mistake, then, to view the markets through an ideologically colored lens.

The data is decidedly more mixed on whether the United States market does better under a Republican or a Democratic administration. If anything, the market over time seems less and less inclined to care which party is in power.

I know plenty of right-wing ideologues who, convinced that President Barack Obama was leading America to ruin, missed out on the market’s long bull run. Similarly many Democrats now think President Trump is taking the country down and assume that stock prices will follow.

The stock market is best understood not as a presidential poll but as a barometer of the nation’s current economic mood, and it remains buoyant now for reasons unconnected to the White House.

For a few weeks after President Trump’s victory, Wall Street was indeed buzzing over how his plans to cut taxes and red tape would stir “animal spirits” and promote American business, albeit at the expense of foreign rivals. Money was coming back to the United States, driving up the value of the dollar. Six months later, the main reason for the market's continued rise has more to do with global rather than local factors. The "Trump bump" is long gone.

Global growth has picked up over the past few months, and the worst fears that caused a short-term slump in Wall Street last year — like a possible breakup of the European Union after Brexit or a financial crisis in China — have not materialized. The American economy continues to grow at a steady clip of around 2 percent, while the economies of Europe and Japan are now stronger than at any time since the crisis of 2008.

The American stock market reflects those trends. Despite Mr. Trump's criticism of "globalists," the more internationally oriented companies have outperformed their domestic peers significantly since Inauguration Day. The global forces lifting the United States market have in the meantime been lifting foreign stock markets even faster this year.

Similarly, the American dollar has given up all the gains it recorded in the immediate aftermath of the November election, and the Mexican peso has clawed back most of the losses it incurred when the markets were taking President Trump's threats against the North American Free Trade Agreement more seriously.

On Wall Street today, the chatter about Trumponomics is fading, because many people no longer expect him to accomplish much, for better or worse, whether pushing tax reform or triggering trade wars. Some analysts still worry about how a tax-cut plan based on unrealistic growth assumptions could further bloat the budget deficit, or how limiting immigration could undermine the economy.

But those story lines are expected to play out at a glacial pace, well outside the market's forecast horizon, which is measurable in months, not years. Corporate profits have started to revive in recent months based on a recovering global economy. As long as that continues and the cost of money remains close to zero, courtesy of the Fed, the default path for the market is up.

None of this is to suggest that there are no risks to the bull market, now in its ninth year. Stocks in the United States have seldom risen for so long without a major setback and have never been more expensively valued, outside the tech boom of the late 1990s. History shows that bull runs tend to last until the next recession starts, so the question is where the next downturn comes from.

If emerging inflation pressures prompt the Fed to raise interest rates more quickly, the economy could stumble and take the market with it. More significantly, there are still threats to the world economy, including China's debt bubble. If it bursts, it could cause the next global recession, hitting the American market hard.

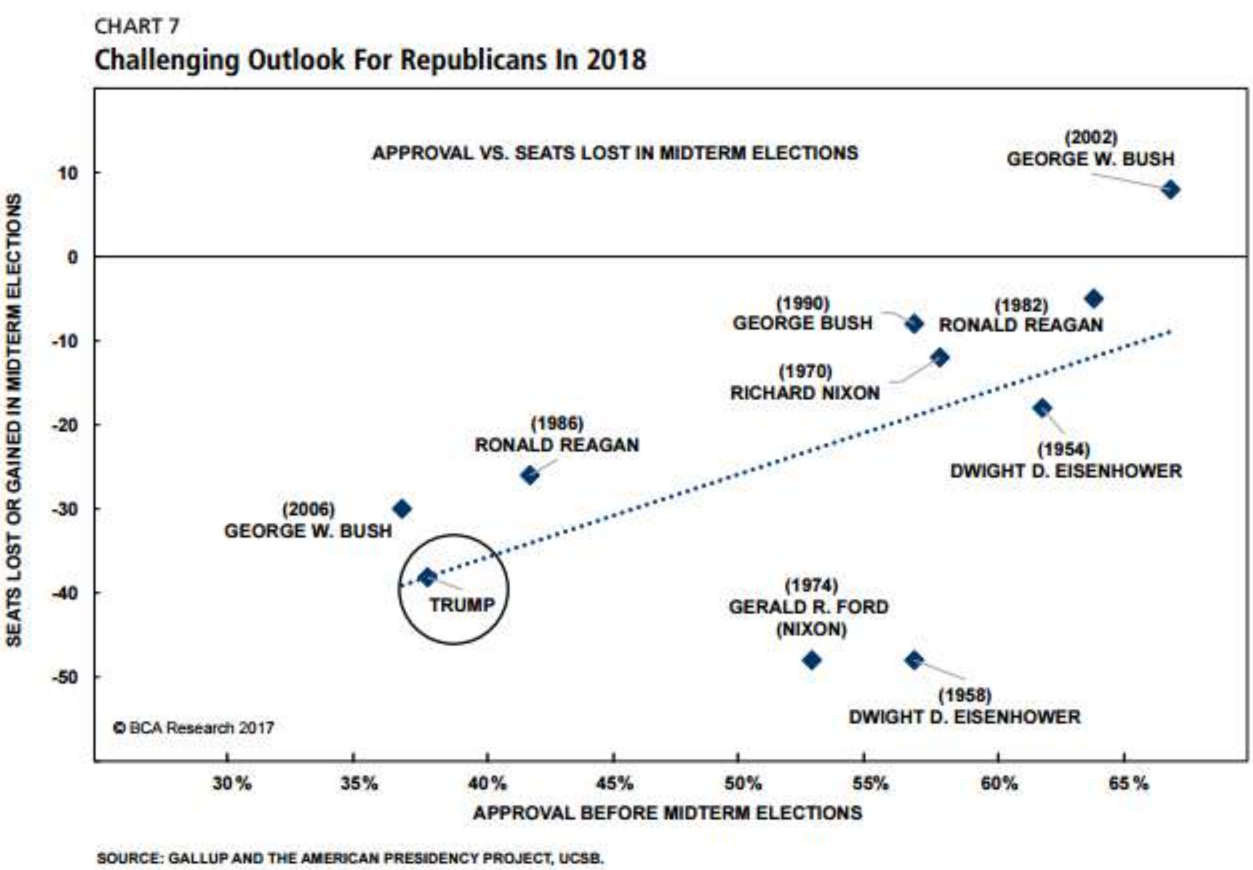
So there is much to worry about in the markets, but it is important to worry about the right things. The cloud of scandal around the White House is not high on the list. Mr. Trump's mercurial ways may be a source of great concern or indifference, depending on your ideological leanings. But Wall Street doesn't seem to care one way or other.

Ruchir Sharma, author of "The Rise and Fall of Nations: Forces of Change in the Post-Crisis World," is the chief global strategist at Morgan Stanley Investment Management and a contributing opinion writer.

Our thoughts

Trump's policy agenda of lower taxes and increased defense and infrastructure spending, both inflationary with our economy at full employment, is drowning in his whirl of self inflicted chaos. The odds of impeachment are growing, with the 2018 midterm elections becoming a referendum on Trump. The Special Counsel's investigation will linger, while the anti-Trump media's feeding frenzy won't let up:

May 26th's Global Investment Strategy again: "Trump’s falling poll numbers have heightened the risk that the Republicans will lose control of the House of Representatives next November (Chart 7)."



Positions

CECE - Fell 12.3% on May 10th's Earnings release. While 1Q had a 17.6% Positive Earnings Surprise, 3 out of 4 analysts lowered their estimate for 2Q, with all 4 lowering for 3Q. Target Price was maintained by 1 analyst, lowered by 2. Insiders did not buy while we waited 3 weeks for a typical bounce.

CVA - A Reaching For Yield opportunity.

Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
SILBERMAN ROBERT S Director	Purchase at $14.60 per share.	Direct	489,100	Apr 26, 2017	33,500
RANGER MICHAEL W Director	Purchase at $14.56 per share.	Direct	582,400	Apr 26, 2017	40,000
JONES STEPHEN J Officer	Purchase at $14.48 per share.	Direct	144,800	Apr 26, 2017	10,000

Morningstar:

Nearing the end of a tough contract reset cycle, Covanta shifts its sights to growth.

by **Barbara Noverini** Equity Analyst

Analyst Note 04/27/2017

In the aftermath of two previously disclosed back-to-back fires at different facilities, no-moat Covanta's first-quarter results suffered from the unplanned downtime. Management hopes to get Covanta Fairfax up and running by the end of the second quarter and decided to use the downtime to accelerate maintenance at the facility. These factors led to lower revenue and higher costs in the quarter, impacts that will be somewhat offset by insurance proceeds later in the year. Nevertheless, the market reacted sharply to Covanta's negative free cash flow in the quarter, sending shares tumbling.

We agree that the company hasn't been able to catch a break lately; however, there were some bright spots in the quarter that suggest the underlying business is strengthening. As such, we're maintaining our fair value estimate of $18 per share. Revenue remained largely flat in the quarter at $404 million, but lower volumes due to the plant shutdown and the expiration of certain power purchase agreements were mostly to blame. Otherwise, average waste revenue per ton increased a healthy 3% year over year from better spot waste pricing, ongoing capture of higher-priced profiled waste, and contract escalation. Realized ferrous metals prices nearly doubled year over year, as Covanta's efforts to recover higher-quality metals continue to reap rewards. Finally, the environmental services segment reported impressive organic revenue growth of 26% in the quarter off a relatively small, but expanding base.

That said, the quarter's challenges weighed on overall profitability. Adjusted EBITDA margins compressed to 12.6% from 18.9% in the prior period, and free cash flow went negative by $17 million. Aided by insurance proceeds, management remains confident in full-year guidance for adjusted EBITDA of $400 million-$440 million, and adjusted free cash flow of $100 million-$150 million. We think this is attainable provided Covanta doesn't suffer any other unexpected mishaps along the way.

Investment Thesis 04/06/2017

With the bulk of a difficult contract renewal cycle squarely in the rearview mirror, we see a much brighter future for waste-to-energy powerhouse Covanta. Since 2009, the company has steadily managed through the expiration of service contracts signed when its incinerators were built 20 to 25 years ago. These original multiyear agreements with host municipalities employed pricing escalators that caused rates to eventually outpace the broader waste services market; as such, recent contract renewals at lower market rates have heavily weighed on revenue, EBITDA, and cash flow. By the end of 2017, most of Covanta's contracts will be at-market, freeing the company to focus on monetizing the byproducts of waste incineration--mainly electricity, steam, and metals. In addition, Covanta's recent success in capturing higher-margin special waste streams remains a budding opportunity for using available capacity to generate higher profits than contracted municipal waste. In our view, these are the main sources of upside in the Covanta story. However, exposure to commodity volatility and an aging asset base could temper the attractiveness of this business model for certain investors.

Although low cost landfills remain the predominant form of waste disposal in the U.S, incinerators offer significant transportation savings when they are near the source of trash. That said, U.S. customers are increasingly demanding integrated collection and disposal, which requires Covanta to share margins with third-party haulers and other service providers. This dynamic is especially apparent in Covanta's fledgling New York City contract, which incorporates costly logistics. However, New York City's acceptance of incineration may compel other U.S. cities to consider doing the same.

Future expansion is dependent on acquiring existing incinerators, or building new waste-to-energy plants. In certain geographies where space is at a premium, such as Europe, Covanta is likely to find greater demand for greenfield development. The long-delayed Dublin, Ireland, project is finally well under way; successful execution will boost Covanta's future in the region and should contribute materially in 2018.

Economic Moat

From a qualitative perspective, Covanta's difficult-to-replace asset base of incinerators near favorable markets seems to mirror the competitive advantages that we assign to landfill owners in the municipal solid waste industry. At minimum, Covanta possesses regulatory permits (intangible assets), switching costs for customers that partner with Covanta to build or operate a capital-intensive incinerator, and a cost advantage in populated areas like the East Coast that are far from landfills. Yet, since 2013, returns on invested capital including goodwill have fallen beneath our estimated weighted cost of capital for Covanta, which shakes our confidence in awarding the company an economic moat. With about 84% of its waste revenue under contract, we would expect the company to easily outearn its cost of capital, given the aforementioned advantages. However, the company has struggled for years to improve returns while under contract transition pressure; moreover, customers continue to demand additional services, such as recycling, which increase capital investment and operational cost and divert waste away from Covanta's legacy assets. Finally, maintenance and upgrade costs have climbed over the years as Covanta tends to the upkeep of an aging asset base.

We view incineration as an emerging substitute in the solid waste arena, with its ability to gain widespread acceptance constrained by significant barriers to entry. While incineration is an approved form of waste disposal in the United States, the public continues to fear the alleged health effects of burning trash, which leads to significant "not in my backyard", or NIMBY, opposition to new projects. As such, we believe it would take a great paradigm shift to significantly divert the waste stream from landfills to incinerators in the U.S., particularly in areas where lower-cost landfills are within reasonable transportation distance. Moreover, the nation's largest landfill owners are fierce opponents--entrenched in local communities with ample experience competing for solid waste volumes. Even as interest in landfill diversion grows, we believe national haulers will continue to dominate the waste stream by developing ever-more-efficient recycling operations, which could heighten overall competition for Covanta.

As Covanta's lengthy contract transition period finally comes to a close, we believe returns should stabilize, and may very likely materially improve for Covanta. If that proves to be true, we would consider revisiting our moat argument; however, we'd need to see considerable improvement in returns on invested capital over several years before we'd be convinced that the trend is sustainable.

Valuation

We've trimmed our fair value estimate for Covanta to $18 from $20 per share after revisiting our longer-term profitability assumptions for the company. We expect Covanta to reach $2.1 billion in revenue by 2021, reflecting a top-line CAGR of 4.7% that is back-half loaded. As the bulk of Covanta's contract transitions ease and the New York and Dublin contracts progress, we expect top-line growth to invigorate, benefiting from stable waste pricing and higher energy and metals revenue. Improved pricing and volume growth in all revenue lines should sustain strong operating leverage, which we believe will boost operating margins to a new midcycle average of 16.5% by 2021, versus our old assumption of 16.8% by 2020. Furthermore, we expect that with an operationally focused CEO at the helm, additional opportunities to increase efficiency will aid longer-term margin improvement. Covanta's business model really works during periods of rising commodity prices, and with volumes also expected to increase due to the New York City and Dublin projects, along with successful growth in higher-margin special waste streams, we believe that Covanta can reach a new level of sustainable profitability over the course of our forecast period. Contract transitions have kept returns depressed for the past several years; however, our forecast assumes that returns on invested capital will grow from here. As Covanta's service-fee facilities transition to tip-fee structures, the company stands to keep a greater percentage of higher-margin revenue streams, which should also enhance ROICs. In addition, Covanta can displace lower-margin municipal waste with higher-priced special waste increases, along with contract transitions. Ongoing capital investment in metal extraction and recovery technology can also substantially increase metal revenue. In a similar vein to electricity sales, these revenue streams have much higher contribution margins. Our forecast is front-loaded with heavy capital investment due to contractually committed construction on the horizon. However, these investments will ease towards the back half of our forecast period as projects come to an end. This should free up cash flow, which we expect the company will use to fund additional organic growth initiatives, M&A, or dividend increases.

Risk

We assign Covanta a medium uncertainty rating due to the highly-contracted nature of its business model, which provides some degree of visibility into its base business. Approximately 84% of its waste services revenue and 60% of its energy revenue is contracted. The remainder comes from spot waste and energy sales, and metals recycling, all of which are revenue streams that fluctuate along with commodity market prices. In addition, Covanta will collect construction revenue for projects from time to time, and has a growing environmental services segment.

While contracted revenue remains fairly steady, cash flow can be challenged by swings in commodity market pricing or unexpected maintenance or operational expenses, which can occur during periods of severe or unusual weather. Furthermore, some of Covanta's plants have been running for several decades, which poses the operational risk of equipment wearing out. Under normal conditions, waste service revenue covers the total cost of operating the plants plus a slim margin, leaving energy and metals revenue to fall to the bottom line. However, during "perfect storms," when maintenance costs escalate and commodity revenue falters, cash flow can take a short-term hit. However, these effects tend to smooth out over the long run.

Management

Overall, we believe Covanta's stewardship of shareholder capital is Standard.

In March 2015, CEO Stephen Jones succeeded Anthony Orlando, who joined Covanta in 1987 and served as CEO and president between 2004 and 2015. It took the better part of Orlando’s tenure to lay the groundwork for the New York City contract, as well as Covanta’s European expansion plans; however, with the Dublin project finally under way, Jones will be responsible for successful execution, as well as the evolution of Covanta’s longer-term growth story. His 20 years of experience at industrial gas supplier Air Products, leading businesses in the U.K. and China, should serve Covanta well as the company looks towards incinerator-friendly international markets for future growth. In addition, Jones implemented a continuous improvement initiative based on Six Sigma, which is combing the legacy operations to root out sources of inefficiency. Successful execution on this front could help reduce structural costs, allowing a wider margin between contracted waste revenues and total plant operating costs.

That said, returns on invested capital leave something to be desired, pressured most recently by legacy contract resets and weakened commodity prices. Since 2013, ROICs including goodwill have stayed below our weighted average cost of capital of 7.5%. That said, we’re encouraged to see some modest improvement between 2015 and 2016, a positive sign for investors that management's efforts to add value is working. However, we'd like to see this trend strengthen even further as Covanta progresses through the bulk of its contract transitions; otherwise, we may feel compelled to revisit our Standard rating.

It is also worth noting that near-term capital allocation priority has shifted towards supporting the company’s dividend during this interim period of cash flow weakness. In 2014, Covanta aggressively raised its dividend to $1.00 per share, in a show of confidence over the company’s longer term prospects. Originally, the company targeted a payout of approximately 50% of its free cash flow; however, at the end of 2016, the dividend gobbled up a bit more than 75% of its free cash flow of $172 million, or $1.33 per share. Management staunchly defends this capital allocation decision, expressing comfort with the notion that payout ratios will fluctuate along with commodity prices and the business cycle, but the underlying, contractual nature of Covanta’s business underpins the current $1.00 per share.

We’ll note that management’s 2017 forecast for adjusted free cash flow of $100-$150 million suggests a range in which the payout could feasibly surpass 100% of free cash flow. With $84 million in cash on the balance sheet at the end of 2016 and ample credit revolver capacity, we think the company is capable of honoring its dividend commitment in 2017 even if free cash flow falls towards the low end of the range. Beyond 2018, we forecast material improvement in free cash flow growth as Dublin comes online, which will help the payout ratio fall back down toward its more comfortable 50% target.

Profile:

In North America, Covanta owns or operates waste-to-energy plants that process nearly 20 million tons of waste annually. The company also owns interests in a project based in Dublin, Ireland, making it one of the largest waste-to-energy operators worldwide. Covanta's incinerators convert nonhazardous solid waste to steam and electricity. It also recovers and sells ferrous and non-ferrous metals as part of the waste-to-energy process.

LSI - Valuations, reflecting strong fundamentals, and a resulting lack of Insider Buying kept us out of the Self Storage REIT Sector until now. We believe Reversion to the Mean, not deteriorating fundamentals, is reflected in Morningstar's 5-year chart.

Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
POWELL PAUL T Officer	Purchase at $73.04 per share.	Direct	51,128	May 8, 2017	700
BARBERIO MARK G Director	Purchase at $74.28 - $74.48 per share.	Indirect	86,000	May 7, 2017	1,150
RUSMISEL STEPHEN R Director	Purchase at $74.35 per share.	Direct	22,305	May 7, 2017	300

RYI - This IVE System Pick was already on our Buy/Watch List with a Buy Target of 8.2 when InsiderInsights added it to their recommended list. We decided not to wait.

Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
BURBACH MICHAEL Officer	Purchase at $9.05 per share.	Direct	19,910	May 16, 2017	2,200
SCHNAUFER ERICH S Officer	Purchase at $9.55 per share.	Direct	2,626	May 11, 2017	275
LEHNER EDWARD J. Officer	Purchase at $9.25 per share.	Direct	46,250	May 11, 2017	5,000
BURBACH MICHAEL Officer	Purchase at $10.29 per share.	Direct	28,811	May 4, 2017	2,800
LEHNER EDWARD J. Officer	Purchase at $9.78 per share.	Direct	38,533	May 4, 2017	3,940
RICHARDSON KEVIN D Officer	Purchase at $10.55 per share.	Direct	52,750	May 4, 2017	5,000
SILVER MARK S. Officer	Purchase at $10.31 per share.	Direct	30,930	May 4, 2017	3,000
SCHNAUFER ERICH S Officer	Purchase at $9.95 per share.	Direct	9,950	May 4, 2017	1,000

From InsiderInsights:

Ryerson is a 175 year old firm that processes and distributes industrial metals in the United States, Mexico, Canada, China, and Brazil, while also providing value-added processing and fabrication services.

For such a broad footprint, Ryerson remains a smallcap with a market cap of around $320 million. Consistent with that metric, the insider buying activity that brought RYI to our attention was smaller in dollar value, though broad and bullish in other important factors.

A group of seven insiders have been purchasing consistently since March of this year, at prices ranging from $9.01 to $11.05. All in this drawn-out buying cluster have very predictive track records with their past purchases, and all increased their holdings of RYI substantially with their buys over the past quarter.

The bulk of the insider buyers acted after Ryerson's Q1 EPS beat and constructive management guidance was met with a sell off in its shares.

The sell side has also stayed bullish on RYI despite the price action. Phil Gibbs, equity research analyst at KeyBanc Capital Markets, reiterated his Overweight rating on RYI with a $16.50 price target. Average EPS estimates for 2017 have risen from $1.28, to $1.49 over the past three months, which would represent 84% growth. For 2018, EPS is expected to rise another 16%. To $1.73.

But these average estimates are derived from wide ranges, and looking closer at Ryerson's bullish insider activity, it should be acknowledged that the excellent track records for its insiders are for the longer-term, with less accuracy 3 months and sooner after purchases are made. ...

And anyone following them and us into RYI had better have a longer-term time frame as well. In the very near-term, any wavering of domestic political will for infrastructure spending, or indications that global GDP growth isn't as robust as expected, could easily make us wish we had waited longer to increase our exposure to RYI, and the infrastructure/energy investment theme.