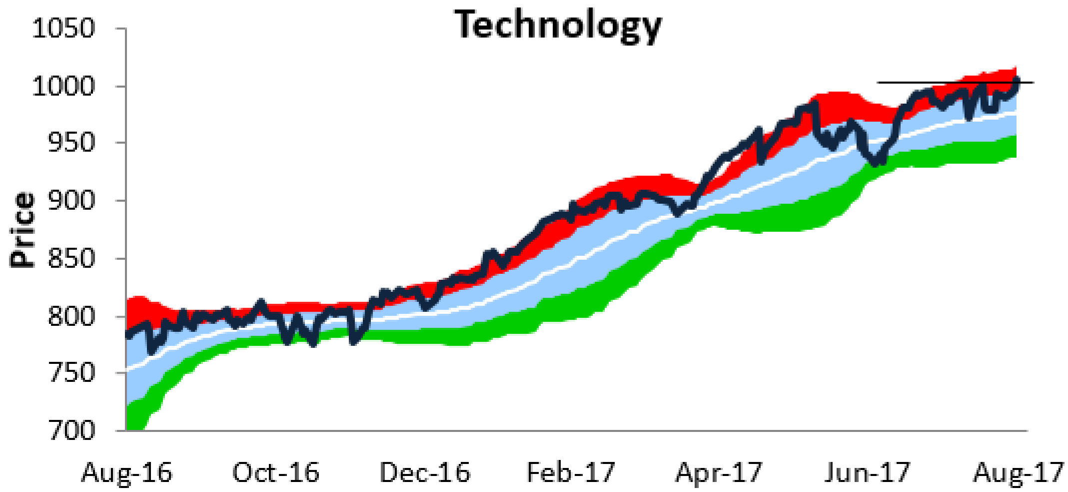
August 2017

While Harvey was the month's big story, the major stock indexes finished the month about where they began. As noted below, the Morgan Stanley Capital International All Country World Index All Cap (our preferred benchmark) was up .2%. Despite big drops on the 10th (-1.4%) and the 17th (-1.5%) the S&P 500 ended up .05%, while the Russell 2000 (Small Caps), down 5.3% at the month's low, finished down .8%. Beneath the surface, the Technology sector continued to lead, while the Energy sector, with just 25% of stocks above their 50-day moving average, lagged. Energy stocks followed the WTI price of oil lower as Harvey shut down Gulf Coast refineries. Individual stocks are also being impacted. With an estimated 300,000 to 1,000,000 cars destroyed, GM closed the month up 8% from its low, while HEES, an equipment rental company, was up 23% from its low. GM is held by most of our clients investing in individual stocks, while HEES is held by all of them.



Despite all the individual suffering, Harvey will boost GDP and likely diminish the political dysfunction in Washington. From Friday's Global Investment Strategy report:

"Nevertheless, at times like these, it is useful to fall back on our time-tested indicators. Bear markets have almost always coincided with economic recessions, with the latter usually causing the former (Chart 2). None of our recession-timing signals are flashing red ....

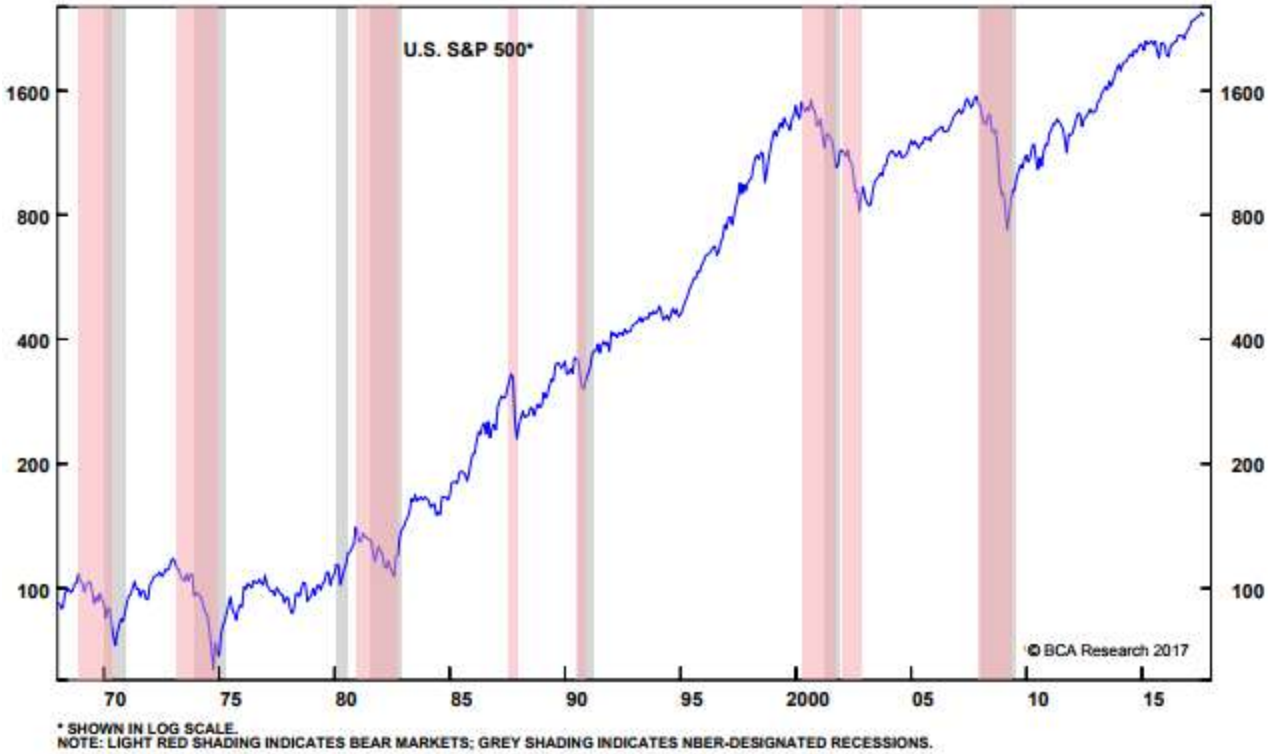
U.S. financial conditions have eased sharply this year, which should support growth over the next few quarters. A recent IMF report highlighted that easier U.S. financial conditions tend to generate positive spillovers onto other countries. The fact that all 45 countries monitored by the OECD are on track to grow this year – the first time this has happened since 2007 – is a testament to the strong fundamentals underpinning the global economy.

In this light, the Fed’s projection that the unemployment rate will end this year at 4.3% and only fall to 4.2% by end-2018 no longer looks credible. If U.S. GDP growth remains above trend, as we expect, the unemployment rate could fall below its 2000 low of 3.8% by next summer. That will be enough to prompt investors to price in a few more rate hikes. Considering that the market expects just 22 basis points in hikes through to end-2018, this is not a high bar to clear.

A bit more fiscal stimulus would add to the pressure to tighten monetary policy. While any meaningful progress on tax reform will be difficult to achieve, the odds are good that Congress will agree to cut statutory corporate and personal tax rates, with the latter focusing mainly on middle-income earners (we are doubtful).

Failure to raise the debt ceiling or extend federal spending authority beyond the current budget window could scuttle the benefits from lower tax rates. Fortunately, the risks of such an outcome have receded. If there is a silver lining from Hurricane Harvey, it is that the disaster could at least temporarily overcome the political

CHART 2
Recessions And Bear Markets Usually Overlap



impasse in Washington. Congress will need to appropriate additional disaster relief funds over the coming weeks. ... The odds of an infrastructure bill passing through Congress have also risen.

All recoveries eventually run out of steam, but this one can last at least until the second half of 2019, which will make it the longest U.S. expansion on record. As we discussed several weeks ago, the next recession is likely to be triggered by the Fed scrambling to hike rates in response to rising inflation. This is not an immediate concern, given that it usually takes a while for an overheated economy to generate inflation – especially since the U.S. currently can satisfy rising domestic demand with higher imports. However, the risks of overheating will increase as unemployment falls further and excess capacity elsewhere in the world is absorbed."

The unedited version of the following historical perspective can be found here: https://blog.thinknewfound.com/2017/02/anatomy-bull-market/

Anatomy of a Bull Market

BY JUSTIN SIBEARS ON FEBRUARY 13, 2017

Summary

- Long-term average stock returns smooth over the bull and bear markets that investors experience, and no two market cycles ever unfold the exact same way. Bull and bear markets can vary significantly in both duration and magnitude.
- But there are other characteristics of bull markets that can also differ in meaningful ways, such as velocity, sources of return, and investor experience.

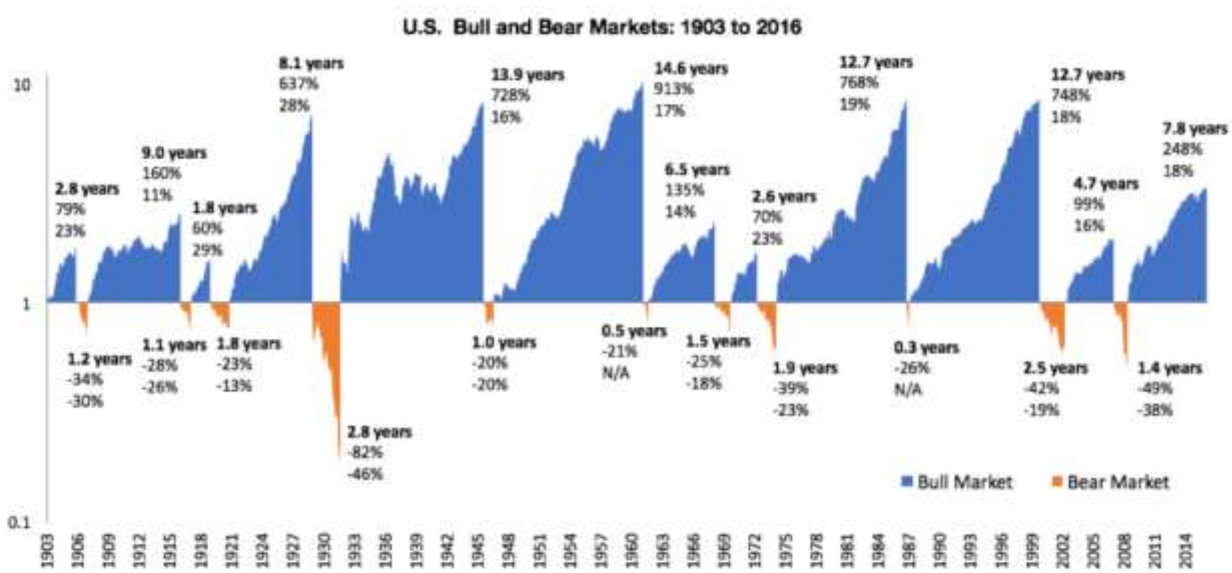
- When it comes to analyzing bull markets, inflation, interest rates, equity valuations, earnings, and dividends all play a part.
- Assessing the current economic environment in the context of historical U.S. and international bull markets can help set better expectations and reduce the risk of surprises that can lead to emotional decisions.

A few days back, we found this "[History of U.S. Bear & Bull Markets Since 1926]" one-pager from First Trust. In our opinion, the graph is a nice visualization of market expansions and contractions over the last 90 years.

We've recreated the graph below. There are some slight differences in what we show vs. the First Trust data since we use a different data source[1] and stick to monthly data. We also go back to the beginning of the first bull market of the 20th century.

Over the period from 1903 to 2016, there were 12 bull markets in the S&P 500. The average bull market lasted 8.1 years with a total return of 387%. The average bear market lasted 1.5 years with a total loss of 35%.

The current bull market, which began in March 2009, is the 7th longest and the 6th strongest. For it to be the longest ever, it would have to continue through the fourth quarter of 2023. For it to be the largest ever, the S&P would have to return another 665%.



Data Source: Robert Shiller's data library. Calculations by Newfound Research. Bull markets are defined from the lowest close reached after the market has fallen 20% or more to the next market high. Bear markets are defined from the last market high prior to the market closing down at least 20% to the lowest close after it's down 20% or more. Monthly data is used to make these calculations. ....

While this analysis is informative, it's still an incomplete picture of the anatomy of bull (and bear) markets. Below, we will examine this same data from three other perspectives:

Velocity: How fast do bull and bear markets unfold?

More often than not, market cycle analysis focuses on duration and magnitude. We can change the focus to velocity by graphing the annualized return experienced in each bull and bear market.

... *Returns are not annualized for market cycles that lasted less than one year. ....*

This snapshot highlights three important characteristics of the historical behavior of U.S. equity markets.

First, *we don't experience the average*. Over the 113+ year period we considered, the U.S. equity market returned an annualized 9.8%. Yet, the path of returns has been defined by thrilling bull markets and crushing bear markets.

Consider this: since 1903, *there has not been a market cycle with a single digit annualized return.*

Ten of the twelve bull markets had annualized gains greater than 15%. Similarly, annualized losses exceeded 15% in ten of the eleven bear markets.

Second, *bear markets typically unfold more rapidly than bull markets*. The average annualized returns for bull and bear markets are 19% and -25%, respectively.

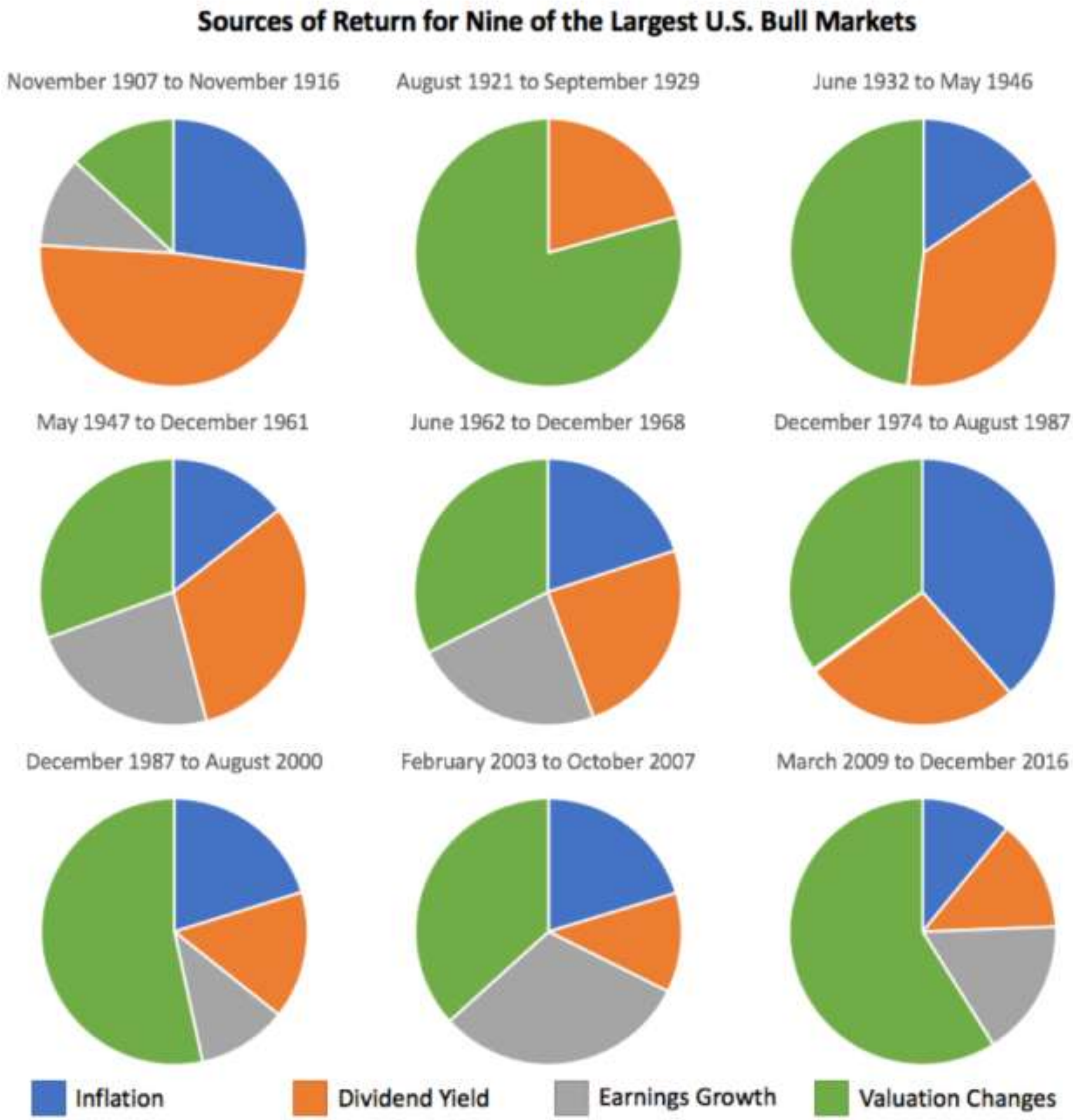
Third, *the current bull market is slow by historical standards*. It ranks 17th in velocity out of the 23 market cycles that we studied. This same phenomenon occurred in the bull market that followed the Great Depression, the only bear market that was more severe than the Financial Crisis.

Sources of Return: How much of a given bull market can be attributed to inflation? Dividend yield? Earnings growth? Valuation changes?

Equity returns can be decomposed into four components:

- Inflation
- Dividend Yield
- Earnings Growth
- Valuation Changes

Using this framework, it quickly becomes clear that not all bull markets are created equal.



For example, the bull market of the 70s and 80s was driven largely by inflation. On a nominal or pre-inflation basis, this was the second largest bull market of all time. On a real basis or post-inflation basis, however, it drops to just the fifth largest.

Both of the two most recent bull markets are unique in their own right.

The pre-global financial crisis bull market – lasting from February 2003 to October 2007 – had the largest share of return driven by earnings growth at just north of 30%. The current bull market is only the second instance of a large (greater than 100%) bull market where more than half the gains have come from expanding valuation multiples.

The contribution from valuation expansion *is larger than even the buildup of the tech bubble*.

Going beyond headline shock and awe, however, we recognize that classifying all valuation changes into a single bucket is probably painting with too broad of a brush. Valuations returning to normal after a market crash is not the same as valuations expanding from historical averages to all-time highs. We can address this by modifying the previous graphic. Specifically, we break the "Valuation Changes" category into two parts[2]:

- "Valuation Normalization": Valuations increasing from historically low levels to the long-term median.
- "Valuation Expansion": Valuations increasing from the long-term median to higher levels.

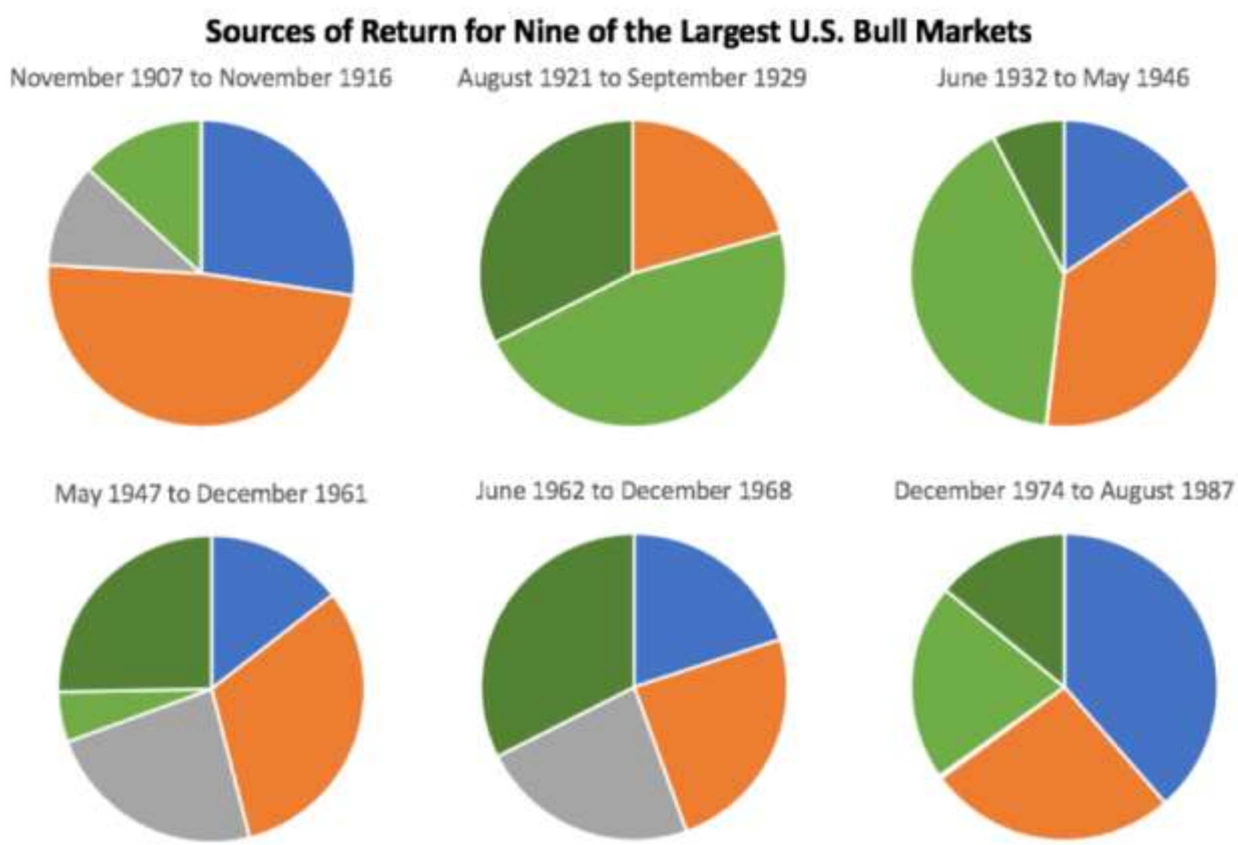
When all valuation changes are lumped together, the five most valuation-centric bull markets of the nine in the graphic are:

1. August 1921 to September 1929 (79%)
2. March 2009 to December 2016 (59%)
3. December 1987 to August 2000 (53%)
4. June 1932 to May 1946 (48%)
5. February 2003 to October 2007 (37%)

When we focus, however, on only "Valuation Expansion," the top five changes to:

1. December 1987 to August 2000 (43%)
2. February 2003 to October 2007 (37%)
3. June 1962 to December 1968 (32%)
4. August 1921 to September 1929 (32%)
5. March 2009 to December 2016 (27%)

When we ignore "Valuation Normalization," the current bull market drops from the 2nd most valuation-centric to the 5th most valuation-centric. The majority of the valuation gains in this cycle were the result of the recovery from the bottom of the financial crisis.



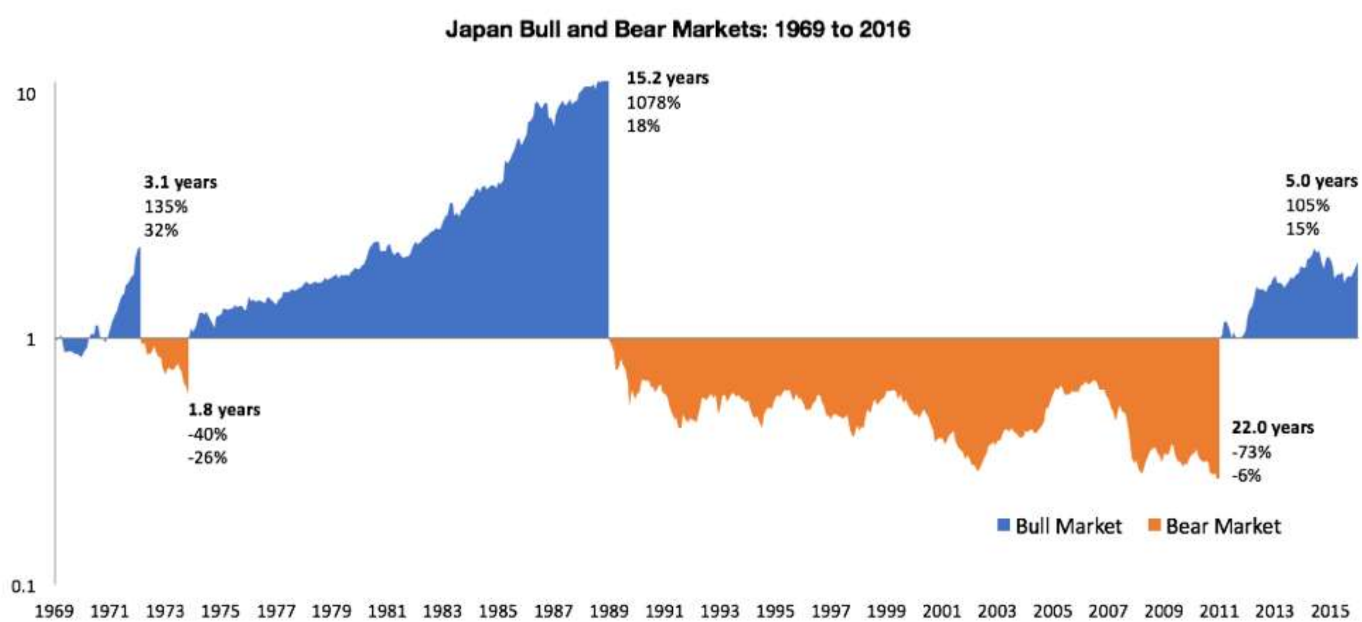
Context: How does the experience of bull and bear markets in the U.S. compare to other markets around the world?

In the following pages, we recreate the First Trust graph for Japan, the United Kingdom, Europe ex-UK, and Asia ex-Japan.

Looking beyond the United States can be a useful reminder that the future behavior of the S&P 500 is not constrained by past experiences.

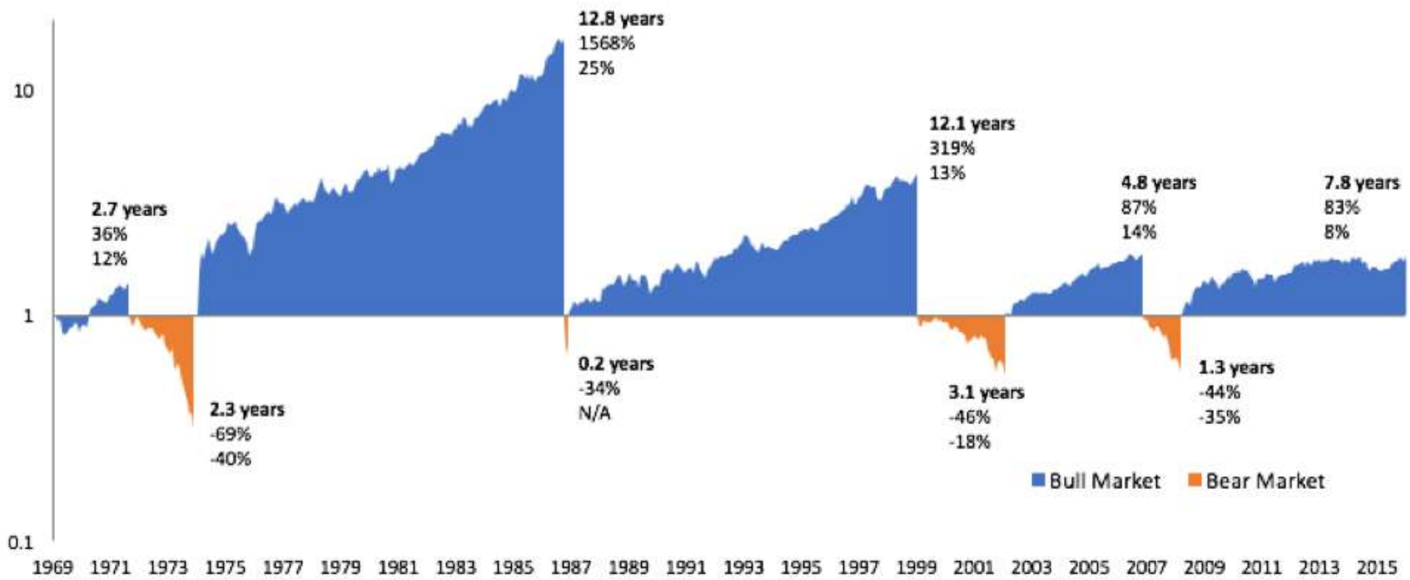
It's possible to have larger bull markets than what we have seen in the U.S., as evidenced by the 1970s and 1980s in Japan and the UK.

It's also possible for bear markets to drag on for years. The longest bear market in the U.S. since 1903 lasted slightly less than three years. Japan, on the other hand, saw a 20+ year bear market that lasted the entirety of the 1990s and 2000s.

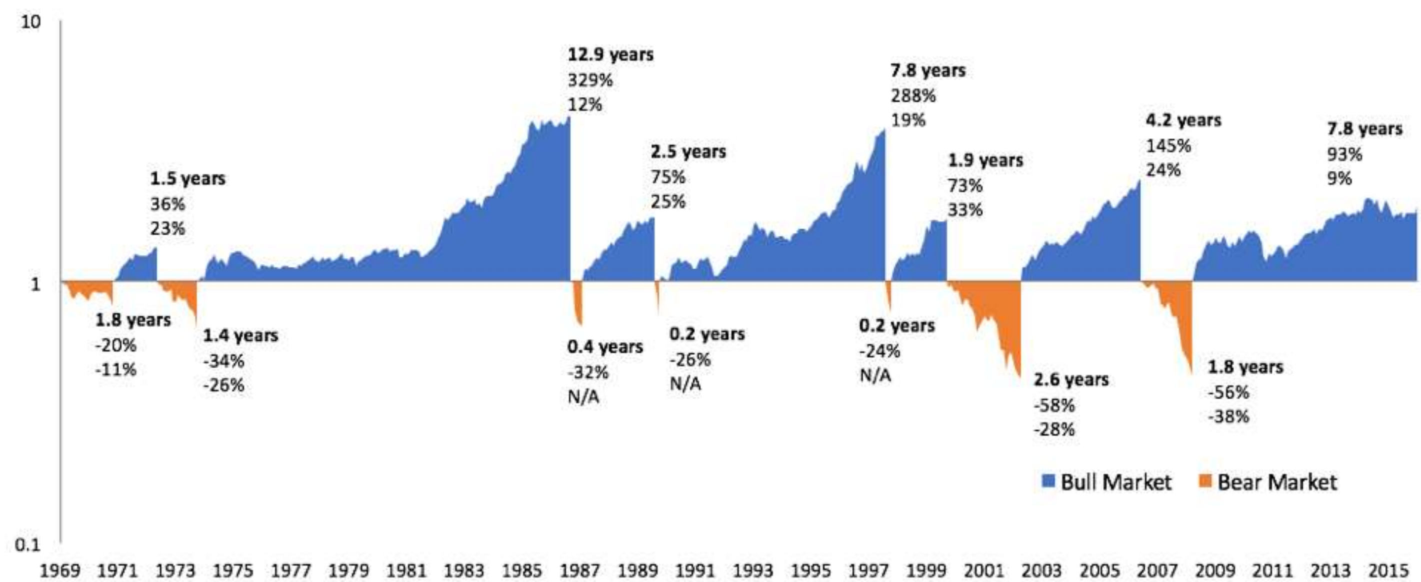


Data Source: MSCI. ...

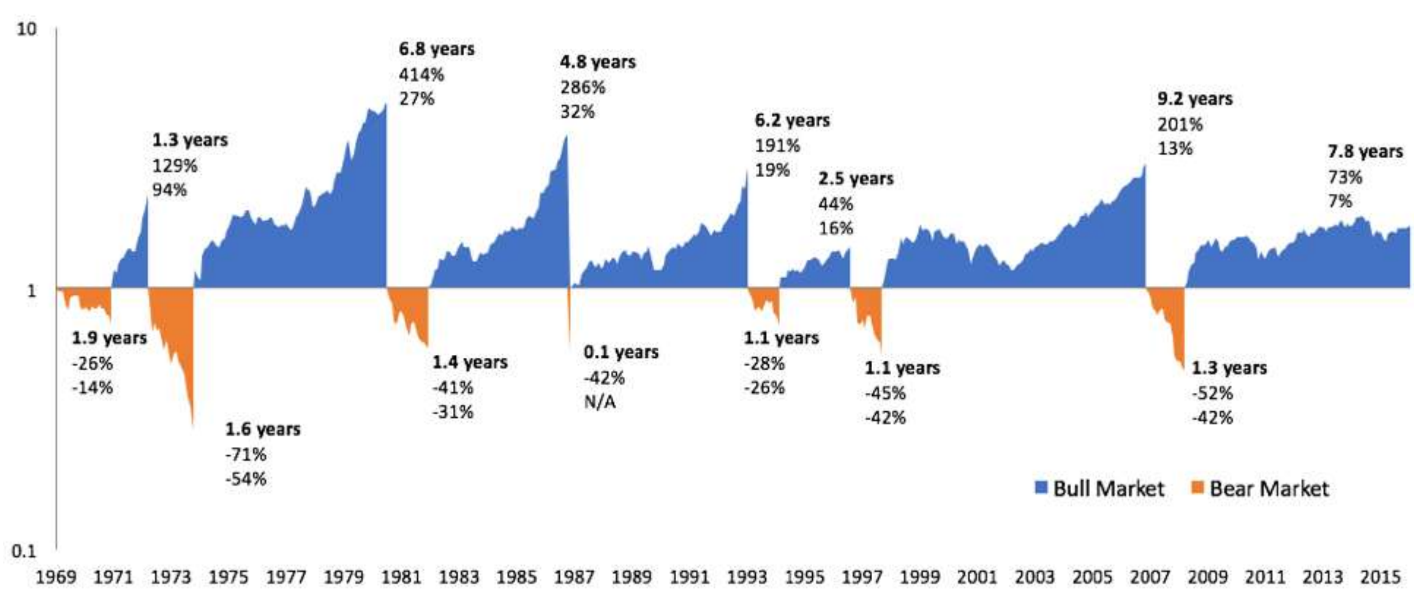
UK Bull and Bear Markets: 1969 to 2016



Europe Ex-UK Bull and Bear Markets: 1969 to 2016



Asia Ex-Japan Bull and Bear Markets: 1969 to 2016



Conclusion

While long-term average stock returns have been high, they smooth over the bull and bear markets that investors experience along the way.

These large directional swings have many characteristics that make them unique, including their durations and magnitudes. Velocity, and sources of return ... have also shown significant variation across market cycles.

This current bull market has been slow by historical standards and has largely been driven by normalization of equity valuations following the financial crisis. ...

[1] We use data from Robert Shiller's website. This data was used in Shiller's book, *Irrational Exuberance*. Shiller presents monthly data. Prior to January 2000, price data is the average of the S&P 500's (or a predecessor's) daily closes for that monthly.

[2] To avoid hindsight bias when calculating the historical median, we used rolling 50 year periods.

Positions

AMZA - With no midstream energy stocks currently having an Insider Buying signal, we bought a 2% position in this actively managed ETF that sells options for our newest client:

From The Dividend Hunter's August issue:

... as near as I can tell, I am the only analyst writing about AMZA that actually talks to the portfolio managers. I have ongoing communication with Jay Hatfield and Ed Ryan, who are the founders, corporate officers and managers of the fund. They will quickly answer any question I pose.

We also recently had Jay and Ed on a live online session for Dividend Hunter subscribers, where they discussed the fund and answered a large number of questions. I do not depend on stale, semi-annual financial reports to understand what is going on with the fund.

This is an important point. AMZA is an exchange-traded fund (ETF). It is a fund that owns a portfolio of securities and not a company that has business operations. As a fund, the securities owned can change every day and do so.

On our call, Jay noted that he spends the first part of everyday looking at options pricing to make the best trades to generate the option premium cash flow that makes up part of the dividend payment. AMZA is a fund that is growing its assets under management. This means new shares will be issued as investors put more money into the fund.

It has been noted that a lot of new money is coming in just before the ex-dividend dates. That is true and shares are being issued. The managers know that they need to pay dividends on the new shares, so they c set aside the cash to pay the dividend and invest the rest into the portfolio holdings. An investor who buys shares just before the ex-dividend is receiving true return of capital, but the fund is not selling assets to raise the cash.

Jay and Ed told us that the money to pay the current dividend comes about 50% from the distributions paid by the MLPs owned by the fund and the other half from sold option premiums. They noted the dividend is being covered by these cash sources. If the dividend was not being earned, the dividend would be reduced. It would not affect the share net asset value. There is no reason for the managers to pay destructive return of capital to maintain the dividend.

After two years of flat distribution payments from some of the larger MLPs, those distributions are again starting to grow. This means AMZA will need less options premium income to support the dividend. Put another way, every quarter it becomes easier for the AMZA managers to earn and cover the dividend. Growing distributions from the holdings will eventually lead to share price appreciation for AMZA. ...

APLE - A Hotel REIT for our newest client and 2 existing clients upon the sale of INN:

Latest Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
FOSHEIM JON A Director	Purchase at $17.94 per share.	Direct	17,940	Aug 13, 2017	1,000
KNIGHT GLADE M Officer	Purchase at $17.62 per share.	Direct	352,400	Aug 10, 2017	20,000
KNIGHT JUSTIN G Officer	Purchase at $17.62 per share.	Indirect	299,540	Aug 10, 2017	17,000
KNIGHT GLADE M Officer	Purchase at $17.62 per share.	Indirect	105,720	Aug 10, 2017	6,000

BBSI - released earnings on 8/9, falling 10.5% on heavy volume. No longer having analyst coverage, nor meeting our Insider Buying or Valuation criteria, we sold on 8/14 @ 52:

CCP merged with SBRA - on 8/17. Forbes Real Estate rates this Healthcare REIT a Hold with a Fair Value of 29.

HRZN - We lost our analyst for this BDC when Wunderlich Securities was bought in July. Our new BDC analyst doesn't recommend it, and without a current Insider Buying signal we decided to sell.

IMTM - For our newest client, we considered this the better of the 2 International ETFs we recommend for the Momentum Factor. We chose EFG (iShares MSCI EAFE Growth ETF, orange line) as the most appropriate benchmark.

INN - released earnings on 8/3, falling 9.4% on heavy volume. A 5.3% Negative Earnings Surprise, by 8/13 all 4 analysts that had updated their estimates decreased them for 3Q and 3 of the analysts also decreased estimates for 4Q. All 5 analysts on 8/13 with a Target Price updated since 8/3 had lowered it. We waited for the typical over-reaction bounce, which didn't occur, until 8/24 when we sold this Hotel REIT @ 14.621. The blue line is APLE, the Hotel REIT that we are now recommending.

LMRK - An Infrastructure REIT that we bought for our newest client on 8/9 @ 16.8312 and for another 2 clients on 8/11 @ 16.482:

Insider Buying:

Insider	Transaction	Type	Value	Date	Shares
BRAZY ARTHUR P JR Officer	Purchase at $15.88 per share.	Direct	111,160	May 22, 2017	7,000
DOYLE GEORGE P Officer	Purchase at $15.94 - $15.95 per share.	Indirect	64,000	May 21, 2017	4,000
AIM UNIVERSAL HOLDINGS, LLC Director	Acquisition (Non Open Market)	Indirect		Apr 27, 2017	221,729
DOYLE GEORGE P Officer	Purchase at $14.90 per share.	Indirect	44,700	Mar 9, 2017	3,000
DOYLE GEORGE P Officer	Purchase at $14.25 per share.	Direct	39,900	Mar 8, 2017	2,800
BRAZY ARTHUR P JR Officer	Purchase at $14.40 per share.	Direct	144,000	Mar 8, 2017	10,000

From Capitalist Times Aug. 17th issue:

The sub-leaser of land underneath wireless towers, renewable energy facilities and billboards raised its quarterly distribution by 0.25 cents per unit, the same rate of growth as previous quarter. Management also affirmed the exit quarter payout will be 10 percent higher than last year’s, as revenue increased by 69 percent and adjusted earnings by 72 percent in the second quarter. A change in legal structure, new strategic partnerships with Ericsson (NSDQ: ERIC) and Penteon Corp and $200 million in drop downs from the parent will drive second half growth. **Lock in the 8 percent plus yield by buying under 17.**

PSEC - Based on our new BDC analyst's (see HRZN above) recommendation we sold on 8/22 @ 7.2625, despite a current Insider Buying signal. PSEC missed 4Q analyst estimates and cut its dividend on 8/28, closing @ 6.7 on Friday:

MTUM for QMOM - for our only client holding QMOM, which returns to our Buy/Watch list. The 5* MTUM, with its lower Expenses (.15%) and better liquidity (3.77 bil Total Assets), is the orange line on the Morningstar chart below:

TGI - released earnings on 7/26, falling 18.0%, and an additional 8.6% on the 27th, both with heavy volume. A Negative Earnings Surprise of 71.9%, by 8/13 7 of the 9 analysts that had updated lowered their Target Price. We unsuccessfully attempted to sell on the initial bounce, but were able to sell on 8/27 @ 27.1192.

HCM's newest Client

While her Risk Capacity would allow for a Weighted Average Risk greater than **1.0**, given that she is new to

%	Symbol	Type	Description	Factors (1)	Yield	(2)	Risk (3)	(4)	Taxable	Trad. IRA	Roth IRA
					Initial						
20	QMNIX	OEF	Global Long/Short Equity Mid Blend	V, M, Q	1.5%	A	0	C	20.0%		
10	GFMRX	OEF	Global Real Estate		2.9%	Q	1.1	C		4.2%	5.8%
10	MTUM	ETF	Domestic Lg Growth	M	1.3%	Q	1.0	C	7.5%	2.5%	
26	IVE System & IBT (5)		Domestic	I, V, E		V	1.4			26.0%	
10	IVAL	ETF	Foreign Lg Value	V, Q	1.5%	V	1.3	C/T		10.0%	
10	IMTM	ETF	Foreign Lg Growth	M	2.4%	S	1.6	C/T		10.0%	
10	GPIIX	OEF	Foreign Small/Mid Growth	S, Q	0.5%	A	1.7	C/T		10.0%	
4	Cash						0	T		4.0%	
			Weighted Average:				**1.0**				
					Goal						
25	QMNIX	OEF	Global Long/Short Equity-Lg Blend	V, M, Q	1.5%	A	0		20.0%		
10	GFMRX	OEF	Global Real Estate		3.0%	Q	1.1			4.2%	5.8%
10	MTUM	ETF	Domestic Lg Growth	M	1.3%	Q	1.0		7.5%	2.5%	
40	IVE System & IBT (5)		Domestic	I, V, E		V	1.4			40.0%	
5	IVAL	ETF	Foreign Lg Value	V, Q	1.8%	V	1.3			5.0%	
5	IMTM	ETF	Foreign Lg Growth	M	2.4%	S	1.6			5.0%	
5	GPIIX	OEF	Foreign Small/Mid Growth	S, Q	0.5%	A	1.7			5.0%	
			Weighted Average:				**1.0**				
			Notes								
1	V=Value, M=Momentum, Q=Quality, I=Insiders, E=Earnings, S=Size										
2	Distribution Frequency: A=Annual, S=Semi-Annual, Q=Quarterly, M=Monthly, V=Varies										
3	Ratio of average historical Max. Drawdowns to S&P 500 declines greater than 10%										
4	Holdings: C=Core, T=Transitional										
5	IBT=Insider Buying Themes										

investing she was uncertain about her Risk Tolerance. We therefore decided to keep her **Risk**, as defined by maximum drawdown relative to the S&P 500, in line with that of the S&P 500. Our goal for clients focused on Capital Appreciation is usually a 40% allocation to individual stocks. Our current buy list gave us twelve 2% and two 1% positions. With Trend favoring Foreign stocks, we decided to increase her exposure to Foreign Funds which will be scaled back instead of investing in our usual Transitional Domestic Funds. We have also shown how her positions were allocated between her Taxable and IRA accounts.