Investment Commentary: 6/2017

U.S. stocks finished May in positive territory despite a mid-month selloff that marked their biggest fall since November's presidential election. The S&P 500 finished the month with a 1.41% gain, while small-cap stocks were down a little. ***European stocks continued to outpace the U.S. market with solid fundamentals and bullish investor sentiment helping to lead indexes higher.*** The MSCI EAFE index was up 3.81% for the month. Emerging-market stocks continued their strong performance with a 2.98% gain for the month, and now are up 17% year-to-date. Fixed-income markets were mostly calm as the Barclays Aggregate Bond Index was up 0.77%, while high-yield bonds did slightly better up 0.87%. Near-term the investment environment may continue to be favorable with modest economic growth, healthy earnings growth, low bond yields, a still accommodative Fed and a relatively soft dollar. ***The biggest short-term risks we see relate to political uncertainty, particularly in the United States.*** Longer-term the biggest risk for stocks is valuation.

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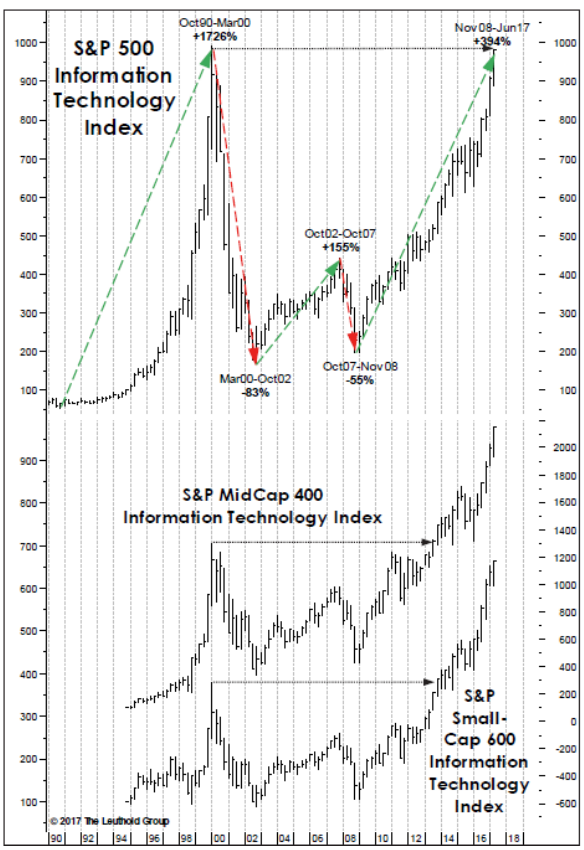
Sizing up the Technology Sector



The S&P 500 information Technology Index has rallied close to 400% from the 2009 bear market low. The rally has been spectacular and a key driver of the current bull market. It is also a good reminder of how insane the valuation for tech stocks had gotten back in the 1990's. The 400% rally in the S&P Tech Index has merely restored the index to where it peaked roughly 17 years ago on March 27, 2000. In other words, the return for tech stocks in the S&P 500 from March of 2000 has been basically 0.0%!

With the S&P 500 Tech Index reaching previous highs, it is natural for investors to ask if we are approaching the bubble levels of the 1990's. The table on the next page helps add some perspective, with the quick answer being, no, tech stocks do not appear to be currently in a bubble. In many regards, the tech sector today doesn't look much like it did back then. The table clearly shows revenue and net income have grown substantially the past 17 years, and although valuations are not cheap they are not nearly as high as they were back in 2000. ***The one statistic in the table that looks troubling is the price/sales ratio at 4.5x, a high level by any standard.***

Investment Commentary: 6/2017

Another concerning signal is how much money retail investors are pouring into the 'FAANG' stocks--Facebook, Apple, Amazon, Netflix and Google. It's estimated that retail investors own up to 70% of the shares of FAANG stocks, and the stock market size of these five companies has reached roughly $2.4 trillion, or about 13 percent of the size of the U.S. economy. In comparison, the combined earnings last year for the FAANG stocks were only $77 billion. ***No doubt these are great companies, and investors are clearly drawn to their fast growth in a slow-growth economy. However, there is a limit to how high these valuations can go before the bubble talk will start to ring true.***

S&P 500 Information Technology Sector: Then & Now

	March 27, 2000	June 5, 2017
Closing Index Price	**988.49**	**980.40**
Market Capitalization	**$3.841 Trillion**	**$5.789 Trillion**
Trailing 12-Mo. Sales	**$561 Billion**	**$1.288 Trillion**
Trailing 12-Mo. Net Income	**$55 Billion**	**$228 Billion**
Trailing P/E	**70.1x**	**25.4x**
Price/Sales	**6.8x**	**4.5x**
Trailing 12-Mo. Net Profit Margin	**9.8%**	**17.7%**

Hidden Fees and Half-Truths

In Tony Robbin's ***best-selling financial book, UNSHAKEABLE, there is a chapter titled "Hidden Fees and Half-Truths." The chapter describes at length some of the ways Wall Street 'fools' investors into overpaying for products that underperform.*** Having recently read the book, I couldn't help but think about this chapter as I read an article in Morningstar's Alternative Investment Observer titled, "The Worst Practice in Liquid Alternatives." The article focused on the poor disclosure around fees and portfolio holdings of some of the funds in the managed-futures category. The deceptive practices focus on managed-futures funds and how some of them are using total-return swaps to access the net-of-fee returns of commodity trading advisors (CTAs) that are running managed-futures hedge funds. By using a total-return swap, instead of investing directly in the hedge fund, the funds aren't required to disclose the cost of the swap or the CTAs management and performance fees in the fund's net expense ratio. This can be deceptive because if they were forced to include the additional fees in their disclosed costs, the increase could be dramatic. A couple of examples in the article showed that actual fees would almost double if they had disclose the cost of the swaps. There really doesn't appear to be any benefit to the end investor from using a fund with this type of structure, other than access to hedge funds with an additional layer of fees tacked on by the fund company. As Tony mentions in the book: financial firms aren't evil, rather many exist first and foremost to make money for themselves, and not necessarily for their clients. ***The best way to avoid being overcharged and deceptive practices is to work with fiduciaries that are not incentivized to sell you products, and avoid firms that push their own high-priced proprietary products. This applies to all areas of investing, not just the managed-futures category.***

'….financial firms aren't evil, rather many exist first and foremost to make money for themselves, and not necessarily for their clients'

--AWM Investment Team (6/17)