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Portfolio Comments
For the Quarter Ending June 30, 2017

Now strikes us as an opportune moment to once again contemplate the wisdom of the Sage of Omaha himself, Mr. Warren Buffett, who once remarked: "The stock market is a device for transferring money from the impatient to the patient." In market times, such as the present, when political news and the popularity of a limited number very large capitalization stocks are exerting unusually strong influences on headline performance numbers, taking a value-oriented approach can indeed require patience. But as the success of the most famous value investor of all time attests, Mr. Buffett knows a thing or two about market efficiency and investment returns for those who heed his advice.

The S&P 500 closed on June 30th at 2,423, representing a return of 3.09% for the second quarter, and 9.35% for the first six months of 2017. The Dow Jones Industrial Average (DJIA) ended June at 21,350 for a return of 3.95% in the past three months and 9.34% for the year to date. The overall U.S. equity markets continued their trend so far for 2017 by exhibiting choppy, but net upward, movement with the S&P 500 and the DJIA hitting multiple record closing highs with the most recent being 2,454 and 21,529 respectively on June 19^{th}.

Also continuing a predominant theme of late is the fact that aggregate numbers hardly tell the whole story. Broader market performance continues to be heavily influenced by the juggernaut-like advance of a small number of mega-stocks. Specifically, just ten companies account for around half of the entire S&P 500's rally year to date. For a market-weighted index this is not a new or surprising observation; a retroactive study of the S&P for the decade from 1994 to 2014 showed that the top ten stocks contributed 45% of the total gains. However, the phenomenon has been particularly acute of late with herds of investors following momentum and piling into household tech and internet-sector names, notably e-commerce behemoth **Amazon.Com, Inc. (AMZN-Nasdaq)**, social media giant **Facebook, Inc. (FB-Nasdaq)** and the world's largest company by market capitalization, **Apple Inc. (AAPL-Nasdaq)**.

At a macro level, this represents a swing away from the gainers that received a post U.S. Presidential election boost which saw industrials, banks and small-cap stocks rise on the back of pro-growth and reduced regulation policies expounded by the new Republican administration.

However, as the promised reforms have become mired in the practicalities of enactment, as well as encountered legal hurdles and contentious debate, investors' enthusiasm for stocks that would benefit most from accelerated economic growth has waned somewhat. Instead, the market has reverted to supporting well-known large caps that are seen as having greater prospects of delivering revenue expansion even in slower-growth periods. This popularity pervades oftentimes regardless of steep valuations based on earnings prospects and is exacerbated by index-tracking funds that assign investment dollars based on market capitalization, further boosting demand for the largest stocks.

The presidency of Donald Trump continues to provide politicians, lawmakers, foreign leaders, the press, and the markets a lot to focus on. A perceived partial victory for Mr. Trump and his agenda was achieved at the end of May when the Supreme Court weighed in on the President's executive order restricting travel from six Muslim-majority countries that began with his overturned directive in January and the continued blocking of his revised proposal at the beginning of March. The Court temporarily endorsed a partial implementation of the travel policy, lifting lower federal courts prior injunctions, and agreed to hear oral arguments surrounding the case when the Courts reconvenes in October following its summer recess. There is, however, an expectation that in the interim period political parties are being given sufficient time to agree on immigration vetting procedures. In practical terms, for 90 days, the ban goes into effect but does not apply to nationals from the cited countries that have a relative or business interest in the U.S. or other "bona fide" relationship here.

As the first half of the year comes to a close, wrangling over the repeal of the Obama administration's Affordable Care Act continues. The House of Representatives passed the American Healthcare Act in early May fully braced for moderate Senate Republicans to rewrite substantial swathes of it. It was expected that first up for challenge would be the House's unwinding of the expansion of Medicaid (health insurance for those with lowest incomes). Somewhat surprisingly, the Senate's Better Care Resolution Act (BCRA) proposes deeper Medicaid cuts with the proviso that they take effect two years later, in 2021, than under the House plan. Larger divergences emerged surrounding subsidies for individuals who purchase their own healthcare, with the House proposing an age-linked system, and the BCRA's subsidies determined by income, as under Obamacare. Under the income model, the poorest would likely still be able to buy insurance although the level of coverage offered to this population segment would likely involve higher out-of-pocket expenses when accessed. Both the House and the Senate's Acts allow states to deregulate insurance and determine which treatments must be covered, and although the BCRA attempts to limit pecuniary discrimination against those with pre-existing conditions, there is concern that insurers could simply refuse to cover expensive treatments under deregulation.

In a blow to what was touted as a cornerstone of President Trump's campaign promises, the Republican leader, Senator Mitch McConnell then announced on June 27th that he was delaying the vote on the healthcare Act that was due to begin debate on the Senate floor the next day. Entrenchment from both sides of the Republican Party – both staunch and moderate conservatives – meant the votes to get the legislation passed were far from a sure thing. Broadly, the most conservative-minded are pushing for wider deregulation, while Senators who are more protective of Medicaid remain concerned, bolstered by the release of a Congressional Budget Office evaluation which postulated that the Senate bill would result in 22 million more uninsured after 10 years, while making out-of-pocket expenses for the poor, as well as the old, unmanageable. As the debate rages on, some insurers are already hiking proposed premiums and blaming the mixed signals and lack of clarity.

In addition to wanting to make concrete progress on substantial mandates, Mr. Trump and his administration continues to contend with accusations and investigations that are making headlines and contributing to market jitters. Specifically, the President has been unable to put to bed allegations that his campaign was in collusion with Russia and that the Kremlin attempted to interfere with the 2016 election. Both sides deny the accusations. Secondly, controversy has emerged following Donald Trump's May 9th firing of James Comey as FBI director. In the wake of his dismissal, Mr. Comey has testified before the Senate Intelligence Committee that the President had come to him to request his loyalty and ask that the FBI back off investigating Mike Flynn, the former national security adviser. Mr. Flynn had resigned in February, after less than a month on the job, after it was revealed that he had misled top White House officials about his conversations with the Russian ambassador to the U.S. Such a request by Mr. Trump to Comey could be construed as an attempt to obstruct justice, although the President vehemently refutes Comey's accounts of the substance of their conversations.

At the corporate economic level, data continues to be positive for the aggregate market with Raymond James estimating a growth rate for the S&P 500 of 6.5% for the second quarter of 2017 compared to the same period last year. Leading the pack for growth is expected to be the energy sector on the back of weak comparable earnings a year ago. Ex-energy, earnings are expected to grow 3.6%. Oil itself is down, with crude prices off around 20% from the start of the year, a fact that has negatively impacted most energy stocks. Often, such as during the most recent prolonged dip in the second half of 2015, dropping oil is construed as a bearish indictor for markets and the global economy. This time crude pricing weakness has had little impact on the rise of the U.S. equity markets since the underlying cause is different. In 2015 there was fear of softening global demand, particularly from the Chinese economy, whereas the issue now is one of excess supply.

Despite the agreement among the members of the Organization of the Petroleum Exporting Countries (OPEC) to cut production we have seen increased output in a number of countries worldwide combined with a revival in U.S. fracking activities. Cheap oil, as a result of overabundance in a robust economy, translates to more disposable spending, which can be a boost for equities, and also exerts a downward pressure on inflation, which is likely contributing to lower Treasury bond yields with the ten-year yield currently at 2.2%.

At the June 14th meeting of the Federal Open Market Committee (FOMC), the U.S. Central Bank increased the federal funds rate by 0.25% to a target range of 1.0%-1.25%, the third rise in six months. This came as little surprise. Fed officials left their GDP growth forecasts largely unchanged – currently 2.2% for 2017 – and Fed Chair Janet Yellen downplayed low inflation numbers and some recent soft economic data. May unemployment numbers, at 4.3%, were the lowest since 2001, although wage growth has not accelerated in conjunction with the tightening labor market. Industrial production and retail spending have also been somewhat weak of late. With President Trump's infrastructure spending and tax proposals unlikely to come to fruition at a rate that will have much impact on the economy this year, the Fed is under no pressure to accelerate the pace of rate hikes. An element of uncertainty surrounding Central Bank policy nonetheless exists in light of the fact that there are currently three vacancies on the Fed's Board of Governors, and Ms. Yellen's term as Chair expires next February.

Over in Europe, politics have also dominated the news with two major election results. On May 7th, the pro-EU centrist Emmanuel Macron was voted in as France's youngest President at 39, in a 66% to 34% victory over his far-right Front National opponent Marine Le Pen. His win was hailed by many as a sign of reversal of the tide of populism that saw the U.K vote to leave the E.U. and Donald Trump's win in the U.S. In the wake of his victory, Mr. Macron pledged to defend Europe and unite a divided France. While his margin was robust, the 11 million votes secured by Ms. Le Pen still represented an unprecedented high for the French far right, with their anti-E.U. and anti-immigration agenda. That faction isn't going to disappear and, additionally, almost a third of voters abstained in the lowest turnout in 40 years. Macron, the former economy minister who has never held an elected office, will have his work cut out for him as he attempts to warm skeptics and opponents to his agenda, address the risk of more terrorist attacks, and revive a stagnant economy weighed down by persistent unemployment. The decisive June victory for his party La République En Marche! In France's National Assembly parliamentary elections should remove some obstacles in governing, although with less than half of voters turning out, the story is still one of a nation divided.

Across the English Channel, there was less exuberance surrounding the win for the incumbent Conservative Party after Prime Minister Theresa May earlier this year called a snap general election that took place on June 8th. The impetus for bringing the vote forward from its scheduled 2020 date was for the Conservatives to try to consolidate their majority and strengthen their hand at home when it came to taking a hard line with Brexit negotiations. Things did not go as planned for Ms. May in a result which saw the Conservatives win the most seats by party, but lose their majority and see the opposition Labor Party make close to a 10% gain. British politics have been effectively reduced to a two-party system with poor showings by centrists. The election timing did not favor the existing government as campaigns were interrupted by two major terrorist attacks in London and Manchester, bringing national security to the fore. Ultimately, the Prime Minister was forced to form a minority Conservative government with pledged support from the 10 seats of the Democratic Unionist Party. It will be a tough road ahead with the path to Brexit more obscured than ever.

Going back to the opening quote from Mr. Buffett, it would seem that patience, in many respects, is a virtue needed as much as ever. We hold faith that markets are efficient over the long term and that value, when correctly identified, is ultimately recognized. We thank you, as always, for the trust placed in us and hope you and your families are enjoying these beautiful summer months whether at home or on travels!

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