

STOLPER ASSET MANAGEMENT

1924 S. UTICA, SUITE 805
TULSA, OK 74104-6516

www.stolperassetmanagement.com

918.745.6060

866.692.3066 Toll Free

918.745.6583 Fax

Stolper Asset Management

An Independent Registered Investment Adviser

Portfolio Comments For the Quarter Ending September 30, 2018

To the consternation of some, the U.S. equity markets are doing just fine. More than fine in fact; they have been breaking record highs this past quarter. As the American novelist James Branch Cabell once wryly observed: “The optimist proclaims that we live in the best of all possible worlds; and the pessimist fears this is true.” Hence, while fears abound in headlines proclaiming “Trade War”, “Midterms”, “Russian Collusion”, “Fed Tightening”, “European Crises” and such, the secular bull market for U.S. stocks resumed its ascent after a sideways pause in the middle part of the year, with positive earnings momentum emerging as the biggest driver.

The S&P 500 closed on September 28th at 2,914 representing a positive return of 7.71% for the third quarter, and 10.57% for the first nine months of 2018. The DJIA ended September at 26,458 for a return of 9.63% in the past three months and 8.83% for the year to date. Both indices breached record closing highs previously set in January of this year with the latest highs of 2,931 and 26,743 set in the second half of September for the S&P and DJIA respectively. Notwithstanding some intermittent rocky patches, the bull market has now been going strong for nine years.

The most constant economic headwind faced by U.S. corporations and markets of late is the escalating trade war between America and China, although investors have not shown enough concern, so far, to discount the U.S. equity market as a whole. Another wave of tariffs on Chinese imports was announced by President Donald Trump on September 17th that affect an estimated \$190 billion of imported products annually that will be subject to 10% duties (rising to 25% on January 1st in the absence of an alternative agreement being brokered). Beijing immediately promised to retaliate with duties on \$60 billion of American imports.

The bulk of these latest rounds of tariffs are being levied on intermediate and capital goods, which means the immediate pain will be felt by domestic manufacturing businesses in the form of increased costs of production. Ultimately, albeit with a delay, such costs will be passed onto the consumer, although according to research by Goldman Sachs, these particular tariffs would boost inflation by less than 0.1 percentage points even at the 25% imposed level.

Stolper Asset Management is a Registered Investment Adviser that offers investment advisory services to private and institutional clients.

Stolper Asset Management is not a registered broker/dealer and is independent of Raymond James Financial Services, Inc., member FINRA / SIPC. Securities offered through Raymond James Financial Services, Inc. Investment advisory services offered through Stolper Asset Management.

In such a climate, the story behind the recent Wall Street Journal article titled: “Meet the Bear-Market Stocks Hiding in S&P 500’s Record Run” becomes more self-evident. The article goes on to elaborate that an unsettling international trade environment has led to the exclusion of dozens of member stocks from participation in the benchmark index’s gains this year. Major materials and industrials companies have fared particularly poorly, some falling during the quarter up to a third from their 52-week highs, hit by sudden increases in the prices of engines and other components, coupled with having to contend with tariffs on imported steel and aluminum.

Despite the price performance malaise of such sectors, investors continue to bet on the anticipated rise of a handful of giant technology companies. According to the S&P Dow Jones Indices, shares of **Amazon.com Inc. (AMZN-Nasdaq)** and **Apple Inc. (AAPL-Nasdaq)** account for close to 30% of the S&P 500’s year-to-date rise. Sounding a cautionary note, if the trade spats escalate unabated, Apple’s manufacturing in China could face issues, and costs of the vast number of Chinese goods selling on Amazon could jump, affecting their e-commerce model. On a side note, both of these companies eclipsed the magical \$1 trillion in market capitalization over the summer.

Stock prices, as we know, only tell a partial story and we remain greatly more interested in identifying underlying value that will, in the long run, be recognized. Overall, with all the numbers in, the U.S. corporate landscape looked robust for the first half of 2018, with the S&P 500 members delivering an overall 5% “positive surprise” (percentage above analyst expectations) in earnings. Of the eleven constituent sectors, Utilities and Consumer Discretionary posted the largest earnings surprises at 8.7% and 8% respectively, with only the Energy sector below

zero with a -7.8% earnings surprise. However, the second half of the year may prove better for big oil with Brent Crude, the global benchmark, breaching the \$80/barrel level toward the end of September on the back of news that members of OPEC (Organization of Petroleum Exporting Countries), as well as major non-members, have no plans to ramp up production to offset the reduction in supply resulting from U.S. sanctions on Iran going into effect November 4th.

As a testament to boardroom confidence in many industries, a significant number of American companies have forged ahead with major acquisitions, spurred on by still-cheap debt, record share prices and – especially in the case of cross-border buys – the strong dollar. According to Thomson Reuters, global mergers and acquisitions so far in 2018 are close to \$3.25 trillion, representing a rise of 40% over the same period last year and on pace to beat 2007’s record. Almost 45% of this year’s figure is attributable to mega deals of \$5 billion or more. The message appears to be that many CEO’s of multinational conglomerates have faith that the global political landscape will not ultimately derail.

The quickened pace of deal closings also reflects the reality that domestic interest rates are on the up. True to expectations, the Fed raised its target rate a quarter of a percent to a range of 2% to 2.25% at the conclusion of its meeting on September 26th, the third rise this year and pushing the rate to where it was more than ten years ago. Another increase in December is widely anticipated and considered warranted by many given the economic stimulus produced by the tax cuts of President Trump’s administration. Even before Wednesday’s announcement, the 10-year Treasury yield had inched back above the 3% barrier, close to a 7-year high. In making the announcement, Fed Chair Jerome Powell sounded a particularly optimistic note, stating

“Economic activity has been rising at a strong rate,” going on to say that job growth, growth of household spending and business investment, were also robust.

As we head into the final quarter of 2018, there is mounting anticipation surrounding the outcome of the upcoming U.S. midterm elections. The Democrats harbor hopes of retaking the majority in the Senate although, despite the President’s approval rating dropping below 40% according to recent major polls, the party has its work cut out. A third of the Senate is elected every two years with each Senator serving six years, and to achieve their desired outcome, Democrats need a net gain of two seats. As the numbers fall this round, they are defending twenty-six seats (including those of two independents that side with them), compared to nine on the line for the Republicans. Tennessee, Arizona, and Nevada have been touted as the Democrats’ best hopes for gains, and in Texas Beto O’Rourke is giving Republican Ted Cruz a tighter-than-expected race. Arguably, the bigger task lies in keeping what they already have in certain states, especially in the case of those that voted in favor of Donald Trump in 2016.

Another political outcome hanging in the balance is the confirmation of Judge Brett Kavanaugh as the President’ Supreme Court pick. If passed, the nomination would swing the Court significantly to the right given that the retiring Associate Justice Anthony Kennedy, although appointed by Republican President Reagan, received bipartisan support and proved the crucial swing vote on a number of ideological issues. At this time, Judge Kavanaugh’s position is uncertain in the wake of accusations surrounding his past private conduct, although he staunchly denies any wrong doing.

Over in Europe, many of the same themes from earlier in the year continue. Teresa May, British Prime Minister, continues to struggle to negotiate her way out of a Brexit near-impasse. Her hopes were dashed on September 20th when the president of the European Council, Donald Tusk, firmly rejected the U.K. premier’s latest overture which essentially proposed that Britain remain in the single European market for goods but not services. Mr. Tusk said this would undermine the whole concept of the single market. A further significant sticking point is how to handle border issues between Ireland (a continuing E.U. member) and Northern Ireland (part of the U.K.).

Time is running out before the October summit to reach an exit agreement, and neither of the two precedents in existence – Norway’s free-trade for free movement of people solution, nor Canada’s looser free-trade arrangement – are overwhelmingly palatable or will please Mrs. May’s detractors. The first would make the U.K. beholden to E.U. rules without any voting say, and the second makes it difficult to avoid a hard Irish border. There are those pushing for a second referendum, either on the terms of Britain’s exit, or on the whole question of whether the original exit vote should be re-evaluated. Others are calling for a general election as a means to replace the negotiator-in-charge. After a year-and-a-half of talks, the only thing that is certain is there is more negotiating to do.

Investors continue to keep a close eye on Turkey, whose economy is teetering on the edge of recession. The country’s lira has shed more than 40% of its value against the dollar since the start of the year, putting enormous strain on banks and Turkish corporations with dollar-denominated debt. Mid-September, Turkey’s central bank hiked its interest rates by a massive 6.25% causing a currency rally that proved short-lived. Inflation is close to 18% and foreign investment has dried up. Turkey’s government, led by the

Stolper Asset Management is not a registered broker/dealer and is independent of Raymond James Financial Services, Inc., member FINRA / SIPC. Securities offered through Raymond James Financial Services, Inc. Investment advisory services offered through Stolper Asset Management.

Stolper Asset Management

An Independent Registered Investment Adviser

uncompromising figure of Mr. Erdogan with his less-than stellar authoritarian and human rights records, is on shaky ground with major world powers but may have the best hopes of rapprochement with Germany. For her part, Chancellor Angela Merkel points out that economic implosion in Turkey isn't in anyone's interests, and Mr. Erdogan has the bargaining power of his country being the line of defense preventing hundreds of thousands of Syrian refugees flooding into the E.U. A free bail-out is unlikely and Mr. Erdogan isn't known for reasonable negotiation, but one hopes a constructive way forward emerges.

Although not in full-on crisis mode, Italy's economy also, continues to be decidedly fragile. Tensions are rife between the country and the E.U. over the handling of migrants pouring in from North Africa. Italy's public debt-to-GDP ratio already stands at a massive 130%, and with the budget deficit forecast to grow, investors are becoming increasingly nervous about the country's ability to meet its obligations. A Machiavellian interpretation of this mounting

fiscal crisis being exacerbated by Italy's leaders' decisions is that there is an ultimate plot afoot to extricate the country from the single currency or the E.U. entirely, blaming the bloc's lack of support rather than their own spendthrift ways.

In conclusion, the U.S. equity markets as a whole have proved resilient to a somewhat turbulent international economic and political landscapes, although not all sectors have fared equally. From our perspective, disparity can equate to opportunity as certain stocks or whole industries fall out of favor causing undervaluation compared to their true or intrinsic value. We continue to diligently research and seek! It's hard to believe we are heading into the final quarter of the year already, but as we enjoy the changing season, and look for further opportunities to help you successfully meet your financial goals, we thank you, as always, for the trust you place in us as your adviser.

The S&P 500 is an unmanaged index of 500 widely held companies and over 80% of the U.S. equities market. The Dow Jones Industrial Average (DJIA), commonly known as "The Dow", is an index representing 30 companies maintained and reviewed by the editors of the Wall Street Journal. The information contained in this report does not purport to be a complete description of the securities, markets or developments referred to in this material. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Any opinions are those of the investment adviser representatives of Stolper Asset Management and not necessarily those of RJFS or Raymond James. Expressions of opinion are as of this date and are subject to change without notice. Investing involves risk and you can lose principal. There is no assurance any strategy will be successful. There is no guarantee that any forecasts made will come to pass. Past performance may not be indicative of future results. This information is not intended as a solicitation or an offer to buy or sell any security referred to herein. Dividends are not guaranteed and must be authorized by the company's board of directors.

Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Raymond James Financial Services, Inc., its affiliates, officers, directors or branch offices may in the normal course of business have a position in any securities mentioned in this report. Raymond James & Associates, has performed due diligence and provides research coverage on Amazon.com and Apple, Inc. Please consult your Raymond James financial advisor for a copy of the most recent report. Raymond James & Associates, Inc., Member New York Stock Exchange, an affiliate of Raymond James Financial Services, Inc., makes a market in AMZN and AAPL. Closing stock prices as of 09/30/18 are: AMZN (\$2003.00) and AAPL (\$225.74).