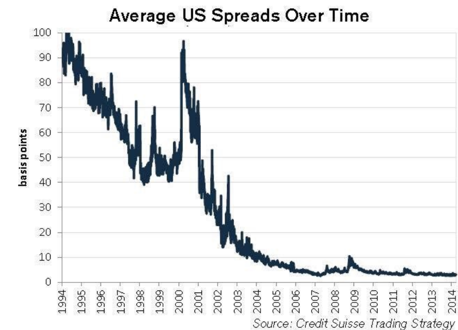
Stonebridge Market Wrap

July 7, 2017

For the week ending July 7, 2017

Second Quarter earnings reports kick off next week. Pepsico and Yum start off on Tuesday and JPMorgan and Wells end the week on Friday. This market has elevated itself this year on a combination of hope and some better than expected earnings and to a certain respect, better economic news. Next week, we will begin putting all of that to another test.

What ever happened to stock splits? 2016 had the lowest level of splits (7) of any year on record. With the proliferation of stocks trading over $100 per share, not to mention over $1,000 which, in the past, would have triggered a split, today there is no action taken. Why? Splits mainly cater to individual investors because splits make their shares cheaper. Today, there is a distinct move toward professionally managed money and ETFs where the price per share makes little difference. Institutions also pay commissions based on the number of shares traded so splits increase their cost of trading. High prices also deter the day traders and high frequency traders. In a 1984 letter to shareholders Warren Buffet also supported higher stock prices as they tend to make shareholders think like owners and also make them look to the long-term. Maybe that is why Berkshire Hathaway is $257,000 per share. There is also some CEO ego involved. Some CEOs view very high stock prices as reflective of their good management. With all of that, I do not expect to see an upsurge in splits anytime soon. In the old days splits could act as a force multiplier leading to great wealth creation. One of the best examples of this was in an article I wrote a year ago profiling McDonalds. If you had bought 100 shares when they went public for $2,200, you would now have 74,358 shares worth $11,575,000. Pretty good.



David A. Eckenrode
Director of Equity Management

Key Economic Releases for the coming week:

Thursday, July 13th:
- PPI; (.1%) expected
- Core PPI; .2% expected

Friday, July 14th:
- CPI; .1% expected
- Core CPI; .2% expected
- Retail Sales; .2% expected
- Capacity Utilization; 76.7% expected
- Industrial Production; .3% expected

Index & Price Changes for week ending 7/7/17	
DJIA– 21,414.34	Rose 64.71 points
NASDAQ– 6153.08	Fell 112.17 points
S&P 500– 2425.18	Rose 1.77 points
S&P Small Cap 600– 854.73	Fell 1.12 points
90 Day T Bill– 1.03%	Yield Rose .02%
2 yr TSY– 1.40%	Yield Rose .03%
5 yr TSY– 1.96%	Yield Rose .10%
10 yr TSY– 2.39%	Yield Rose 11%
30 yr TSY– 2.93%	Yield Rose .10%
Oil- $ 44.24*	Fell $1.88 per barrel
Gold- $ 1242.20*	Fell $14.60 per oz.
Unleaded Gasoline*-$1.50	Fell $.01 per gallon
Euro- $ 1.1404	Rose $.0016 against the $

* Wholesale price for NY Mercantile Exchange traded contract

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Equity Markets – Mid Year Review

The equity markets have provided a variety of returns during the first half of 2017. Outlined below are the "year to date" returns for specific indices, with noticeable differences for certain sectors of the market:

Index	Year to Date Return
Dow Jones Industrial Avg.	8%
Standard & Poor's 500	8%
U.S. Large Growth	15%
U.S. Large Value	3%

Year to date return as of July 7, 2017 | Sources for returns; The Wall Street Journal and Morningstar

We stated at year end 2016 that the market is in the latter stages of a bull. During this stage, the selection of companies by investors will narrow and we will experience faster rotation in and out of sectors and styles of management. The returns in the chart above demonstrate rotation and the narrowing of companies having improved valuations. The narrowing of companies benefitting from investor focus include technology, healthcare and select consumer discretionary. The companies with growing revenues and growing earnings in these sectors, up 15% to 25% year to date, include: Amazon, Apple, FaceBook, Nvidia, Alphabet (Google), Lab Corp of America and Thermo Fisher. The key to their success in attracting investors has been these companies 'ability to demonstrate solid growth of revenues and earnings. Investors have redirected their focus on "growth" as opposed to 2016 when investors focused on "value" or dividend income stocks. In 2016, the "value" stocks had 15% to 18% returns while growth showed 3% to 6% returns. Why the change in attitude by investors from 2016 to 2017?

- Investors recognize that over the past few years most companies have cut costs about as much as they can to produce improved net earnings. The next step in this cycle for companies to have improved earnings is they must have strategies to increase revenues. Earnings matter to investors so, companies will have to improve revenues to accomplish growing earnings.
- You may recall last year from January to March we experienced a drop in interest rates. The 10 Year U.S. Treasury dropped in yield from 2.0% to 1.6%. Yield hungry investors sought out companies with dividend yields of 3% to 5%, driving the prices of these stocks up.
- This year, interest rates have turned the other way. The 10 Year U.S. has increased in yield from roughly 2% to 2.4%. This may not seem like much of an increase but enough to slow down investor interest in traditional dividend paying "value" stocks like energy, telecom, utilities, REIT's, etc. Companies in these sectors tend to have much slower growth in revenues, thus less likely to have improved earnings.

It is likely that investors will continue to focus on companies they believe will be able to sustain and grow revenues to deliver growth in earnings. Our approach to a narrowing of select stocks and rotation from one sector to another is to take gains on companies that have run up in price and are unlikely to attain earnings expectations.

Focus on companies in industries that are likely to deliver growth in revenues in the latter stages of a market cycle such as: Healthcare, Technology, Finance (Banking), select Consumer Discretionary and Business Services. For clients seeking companies offering dividend yield, we prefer companies that have a history of growth in earnings and increases in dividend payout delivering growing dividend payouts.

We believe the equity markets have more room to run and continue to view that stocks in quality companies offer the best investment value over other investment vehicles. We are also well aware that the latter stages of a bull market must be approached with a slightly different strategy. If you have questions about what strategy best fits your investment objectives and goals at this stage in the cycle, please contact us.

Robert A. Kincade
President & Portfolio Manager