OLIVAR & ASSOCIATES

The Value Investor Note

Insights & Think Pieces for the Prudent Investor
June 2nd 2017

Market Snapshot
DOW JONES: 21,144.18
S&P500: 2,430.06
NASAQ: 6,246.83

The Bull Market Turns 3000 Days Old

This month we examine what is supporting continued market gains, as the S&P500 breaches the 2,400 level for the first time ever. After the US election, the reflation meme (otherwise known as "The Trump Trade") gave investors confidence in revamped growth and inflation, pushing the market forward. After a massive uptick in expected inflation after the election, this metric has since declined to pre-election levels, while stocks have diverged upwards.

A higher stock market combined with lower expected inflation, signifies that Trump euphoria appears to be priced *out* of the market. If "The Trump Trade" has run its course, why did the US stock market close the last trading day at a new historical high? Disappointing hard data vs. soft data (in particular core CPI), a fading commodity recovery, and signs of slow growth are certainly not the cause. Weak fundamentals could have been ignored during the post election euphoria; however, without "The Trump Trade" to fall back on, navigating this market is even more treacherous.

Just 5 Stocks: (Apple, Google, Amazon, Facebook, and Microsoft) are responsible for 40% of the S&P's returns

Market Extremes

To give a sense of how unbalanced the market is, give this statistic a thought: Only 5 stocks are responsible for 40% of the S&P's YTD return: (AAPL, GOOGL, AMZN, FB, MSFT).

Aware of this fact, active mutual fund managers are overweighting these 5 companies relative to their fund's benchmarks, in an effort to boost returns. This produces higher returns when the market is going up, but dramatically increases risk on the downside. On the subject of downside risk, Amazon made headlines yesterday for reaching $1000/share for the first time ever. The absurdity of the market slapping a $475 billion market cap on a company that has cumulative earnings of just $5.6 billion over 20 years, appears to have been masked by this milestone.

The disconnect between underlying fundamentals and stock valuations may end tomorrow, or continue through the Trump presidency. From the perspective of portfolio management, our task is to maintain exposure to the market in a way that will take advantage of the current optimism, while avoiding losses when the market turns.

Stocks of Interest

On May 17th, the S&P500 fell 1.8%, and experienced its 66th worst trading day in the past decade. Despite a swift rebound, it is a reminder that the market can turn aggressively and without warning. For this reason we maintain our high cash reserves, held in US dollars and short term fixed income instruments. We are adding to our core holdings when prices become attractive, with an emphasis on building our international holdings for geographic diversification. Lastly, exposure to gold miners continues to act as a valuable hedge.

New York Community Bank (NYCB – $12.92 - NYSE): NYCB is a regional bank located in New York, with $50 billion in high quality assets. After the financial crisis, the Dodd-Frank Act of 2010 created a boundary at $50 billion in assets, to separate big banks from small. Firms with assets in excess of that figure now face stricter rules on capital, mergers, and other business. For this reason, NYCB has strategically maintained an asset value below this threshold in an effort to avoid unnecessary costs. While the underlying business is exceptional, NYCB's stock price has been hindered by this necessity to artificially suppress growth. Popular belief by many banks and industry analysts is that a change is rational. As Treasury Secretary Steven Mnuchin recently told the Senate banking Committee, banks with $50 billion in assets don't pose "the same risk as a bank that has $750 billion or $2 trillion (JP Morgan)". Both sides of the table (Democrats & Republicans) appear to agree that the threshold of $50 billion should be raised, which will act as an upward catalyst for the company if the compromise can be made. Trump's promise to reduce bank control may provide this catalyst, and if not, we are happy with the 5% dividend and quality asset base.

CBL & Associates Properties, Inc (CBL – $7.55 - NYSE): CBL is a REIT (real estate investment trust) with exposure to Tier 2 malls in the US. Fears that the likes of Amazon will be the end of retail have left CBL's stock price under pressure. Despite a difficult environment, the firm has been able to grow net operating income to easily cover its 14% dividend, with less than half of its cash flow being used to support this dividend. As a final point, a quick look at the credit market shows that the overly bearish sentiment reflected in the stock price has not translated to the bond market. CBL's longest-dated paper expiring in 2026 yields just 5.95%, and is trading at exactly par. For those inclined or who are especially worried about the outlook for US malls, shorting these bonds against the common stock is a high yielding, limited risk bet.