The May 2018 Client Note

Since the start of the year, the market has moved sideways. Bulls bounced back after steep selloffs in February and March, due to concerns over inflation, spiking bond rates, and political risk.

The effect of rising interest rates has been a topic of previous newsletters, and this week confirmed that the trend is up. Amazingly, the U.S. 3-month bond yield is nearing 2%. **Investors can now earn a guaranteed 1.90% by holding the 3-month bills, an increase from about 0.01% in 2015**. In fact, the 3-month Treasury bill yield has surpassed the dividend yield of the S&P500, which stands at 1.89%.

At the same time, the ever-important 10-year yield has broken out above 3%. Given that this interest rate has been driving the panic selling in REITs, consumer staples, utilities and other such dividend paying stocks, this is a chart we need to be watching closely. It's unrealistic for consumer staples to drop 30% (as we've seen) every time interest rates move up a point – we'd be into high single digit PE territory by the time the 10-year treasury hits 4% if current tendencies were to hold.

Consumer Staples Down, But Not Out

Consumer staples were a favorite sector for dividend growth investors in 2017, and have been decimated over the past several months. 9 major sector names recently hit 52-week low prices (**PM, PepsiCo, P&G, Clorox, British American Tobacco, Altria Group, Hershey, Kimberly-Clark, General Mills**). Philip Morris **(PM)** lead the way last month with a 16% one day plunge – its worst trading day since 2008. Procter & Gamble **(PG)** also set off a fresh round of selling, falling 21%.

Perhaps the most interesting of the bunch is Hershey Co. **(HSY)**, a top-tier consumer staple company. After a 20% year-to-date decline due to interest rate concerns, the general packaged foods market, and higher cocoa prices, it is attractively priced at this level. **HSY** has grown revenues 9% yearly over the last 5 years and is trading at a 16x forward PE ratio; intriguing metrics for such a high quality company. Purchasing a company that is on the decline runs the risk of short-term losses, however with a long-term investment horizon (5-10 years), this type of investment will pay off.

Argentina: A Big Mess

Faced with a recent rise in dollar and U.S. bond yields, Argentina has found itself at the center of an emerging market sell-off, with its currency losing a quarter of its value year-to-date. This has prompted the Argentinian central bank to sell reserves and hike interest rates to a staggering 40%, in an attempt to contain one of the world's highest inflation rates and stop the peso's slide.

These abnormal market conditions have bled across South America, and affected some of our holdings. Investors are dumping the country as a whole leading to sell-offs in companies that aren't so closely tied to Argentina's economic conditions, such as Despegar.com Corp. **(DESP).** Despite notable progress with NAFTA talks, the Mexican ETF **(EWW)** is hitting the lowest levels of the year and cutting down the share prices of our struggling airline holding Volaris **(VLRS)**. We are eager to pick up more Mexican shares, particularly in airports, however waiting patiently to see how the drama plays out in Argentina, as well as the Mexican election at the beginning of July.

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