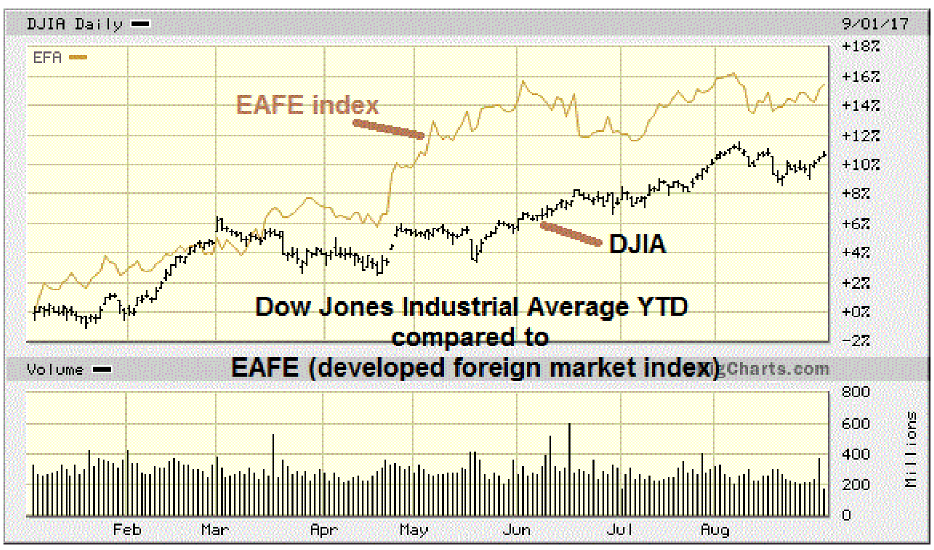
September **Update** September 1, 2017

# Greener Pastures

With all the angst over the pricy U.S. stock market, U.S. political dysfunction, the up-coming debt ceiling debate, retail turmoil, worries about Fed tightening, the declining dollar and the economic impact of the horrific hurricane, it's an understatement to say that **U.S. investors are nervous.** Indeed, the stock market has taken a bit of a break the past two months. The Dow Jones Industrial Average and S&P 500 Indices were flat in August, gaining just 0.3% and 0.1%, respectively; while they are each up about 2% over the past two months—a decline in momentum relative to the strong 22% gain since the November 4, 2016 election. There have been a couple previous of 6-8 week "plateaus" in this rally but August also brought an alarming increase in volatility as well a spurt of dramatic declines in high quality retail and consumer goods companies affected by changing consumer habits.




We have addressed many of the concerns worrying investors in previous *Market Comments* and we continue to agree that the concerns are real—even while the bull market continues to exhibit long-term resilience. Yes, a ***"correction"*** could occur anytime but strong underlying economic health, accelerating corporate earnings and low interest rates all help offset the concerns and stocks, even with the recent plateau, continue to have upward momentum and, generally, still look rewarding for the long-term investor. (And, on top of arguments still favoring stocks, we like to remind clients that we invest for the long-term and don't try to predict major tops or bottoms.)

So while we expect to continue to benefit (even if it is painful) from the most hated bull market in history, we can point to **new opportunities**—green(er) pastures for investors to graze. We are referring to **foreign stock markets**. After years of dismal conditions, 2017 has brought a resurgence of economic strength and stock price appreciation for the majority of foreign stock markets. As for economic strength, the ***Wall Street Journal*** ran article on August 23rd titled ***Synchronized Global Growth***. Following is an excerpt from the article:

> *For the first time in a decade, the world's major economies are growing in sync, a result of lingering low-interest-rate stimulus from central banks and the gradual fading of crises that over years ricocheted from the U.S. to Greece, Brazil and beyond. All 45 countries tracked by the Organization for Economic Cooperation and Development are on track to grow this year, and 33 of them are poised to accelerate from a year ago, according to the OECD. It is the first time since 2007 that all are growing and the most countries in acceleration since 2010, when many nations enjoyed a fleeting snapback from the global financial crisis. The International Monetary Fund in July projected global economic output would grow 3.5% this year and 3.6% in 2018, up from 3.2% growth in 2016.*

Resurgent economic growth has boosted global stock prices but foreign markets also are benefiting from other positive catalysts. First, after years of decline, foreign markets are **valued dramatically cheaper than U.S. stocks**, even while their earnings are accelerating. For instance, according to JP Morgan, stocks in "developed" countries other than the U.S. (i.e. Europe, Australia, etc.) are currently prices at 14.5 times future earnings while "emerging" economies (i.e. China, India, S. America, etc.)

trade for just 12.8 times earnings. Those "reasonable" valuations compare to a pricy 17.4 times earnings for the S&P 500.

A second extremely important driver of foreign share prices is **a declining U.S. Dollar**. Our Dollar surged to a 14 year high relative to the Euro in November and December based on *"Make America Great Again"* expectations and trade war concerns immediately after the election plus the widely accepted belief that the Fed was about to dramatically increase interest rates. As those expectations faded and foreign economies showed encouraging growth, Dollar strength reversed and our currency is now about 14% lower relative to the Euro compared to its peak on December 20, 2016.

When the Dollar drops relative to foreign currencies, it means profits earned abroad are worth more when translated into Dollars; it also boosts commodity prices (which are priced in Dollars) and many emerging economies are heavily dependent on commodities; and, a weak Dollar helps foreign companies and countries deal with debt since so much global debt is denominated in U.S. Dollars (the weak Dollar translates to easier repayment terms). Thus, a declining U.S. Dollar makes foreign investments, participially stocks, more attractive.

There is another opportunity here—closer to home. Giant U.S. global corporations have ever increasing percentages of foreign sales and they benefit from the above discussed concepts benefiting foreign stocks. They are realizing greater sales due to improving global economies and their foreign profits are more valuable when translated into the weaker U.S. Dollar. This has led to a significant outperformance of stocks with heavy foreign sales. According to Goldman Sachs, U.S. stocks with heavy foreign exposure are beating pure domestic stocks by about 11 percentage points year-to-date.

Along with improving foreign markets and the broad impact of the declining Dollar, the long bull market and its most recent up-leg since November 2016, are offering new opportunities as well as increasing risks and rewards. We want to comment on two more of these risk/opportunity shifts in the landscape.

First is the amazing **decline in retail**. Retail giants like Sears, Penny's and even Macy's have been in decline for years as online commerce and, more recently, the overwhelming " Amazon Effect" appears to be eliminating retail as we know it. Indeed, even previous islands of retail strength such as Nordstrom's or Kohl's have suffered unusual sales and profit declines as they struggle to deal with the changing landscape.

While Amazon is an amazing, dominate company with a desire to crush all competition, it is important to *keep this overall movement in perspective*. There will be more losers than normal in the retail space due to online commerce and Amazon, but many great companies will (are) finding ways to compete—both online and in their bricks & mortar stores—and will survive and thrive. A great example is Best Buy. The company's highly competitive electronics/appliance business is the perfect target for online competitors. And Best Buy took its lumps early and hard in the move to online commerce; however, the company has seemingly overcome, or at least matched, the competition. In the last week of August, Best Buy announced a 21% surge in profits on a 5.4% increase in sales—and online sales were up 31% to $1.1 billion. Appropriately, the stock has rewarded investors with a gain of 40% over the past year. Or, take a look at Walmart's online efforts which have been greatly enhanced since early 2017. My personal opinion is that Walmart is rapidly becoming a formidable online competitor to Amazon. (We are not currently recommending new purchases of either Best Buy or Walmart.)

Another dramatic shift in the market seems to be developing in the packaged food/personal product companies; traditional giants like Heinz Kraft, General Foods, Colgate and others. Unlike the long ongoing turmoil in retail stores, these stalwarts seem to be in the first throws of upheaval. These companies typically have dependable, consistent growth but problems emerged as some missed sales expectations and even saw sales decline by up to 5% in the recent quarter. One issue is online competition seems to make the big brand name, with its commensurate premium price, less attractive—smaller, nimble, newer brands are finding it easier to compete. Another issue is the growing trend away from packaged and processed foods and the movement to more local foods and products (Who would have thought that start-up local breweries would put a dint in sales of Bud Light?) Of course, many of these companies have yet to show any ill effects but this is a new red flag for this group of stocks which have long been prized for dependable growth. And, it will be another opportunity to find the winning companies that navigate the changing trends to new successes!

So we are finding opportunity as well as areas of risk and concern in the ever-changing financial market landscape. (And we didn't even dwell on the many ugly political and policy questions!) It should make for an exciting last few months of the year and clients have seen our reactions to these opportunities in changes to their portfolios (and can expect to see more).

Best regards,

*Ted Ingraham*

**EGI Financial, Inc.**
**American Heritage Securities, Inc.**

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**Questions or comments?**

Email us at: **ahs@egifinancial.com** or call 330-535-0881. Visit us at **www.EGIFinancial.com**