

Rated "R" ...for mature investors only

Buoyed by several consecutive months of post-election euphoria, the market took several short pauses towards the end of last quarter. Not that there's anything wrong with that. The respite, if nothing else, offered investors a chance to catch their breath; to look around and rejoice in their bounty; perhaps even to reevaluate their year-end goals and to reflect upon what they do next to ensure portfolio balance for the duration of the quarter.

Amidst all this swirl, we remain quite bullish about the long term prospect for investment success, this quarter and beyond. However, one must define what success is going to look like if their claim is to hold any merit. For example, does "success" mean an expectation of stock price indices growing at 6% per quarter? Perhaps a more modest quarterly goal might be 1 or 2%. Is "success" a belief that interest rates will remain in a perpetual standstill? Consider that many global central banks have finally acceded, at least verbally, to the sustainability of the global economic recovery and are now talking about managing over-production rather than encouraging stimulus. Is "success" measured by the consumer confidence indicators? Perhaps not, as long as political inertia and rhetorical discord hold the legislature hostage to achieving fiscal initiatives.

And what becomes of a stock market that has already recorded a "typical" year's worth of capital gains by April? To be sure, portfolios have grown well beyond anyone's expectations at the commencement of the year, but for how much longer, really?

Markets

As previously noted, the magnitude and duration of the recovery following this generation's Great Recession (2008) has been extraordinary, aided in part by a sustained monetary philosophy that created incentive and opportunity to borrow money and put it to work. Although most of that activity has been institutionally driven, the expansion is real nonetheless. Free from inflationary constraints, banking and corporate finance represent the locomotive at the front end of the train. One can only hope that the "trickle down" effect somehow permeates into the retail consumer landscape. It is still troubling that an enormous wage and wealth gap persists even as the recovery lengthens.

While I don't believe that intensive patterns of corporate expenditure are likely to abate in the next few months, we do see indications which exemplify the latter stages of a stock market growth cycle. For example, the well-embedded policy of monetary *laissez-faire* is being replaced by more active discussion...and action...of interest rate manipulation designed to limit excessive borrowing. In addition, the economy is simply not growing wages and jobs commensurate with the projections of other economic data. These factors bring uncertainty into the lives of "retail" markets. While some sectors are performing extraordinarily well, others are lagging. This quarter's stock analysis sees a heavy shift into the "back-end" of market leadership, favoring tangible assets and commodities equities as likely near-term performers. Any dislocation of the epicenter lessens the potential for all market expansion, making portfolio allocation methodology even more critical. One could only imagine the panic response if there were to be a concurrent increase in employment, wages, and inflation. How might the market cope?

Despite our harping on the negative, our market optimism derives from a golden opportunity at hand to execute our proprietary strategies and to be selective about those sectors/equities that offer trans-generational potential for earnings and price appreciation. To do this, we need only look at a "top down" multi-layered secular demographic that uncovers questions and answers that guide our future. **Biotechnology and medicine, environmental control, alternative and renewable energy, computer technology, and basic material resources and harvesting represent the benchmark possibilities of this and the next generation of investment to provide for clarity in sustaining the planet and for basic needs of all citizens irrespective of border, nationality, or persuasion.** Can you imagine that inhabitants of this planet still go to bed hungry or homeless? We also acknowledge that structuring these solutions on behalf of the disenfranchised requires political "buy-in" from government, social institutions, and the public-at-large if they are to succeed.

No one likes to see the sausage being made...they only like partaking of the end result.

As Federal Reserve Chairperson Yellen comprehensively described last quarter, the underpinnings of any successful economic expansion might also lead to higher prices and inflationary pressure. We know that a decades-long policy of easy money could easily spiral out of control and produce the very price and production pressures that monetarists now wish to control. But curiously, we look around and see *very little* evidence of inflation or price pressures that usually define an out-of-control economic expansion. There is, however, one notable exception to that observation and that would be regional pricing power exerted in areas of natural resource concentrations, particularly energy and food resources. In that instance we see global examples of capitalist "pirates" who use others' suffering as reason to exploit their situation.

Thus, The US Federal Reserve has left itself no choice but to adjust interest rates higher for the balance of the year. We are skeptical, however, about the "data" they are citing indicating wage pressure, disproportionate borrowing, and excessive consumption. Ask the "average" citizen whether he/she feels "flush" with cash and secure in their job right now.

The seeds of inflation require a long gestation. But it is not *over-consumption* or *inventory expansion* that needs addressing, it is unabated stock speculation and a breakdown in traditional fundamental analytics. Bidding this bull market up continuously without pause is a recipe for come-uppance at some point in the future. Our proprietary measurements suggest that we have already spent the better part of the last 5 months bumping up against relative strength resistance points during a period of consecutive "new highs" in the averages. Typically, a period of that duration might be cause for reevaluation but would not pose any problems for sustainable longer-term trend lines, except that in this instance prices have been inordinately gapping up well beyond nominal rates of appreciation.

Strategy

These are not insurmountable obstacles. The reason for our market optimism lies exactly in what some profess *not* to like: globalism. Relying solely upon US domestic equities to provide impetus behind portfolio performance would be to ignore the potential for innovation and growth beyond US borders, and that US stocks are currently trading above several standard deviations to nominal appreciation patterns. Integrating disparate cultures also affords portfolio managers a wider tapestry of resources, including commodities, technology, financial, healthcare, telecommunications, and manufacturing spheres. All of these sectors represent a borderless capital gains landscape from which to identify leadership for the next decade. Their commonalities are more striking than those with jingoistic biases would have you believe. The global recovery of the past 8 years has shown us that nations need food, water, infrastructure, education, security and healthcare for their populace. The equity markets should appreciate a historically diverse opportunity for modernization and commercial integration to take root.

Standing in juxtaposition to our positive scenario for stocks is our rather bearish picture about fixed income securities. The latest pronouncement from our money centers ceases the policies of accommodation and moves squarely in the direction of accepting rate increases. Their predicate for the shift is based in economic data telling them that jobs are increasing, capacity production is widening, inflation is building, and rising stock prices are an indication of economic revival. Their theory, yet untested, is to head off unabated growth before growth turns around and chokes the market's potential.

Of course, expansion is happening at various speeds in different nations. While some nations are emerging swiftly from recession, others still might require a steadier hand in guiding monetary policy in the short-term. Re-inflation in commodities, energy prices, and natural resources is a common thread that could set up a global chain reaction, causing "local" or "regional" monetary policy to become more uniformly applied everywhere.

As earnings and capital appreciation-driven investors, we recognize that an interest rate rise in 2017 could be problematic to maintaining the rate of expansion in stock prices and economic forecasts. Industrial activity might have to work overtime to keep pace with analyst's and investor's expectations for this year's figures. As the spigot of "free money" closes, so too will the ability to manufacture profits at any cost. Thus, our focus must turn to persistent long term factors, irrespective of national origin or exogenous influences. It is vital to maintain a top-down secular orientation towards stock and sector-picking if we are to achieve market outperformance. Rising interest rates might also provide the occasional one-off possibility to enhance portfolio yield with bond purchases, but our models are pointing towards tangible assets (Basic Materials), Technology (Biotech, Computers) and Energy as safe havens to score portfolio returns in the near-term.

Conclusion

It is impossible to fly in the face of trends and objective data. Those who try to "time" the market are playing with fire. There are massive secular shifts taking place right now...from globalism to jingoism, from accommodative monetary policy to "tighter" money, from post-recession near-euphoria to a more restrained asset allocation. These issues are leading us towards a more defensive, one-step-at-a-time economic framework. In general, it's easier to find investment success with long-term analysis rather than stampeding from one hot idea to the next. The herd mentality is for those who lack a unique perspective. In the end, perhaps this approaching period of reevaluation and recalibration might lay an even stronger foundation for consistent market outperformance than simply being buffeted around by exogenous noise.

Suggested balanced account asset allocation, Q2, 2017

Equity: 56%
Fixed Income: 20%
Cash: 26%

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