Market Structure and Opportunities

Baltimore Chapter

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Disclosures

Thoughts expressed are personal opinion. The information provided is not an investment recommendation.

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The presentation is based on current public information that is considered reliable, but it is possible the information could be restated.
Central Banks Around the World Move to Cut Rates to Support Consumer Spending

Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management. Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for October 2019, where real yields are calculated by subtracting out September 2019 year-over-year core inflation. Guide to the Markets – U.S. Data are as of December 19, 2019.
Central Bank Bond Purchases

Source: J.P. Morgan Asset Management; Bank of England, Bank of Japan, European Central Bank, FactSet, Federal Reserve System, J.P. Morgan Global Economic Research. **Bond purchase forecast assumes no further purchases from BoE; continued BoJ QE of $20trn JPY ann. for 2019 and 2020; restarting of purchases from the ECB at a pace of $20bn EUR per month beginning in November 2019; and conclusion of Fed balance sheet reduction per the July 2019 FOMC statement, in which beginning August 2019, maturing MBS holdings will be reinvested in Treasuries up to $20bn per month, anything in excess of that is reinvested back into MBS. The Fed balance sheet begins to rise again due to rising liabilities. U.S. data is as of 9-30-19.
The S&P 500 Price Index and Valuation Inflections

Source: Compustat, FactSet, Federal Reserve, Standard & Poor’s, J.P. Morgan Asset Management. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns. Guide to the Markets – U.S. Data are as of December 19, 2019.
The Haves and the Have Nots
Total Return in local currency since January 2009

Source: Goldman Sachs as of December 2017
# Tax Deferred Savings Contributions

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Beginning of year</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>No Contribution</td>
<td>? Contribution</td>
</tr>
<tr>
<td>S&amp;P 500 Total Return</td>
<td>26.46%</td>
<td>15.06%</td>
<td>2.11%</td>
<td>16.00%</td>
<td>32.39%</td>
<td>13.69%</td>
<td>1.38%</td>
<td>11.96%</td>
<td>21.83%</td>
<td>-4.38%</td>
<td>31.49%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$6,323</td>
<td>$13,028</td>
<td>$18,409</td>
<td>$27,154</td>
<td>$42,569</td>
<td>$54,081</td>
<td>$59,896</td>
<td>$72,658</td>
<td>$94,610</td>
<td>$95,248</td>
<td>$125,241</td>
<td></td>
</tr>
</tbody>
</table>

**Calculation formula for $13,028**

\[
\begin{align*}
\text{2009} & \quad \text{2010} & \quad \text{2011} \\
$5,000 & \quad $5,000 & \quad $5,000 \\
26.46\% & \quad 15.06\% & \quad 2.11\% \\
$6,323 & = (D8*E6)*(1.1506)
\end{align*}
\]

**Key Points:**

- Your savings benefit from compounding returns
- Tax fee and remain tax free as long as in tax deferred retirement savings account
- Eligible for employer match up to established threshold
- There is the risk your investments will decline in value
Buybacks are the New Dividend as Long as Companies Are Not Creating Negative Equity

Source: Financial Times and S&P Global
Reported Earnings vs Buyback and Dividends – S&P 500

Source: S&P Global
McDonald’s has a Whopper of Negative Equity

Source: FactSet
Home Depot Has Negative Home Improvement Equity

Source: FactSet
Earnings Per Share Growth is Slowing

Source: Compustat, FactSet, Standard & Poor’s, J.P. Morgan Asset Management. EPS levels are based on annual operating earnings per share except for 2019, which is quarterly. Percentages may not sum due to rounding. Past performance is not indicative of future returns. Guide to the Markets – U.S. Data are as of December 19, 2019.
Productivity is a Key Driver of Economic Growth

Source: J.P. Morgan Asset Management; (Top left) Census Bureau, DOD, DOJ; (Top left and right) BLS; (Right and bottom left) BEA. GDP drivers are calculated as the average annualized growth in the 10 years ending in 4Q18. Future working-age population is calculated as the total estimated number of Americans from the Census Bureau, per the September 2018 report, controlled for military enrollment, growth in institutionalized population and demographic trends. Growth in working-age population does not include illegal immigration; DOD Troop Readiness reports used to estimate percent of population enlisted. Numbers may not sum due to rounding. Guide to the Markets – U.S. Data are as of November 8, 2019.
Nonfarm Business Labor Productivity
Change in from Year Earlier

Source: U.S. Labor Department
Federal Budget is an IOU that is Debt Dependent

Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department.
2019 Federal Budget is based on the Congressional Budget Office (CBO) August 2019 Baseline Budget Forecast. CBO Baseline is based on the Congressional Budget Office (CBO) August 2019 Update to Economic Outlook. Other spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Note: Years shown are fiscal years (Oct. 1 through Sep. 30). Economic projections as of August 2019. Guide to the Markets – U.S. Data are as of December 19, 2019.
How Does Federal Spending Contribute to Productivity?

Total Federal Spending 2015: $3.8 Trillion

Source: Office of Management and Budget and National Priorities Project
Benefit Programs Dominate U.S. Federal Spending

Source: Office of Management and Budget
Credit: Lam Thuy Vo and NPR

Blue Point Investment Management
Remember Confidence Shapes Global Equity Returns

Source: FactSet, MSCI, Standard & Poor’s, J.P. Morgan Asset Management. All return values are MSCI Gross Index (official) data, except the U.S., which is the S&P 500. *Multiple expansion is based on the forward P/E ratio, and EPS growth outlook is based on NTMA earnings estimates. Chart is for illustrative purposes only. Past performance is not indicative of future results. Guide to the Markets – U.S. Data are as of December 19, 2019.
Global Trade and Exports as a Percentage of GDP

Source: FactSet, J.P. Morgan Asset Management; (Top left) CPB Netherlands Bureau for Economic Policy Analysis; (Bottom left) IMF, USITC, World Bank; (Right) IMF. Guide to the Markets – U.S. Data are as of November 8, 2019.
Imagine U.S. Market as an Upside Down Cake with Large-Cap Stocks on Top

Source: Deuce Events
Question & Answer
Why are Technology Companies So Difficult to Invest In?

January 10, 2016 - Technology companies are one of the most challenging industry sectors of the economy in which to invest. The risk of failure is above average. New technologies require huge amounts of capital investment before they realize their revenue potential, so the investor bears the cost of building before customers come. Further, valuations are enormous, and the profits are often nowhere to be found. The challenge is identifying the public companies that will offer innovations that will gain acceptance, be perceived as value-added products or services, or even become essential to daily life.

Baltimore Business Review

January 10, 2016 - This piece was produced jointly by the CFA Society Baltimore and the Towson University College of Business and Economics. It was co-edited by Niall O’Malley, who serves as program committee and board member for CFA Society Baltimore. O’Malley also wrote “Why are Technology Companies So Difficult to Invest In?” starting on page 12.
Where do Equity Markets Come From?

Market Structure:
- East India Company in 1600 and Dutch East India Company 1602
- Entrepreneurial merchant class sought trade with the East.
- Balance of Estate becomes Balance Sheet and the continuous corporation is born.
- Joint Stock companies enter an age of importance.
- Trade with the East required long-term capital.

Societal Considerations:
- Does the society endorse entrepreneurship?
- How open is the market? Are disclosures available?
- Why are German equity holdings two thirds less than American equity holdings?
The Investable Asset Pool is Shrinking. Number of Listed Companies in the U.S. Excluding Investment Funds and Trusts

Source: National Bureau of Economics, Wilshire Associates and Political Connections
How Sustainable is Buying Back 6% of Shares Outstanding with 20% of Balance Sheet?

*S&P 1500 excluding financials
Source Wall Street Journal
Central Bank Balance Sheets Compared to Percentage of GDP

Source: Citi Research and Haver
How is U.S. Corporate Debt Changing?

Source: FactSet, J.P. Morgan Asset Management; (Left) Bank for International Settlements (BIS); (Top and bottom right) Barclays, Bloomberg. Government, household and non-financial corporate debt refers to gross debt. General government debt is comprised of core debt instruments that include currency and deposits, loans and debt securities. All debt values are shown at market value. *Baa debt outstanding and duration of investment grade is based on the Bloomberg Barclays U.S. Aggregate Investment Grade Corporate Credit Index. Baa debt is the lowest credit rating issued by Moody's for investment-grade debt. Guide to the Markets – U.S. Data are as of December 19, 2019.
Is the 10-Year Treasury is at the End of a 35-Year Bond Bull Market

Source: Multpl.com
Remember Cultural Differences When Making Equity Investments

Source: Deutsches Aktieninstitut and Gallup
Open Versus Closed Society

- U.S. media offers many perspectives versus China’s party controlled media.
- A strength of the Chinese system has been effective central planning that has overseen the most dramatic industrialization in human history. NIMBY issues do not prevent the pipelines from being built.
- Central planning is not well suited for determining consumer wants, which exposes challenges for China.
- Consumer economies benefit from encouraging entrepreneurship. A service provider takes a risk and provides differentiated service with the expectation of having ownership rights if they succeed.
- A core challenges for China are protections for intellectual property, lack of disclosure and excessive investment infrastructure.
Who depends on Who?  Trade Imbalances

The U.S. imported $479.53 billion in total goods and services from China and exported $169.61 billion to China in 2016.

BALANCE BY SECTOR

U.S. demand for imports of Chinese consumer and capital goods works to dwarf exports. But farm states will be watching closely as they seek to protect the U.S. edge in agriculture.

Source: Wall Street Journal
Imbalances Mean that U.S. Consumers are a Critical Global Demand Driver

World Map of U.S. Trade Balance
Trade in Goods (in billions of dollars)

Source: U.S. Census Bureau for FY 2016 and Howmuch.com
Look at the Power of Sustainable Trends

Source: Bloomberg

Blue Point Investment Management
Is Rule-Based Investing Creating a Perfect Storm?

**Largest 25 stocks in Nasdaq 100**

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Name</th>
<th>Sector</th>
<th>Weight in index</th>
<th>2018E growth (consensus)</th>
<th>NTM P/E</th>
<th>EV / Sales</th>
<th>GS rating</th>
<th>Upside to GS target</th>
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<tbody>
<tr>
<td>AAPL</td>
<td>Apple Inc.</td>
<td>Information Technology</td>
<td>11.9 %</td>
<td>13 %</td>
<td>8 %</td>
<td>15.0 x</td>
<td>3.6 x</td>
<td>Buy</td>
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<tr>
<td>GOOGL</td>
<td>Alphabet Inc.</td>
<td>Information Technology</td>
<td>9.4</td>
<td>2.7</td>
<td>18</td>
<td>16</td>
<td>27.1</td>
<td>5.0</td>
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<tr>
<td>MSFT</td>
<td>Microsoft Corporation</td>
<td>Information Technology</td>
<td>8.2</td>
<td>2.6</td>
<td>11</td>
<td>8</td>
<td>21.6</td>
<td>5.5</td>
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<tr>
<td>AMZN</td>
<td>Amazon.com, Inc.</td>
<td>Consumer Discretionary</td>
<td>6.9</td>
<td>1.8</td>
<td>69</td>
<td>21</td>
<td>120.9</td>
<td>3.1</td>
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<tr>
<td>FB</td>
<td>Facebook, Inc.</td>
<td>Information Technology</td>
<td>5.5</td>
<td>1.7</td>
<td>23</td>
<td>28</td>
<td>29.6</td>
<td>10.8</td>
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<tr>
<td>CMCSA</td>
<td>Comcast Corporation</td>
<td>Consumer Discretionary</td>
<td>2.8</td>
<td>0.9</td>
<td>11</td>
<td>7</td>
<td>19.4</td>
<td>2.9</td>
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<tr>
<td>INTC</td>
<td>Intel Corporation</td>
<td>Information Technology</td>
<td>2.7</td>
<td>0.8</td>
<td>4</td>
<td>2</td>
<td>13.0</td>
<td>3.0</td>
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<tr>
<td>CSCO</td>
<td>Cisco Systems, Inc.</td>
<td>Information Technology</td>
<td>2.6</td>
<td>0.8</td>
<td>5</td>
<td>2</td>
<td>14.1</td>
<td>2.8</td>
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<tr>
<td>AMGN</td>
<td>Amgen Inc.</td>
<td>Health Care</td>
<td>1.9</td>
<td>0.6</td>
<td>2</td>
<td>0</td>
<td>13.4</td>
<td>5.1</td>
</tr>
<tr>
<td>KHC</td>
<td>Kraft Heinz Company</td>
<td>Consumer Staples</td>
<td>1.7</td>
<td>0.3</td>
<td>9</td>
<td>2</td>
<td>23.8</td>
<td>5.4</td>
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<tr>
<td>CELG</td>
<td>Celgene Corporation</td>
<td>Health Care</td>
<td>1.5</td>
<td>0.5</td>
<td>21</td>
<td>17</td>
<td>16.3</td>
<td>8.9</td>
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<tr>
<td>PLCN</td>
<td>Priceline Group Inc</td>
<td>Consumer Health</td>
<td>1.4</td>
<td>0.5</td>
<td>17</td>
<td>15</td>
<td>25.6</td>
<td>9.0</td>
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<tr>
<td>WBA</td>
<td>Walgreens Boots Alliance Inc</td>
<td>Consumer Staples</td>
<td>1.4</td>
<td>0.4</td>
<td>9</td>
<td>4</td>
<td>16.7</td>
<td>0.9</td>
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<tr>
<td>AVGO</td>
<td>Broadcom Limited</td>
<td>Information Technology</td>
<td>1.4</td>
<td>0.4</td>
<td>9</td>
<td>6</td>
<td>15.3</td>
<td>6.7</td>
</tr>
<tr>
<td>GILD</td>
<td>Gilead Sciences, Inc.</td>
<td>Health Care</td>
<td>1.4</td>
<td>0.4</td>
<td>(10)</td>
<td>(9)</td>
<td>8.7</td>
<td>3.5</td>
</tr>
<tr>
<td>SBUX</td>
<td>Starbucks Corporation</td>
<td>Consumer Discretionary</td>
<td>1.4</td>
<td>0.4</td>
<td>14</td>
<td>10</td>
<td>27.1</td>
<td>4.1</td>
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<td>CHTR</td>
<td>Charter Communications, Inc.</td>
<td>Consumer Discretionary</td>
<td>1.3</td>
<td>0.3</td>
<td>67</td>
<td>6</td>
<td>62.9</td>
<td>4.3</td>
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<td>QCOM</td>
<td>QUALCOMM Incorporated</td>
<td>Information Technology</td>
<td>1.3</td>
<td>0.4</td>
<td>(1)</td>
<td>2</td>
<td>13.9</td>
<td>3.3</td>
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<tr>
<td>COST</td>
<td>Costco Wholesale Corporation</td>
<td>Consumer Staples</td>
<td>1.2</td>
<td>0.4</td>
<td>12</td>
<td>6</td>
<td>30.3</td>
<td>0.7</td>
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<tr>
<td>TXN</td>
<td>Texas Instruments Incorporated</td>
<td>Information Technology</td>
<td>1.2</td>
<td>0.4</td>
<td>4</td>
<td>3</td>
<td>20.5</td>
<td>5.8</td>
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<td>MDLZ</td>
<td>Mondelz International, Inc.</td>
<td>Consumer Staples</td>
<td>1.1</td>
<td>0.3</td>
<td>11</td>
<td>2</td>
<td>20.8</td>
<td>3.3</td>
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<td>NFLX</td>
<td>Netflix, Inc.</td>
<td>Consumer Discretionary</td>
<td>1.0</td>
<td>0.3</td>
<td>82</td>
<td>20</td>
<td>137.8</td>
<td>7.3</td>
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<td>ADBE</td>
<td>Adobe Systems Incorporated</td>
<td>Information Technology</td>
<td>1.0</td>
<td>0.3</td>
<td>26</td>
<td>19</td>
<td>32.4</td>
<td>10.4</td>
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<td>PYPL</td>
<td>PayPal Holdings Inc</td>
<td>Information Technology</td>
<td>0.9</td>
<td>0.3</td>
<td>17</td>
<td>17</td>
<td>26.5</td>
<td>4.8</td>
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<tr>
<td>NVIDIA</td>
<td>NVIDIA Corporation</td>
<td>Information Technology</td>
<td>0.9</td>
<td>0.3</td>
<td>20</td>
<td>13</td>
<td>36.3</td>
<td>8.3</td>
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**Top 25 stocks (median)**

<table>
<thead>
<tr>
<th>NDX</th>
<th>S&amp;P 500</th>
<th>EPS</th>
<th>Sales</th>
<th>NTM P/E</th>
<th>EV / Sales</th>
<th>GS rating</th>
<th>Upside to GS target</th>
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<tbody>
<tr>
<td>72 %</td>
<td>22 %</td>
<td>12 %</td>
<td>7 %</td>
<td>21.6 x</td>
<td>4.8 x</td>
<td>9 %</td>
<td></td>
</tr>
</tbody>
</table>

Source: Goldman Sachs and FactSet
Rule-Based Indexes are Being Amplified Further by Familiar Stock Baskets

Source: ETFGI
Central Banks Further Amplifying Rule-Based Indexes and ETFs.

Top Holdings in the Swiss National Bank’s $80 Billion Equity Holdings
A World Wide Problem - Debt Growing Faster than Economic Growth

Source: National Bureau of Statistics, BIS, CEIC and FT
U.S. GDP - What Happened to Private and Public Investment?

Source: Doug Short, Advisor Perspectives
Monthly Return of U.S. Double B Collateralized Loan Obligations

Health Expenditures Compared to Life Expectancy 1970 to 2008. Demographics Support More Demand

Source: OECD and Lane Kenworthy
Where to Invest? Understand the Unit of Risk verses the Unit of Return

• Passive investing is reinforcing herding behavior. The U.S. market is very top heavy. Central banks have magnified valuation. A valuation correction is a risk.

• Following the financial crisis large-cap companies benefited from multinational tax strategies, financial engineering and the ability to navigate complex regulatory challenges. Mid and small-cap companies and banks look increasingly attractive.

• The U.S. corporate tax reform is a game changer. It discourages financial engineering and encourages investment.

• Sectors of particular interest are financials, energy, infrastructure and technology.

• Rising interest rates foretell a great challenge. The developing inflationary pressures will dramatically challenge the value of fixed income securities.
China as a Percentage of the World

Source: Mathews Asia MSCI ACWI Index China/Hong Kong weighting as of 6/30/19 from FactSet Research Systems; China as a % of Global Consumption figure from World Bank as of 4/24/19; China as a % of 2018 Global GDP, Global Population and Global GDP Growth figures from International Monetary Fund (IMF) as of April 2019; 10-year Global GDP Growth for the time period 2008 – 2018 from IMF. China as a % of Global Market Cap, Global Equities and Global. Market Liquidity (average 52-week $ traded) from FactSet Research Systems as of 6/30/19.
Soaring Student Debt is Disabling the Biggest Spenders and Household Formation

[Diagram showing the increase in prices for various categories compared to overall inflation, with labels for Textbooks, College Tuition, Childcare, Health Care, Food and Beverage, Housing, New Cars, Household Furnishings, Clothing, Cellphone Service, Software Toys, and TVs, indicating that some categories are more expensive and others are more affordable.]
Soaring Student Debt is Disabling the Biggest Spenders and Household Formation

Source: Federal Reserve Bank of St. Louis
Wage Growth Tracker by Full-Time and Part-Time
12-Month Moving Average of Median Wage Growth

Source: Atlanta Federal Reserve Bank of Atlanta
No Growth Has Lead to Humanity’s Worst Conflicts. Why Would Saudi Arabia Destroy the Market Value of Its Primary Asset?
Technology Has Made the U.S. the World’s New Swing Producer

Source: BP Statistical Review of World Energy