



The Narwhal Letter
Third Quarter 2016
October 28, 2016

Dear Reader,

Despite clouds of uncertainty hovering over financial markets—the most polarizing and volatile presidential election in recent American history, back-and-forth views on interest rate hikes and Fed action, etc.—stocks marched forward quite forcefully in the third quarter. The S&P 500 posted a gain of 3.85% bringing its year-to-date tally to +7.84%. Along the way major U.S. equity benchmarks (the Dow Jones Industrial Average, Nasdaq as well as the S&P 500) touched on all-time highs.

Those numbers are nothing to scoff at, but given the downward spiral with which the year began and a prolonged multi-year bull run, these milestones carry even more weight. The S&P 500 closed at 2,168.27 for the quarter—that's 19.8% above the intra-year low hit in early February (1,810.10). For even broader context, since hitting a low on March 9, 2009 (at 672.88), the index has rallied almost 225%.

We share all of this data to contextualize a few observations about the current state of the market. First and foremost, we *are* monitoring the major headlines and macro themes that dominate the rhetoric. We're not making calls (though it is becoming seemingly easier and easier to predict the outcome of the 2016 Presidential Election) for Washington D.C. or Fed action, but we're processing data as it becomes available and looking for read-throughs as applicable.

Though chaos may continue to remain supreme (at least at surface level), we appreciate the opportunities that uncertainty does create and though we are far from perfect in our valuations, we have at least *seen* approximations of true value in the equity market on an individual basis over recent months.

We used recent interest rate uncertainty to fine-tune our perspective on financial institutions and make adjustments in a generally under-valued sector. We added some money to familiar positions like Bank of America (ticker: BAC) and picked up new positions like Citizens Financial Group (ticker: CFG) where appropriate. But the largest adds in the financial sector were Citigroup (ticker: C) and Wells Fargo (ticker: WFC).

We also identified a number of undervalued individual entities. Flowers Foods (ticker: FLO) was disproportionately (we think) affected by negative headlines and speculation about the treatment of contracted delivery drivers. We used that relative weakness to move into the stock (which also pays a nice dividend north of 4%). Additionally, we picked up General Motors (ticker: GM) stock to diversify our automaker holdings (Ford is the primary holding in that space) at what we believed to be undervalued prices.

On the sell side, we finally "gave up" on Twitter (ticker: TWTR). We bought Twitter at various points in 2015 (and on limited occasion in 2016) hoping that the strength of the platform—not just in terms of users but also in terms of use on regular broadcast programming, etc.—and deceptively strong improvements in monetization might outweigh management missteps. That theory may or may not ever come to fruition, but continued miscues from leadership backed the stock into a corner in which the entirety of its valuation was driven by buyout speculation. We exited the position between \$18.83 and

\$18.93 in one fell swoop as the stock rebounded from a low of \$13.73. Shortly thereafter, continued speculation drove the price briefly north of \$25, but the stock is currently trading in the \$17-range as all speculated bidders have bowed out. Twitter is a fantastic (in a bad way) example of a miscalculation of management and abandonment of our core strategy (buying undervalued stocks). Fortunately it was never a large position for the firm.

We also trimmed some positions in the Real Estate Investment Trust (REIT) space as valuations began to expand. Two such examples were Nexpoint Residential (ticker: NXRT) and Ventas (ticker: VTR). We still hold both positions but did trim selectively in some accounts.

Obviously, these movements (both buys and sells) do not reflect the entirety of our actions taken, but they do provide a snapshot of some themes we pursued.

As has been the case for some time, our greatest challenge in day-to-day portfolio management remains fixed income. For the quarter, the Barclays Municipal Bond Index returned a *loss* of 0.30%, and as interest rates remain low (and push lower internationally), filling bond allocation buckets has been difficult. We wrap up seemingly every portfolio management meeting with the prompt: If anyone sees anything attractive in the area of fixed income, let us know. We keep thinking things *have to turn around* and we are starting to see some growth on the longer end of the yield curve (layman translation: longer-dated bonds are starting to pay a *litttttle* bit more), but at the same time demand seems poised to keep yields low for some time.

The flip side of this frustration that dividend paying stocks (which we always favor) are being placed at a premium and seeing a run up. A simple way of viewing this phenomenon is by comparing DVY (the iShares Select Dividend ETF) to IVV (the iShares Core S&P 500 ETF). Over the past 12 months (as of 10/17/2016), IVV (a close approximation of the market) has returned 6.85%. DVY (again, with an emphasis on dividend-paying stocks), is up 13.23%. That's significant out-performance.

On the home (or office) front, we are pleased with several initiatives at Narwhal and looking forward to a few more. Last quarter we bemoaned the hammering next door as our office expansion and renovation was just getting underway. Now, we're picking out paint colors, selecting finishes and planning to take root in the weeks to come. Additionally, Tusk Media (our podcast and video project) is continuing to pick up traction. A few weeks ago we were picked up by Seeking Alpha, a popular resource for investment commentary, for syndication. If you want more commentary from us, go to YouTube or iTunes and search "Tusk Media." We provide about 30 minutes of insights, stock analysis and other tomfoolery every day.

We have two new hires waiting in the wings and I expect we'll introduce them in our next newsletter installment (and maybe a blog post in the interim). With their addition, our staffing will reach 12. Lastly, we have partnered with a new financial reporting product called Wealth Access. We've sent out trial access to a few clients, but this product will allow clients to see all of their financial accounts—even accounts held away from Narwhal—in one secure location accessible via the internet or a smartphone app. Be on the lookout for this introduction over the coming weeks.

As always, we appreciate the opportunity to serve you.

Sincerely,



Matthew D. Burton
Founder, President



Andrew D. Hall
Vice President



Benjamin J. Nye
Sr. Equity Analyst



Matthew T. Krebsbach
Portfolio Analyst



Samuel T. Frost
Jr. Investment Analyst

***Disclosure:** The securities presented in this newsletter are examples of securities held in Narwhal portfolios and may not be representative of the current or future investments of Narwhal portfolios. You should not assume that investments in the securities mentioned in this newsletter were or will be profitable. We will furnish upon your request, all securities purchased, sold or held in the portfolios referred to in this newsletter during the 12 months preceding the date of this newsletter. Although we are investment advisors, our publications are not to be construed as investment advice. We certify that the opinions and predictions set forth in this publication are, for better or worse, our professional beliefs at the time of publication. We are not under duress or pressure from the corporate entities mentioned in this report. Further, this is not a solicitation to take action; rather it is a summarization of our professional beliefs. Please note that Narwhal or related persons buy or sell for itself securities that it also recommends to clients. Past performance is no guarantee of future results. For more information about Narwhal, request our Form ADV by contacting John Holt at jholt@narwhalcapital.com or 770-344-0172 or write to Narwhal Capital Management, 531 Roselane St., Suite 420, Marietta, GA 30060.*