The Narwhal Letter
Second Quarter 2017
July 26, 2017

Dear Reader,

As we reflect on the second quarter of 2017, two themes seem immediately impressing. First and foremost, we would be remiss if we failed to observe another strong quarter by equity markets. The S&P 500's gain of 3.09% kept the prolonged bull market in conversation as the index racked up a seventh-consecutive positive quarter (on a total return basis). Knowing what we know about the market – it doesn't just trend straight up and year nine of recovery and growth post-Financial Crisis marks a particularly long continuous rally – it's hard not to take a second look at the market's upward trajectory.

And that brings us to the second theme for the quarter: You don't always have to explain away a strong market. We heard more clamoring for a bearish tilt in this quarter than at any time in recent memory. "This has to be the top," one commenter would observe. "Here are 10 reasons why this market is due for a tumble," another article would read. There was no shortage of explanations for how the rally was some variation of Fake News and yet the rally itself was very real. We can debate valuations all day long, but the fact remains, those calling for a second quarter tumble after a mid-April slip and a sharper May sell-off were flat-out wrong.

Now, don't misread that second observation as a big, fat we-told-you-so. If you go back and read our first quarter newsletter, we made no such prediction for a march upward. But we're not really in the market-calling game. We were neither right nor wrong on our call, because we didn't make one.

And yet the feeble attempts to explain away the market's quarterly run up is not only memorable to us as an indictment of the premature Bear Market prophets. Equally incorrect, in our estimation, are the optimists quick to credit the late 2016 and early 2017 rally to outside political forces. Truthfully, the Trump Bump myth has been busted – not by a market decline but by a prolonged rally despite relatively little meaningful policy change.

Those who credit Trump for the market's rise this year (The S&P 500 is up more than nine percent over the first two quarters), are short-sighted. Sure, Trump may ultimately oversee the passing of a debatably better healthcare bill and at some point meaningful tax reform may come to fruition. But, if you believe the market was already accounting for these changes in the late stages of 2016 and the opening months of 2017, how do you explain the market's continued rally despite only residual progress on healthcare and no tangible advancement on tax cuts? If the market had truly been responding solely to Trump's potential, then recent impediments would have curtailed the market's run up. That has not been the case.

A more likely and less "sexy" explanation for the market's continued rally is that the broader economy is actually performing well. For political reasons, that's not necessarily a popular opinion. It implies that certain policies enacted by former President Barack Obama may have eventually led to stability; Republicans reject that notion. And it means that despite his trigger-happy Twitter fingers and lack of political experience, President Trump has not meaningfully disrupted markets. Democrats don't like that narrative.

But from our perspective, major economic data is trending in the right direction and unsurprisingly corporations (both publicly traded and privately held) are keeping pace. That doesn't always mean that we're finding loads of truly *cheap* investment opportunities on the equity front. It does, however, mean that we're also not blindly selling out of a slew of

stocks because their valuations are inexcusably high. We analyze the market on a stock-by-stock basis, and we do still think there are some opportunities and we're not panicked by valuations on the top-end.

On the buy-side, we're tip-toeing a little more into the waters of Consumer Discretionary stocks. In recent months we have picked up and added to positions in companies like TJ Maxx (ticker TJX), Target (TGT) and even Dunkin Donuts (ticker DNKN). Valuations in this sector are a bit more attractive, but given typically lower dividend yields and more varied cash flows, that is to be expected. We also opportunistically added to familiar names like Anheuser-Busch (ticker BUD), Pfizer (ticker PFE), Cisco (ticker CSCO) and General Electric (ticker GE), when prices slipped into what we deemed to be appropriate names. Broadly speaking, we continued moving into financials as the sector lagged the market's rally (year-to-date) and we continue to believe in the benefits of a rising-rate environment and strengthening economy for banks.

Many of our sells were driven strongly by asset allocation. At this juncture in a market rally, trimming equity exposure can be both laborious and very client-specific. As a result, mass moves are a bit less common. We did sell out of ConocoPhillips (ticker COP) entirely – there are more attractive names in the energy/oil space. Other common moves were the selling of a number of REIT names and select trimming opportunities in the Consumer Staples sector.

On the fixed income portion of portfolios, we have been encouraged by seeing more bonds coming to market and rising rates are providing a little bit of "juice." Gold was down for the quarter but remains up big for the year, and many of our real estate investments (both direct and publicly traded) continue to perform well for uncorrelated assets.

On the home front, we continue to pursue education and client engagement. We are currently interviewing candidates for a new, full-time client support role, and we will be bringing on two interns in the weeks to come. We are launching a quarterly macroeconomic webinar (available now at narwhalcapital.com/blog), which will supplement this newsletter and we have a number of exciting educational resources that are in process.

We are appreciative of the opportunity to work alongside such an encouraging group of clients and we are grateful for the recent rewards brought forth by an up market. But we remain focused on client-by-client management, disciplined asset allocation and the pursuit of undervalued investments.

Sincerely,

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