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MARKET INSIGHTS

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From RiverPoint Capital Management

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May Sound Bites on the Market and Economy

In this month's Sound Bites, we wanted to kick-off your Memorial Day weekend holiday by setting the mood and sharing with you the outstanding earnings news and guidance that came out of the Q1 2017 earnings reports from corporate America. It was quite good—and this may actually be a bit of an understatement. In addition, as you gather with family to remember all the great sacrifices and contributions made by past generations and loved ones no longer with us, we wanted to provide you with some interesting observations and characteristics of a younger generation that is now coming of age and which represents the future leadership of this country—the millennials. These trends and factoids will hopefully shed some light on the opportunities this generation has to impact the longer term outlook and fabric of the US as well highlight the near term influences they may have on our economy and markets, from our perspective. We also hope you find the focus of this month's issue on the impressive earnings results, and our youth in America, to be an uplifting read as you begin your Holiday weekend!

Earnings—THE litmus test of all litmus tests on how the economy and corporations are doing.

As you know, we have been writing for some time that we have viewed this market rally following the November election NOT as one based on hopes and dreams, but, instead one that is based on good old fundamentals…better earnings! After five consecutive quarters of negative earnings growth, S&P 500 EPS growth was 5% and 6%, respectively, in Q3 and Q4 of 2016, and we felt it would be in double digit territory in Q1 of 2017. As GDP growth came in a bit light in the early part of this year, market pundits began to question whether this so-called recovery was real and they worried that the earnings acceleration and hoped for positive earnings guidance might not follow suit as originally anticipated. The good news is that earnings did come through…and then some! Earnings for Q1 2017 advanced at a 13% annualized clip, which was far better than expected. Almost 80% of companies beat earnings expectations and further, and more important in our eyes, REVENUES advanced by over 7%. Indeed, it has been that sales oomph that market critics have long said was missing from the true recovery equation.

Well, companies delivered in Q1 and that is a good sign. Now, we don't need to get carried away; one quarter a trend does not make. But, April marked the second consecutive month that more companies have provided above-consensus guidance than those that have signaled disappointing future results; historically the opposite is normally the case during these quarterly pronouncement periods. And, these optimistic outlooks have allowed Wall Street analysts to raise their full year 2017 EPS expectations for the first time since 2012. That's a nice little factoid for stock investors to carry with them into this Holiday! Stay tuned.

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Millennials—Influences of Our Youth

Baby boomers may remember the 1967 song, "For What It's Worth", by Buffalo Springfield…particularly a well-known excerpt from the song's lyrics:

"There's something happening here, but what it is ain't exactly clear"

There are key trends occurring in our country's demographics and in the preferences of the younger generation that are worthy of comment; all of the implications of these trends may not be fully visible at present, but they will have major social impact for the longer term, and, certainly economic and market impact in the near/intermediate term.

We continue to research these demographic trends and behavioral characteristics in ongoing fashion, but two recent reports stand out in shedding interesting light on this subject: **1. An April 2017 US Census Bureau Report entitled, "The Changing Economics and Demographics of Young Adulthood from 1975 to 2016"; and 2. A 2016 Fidelity Study on Philanthropy and Investing. Some key takeaways from the reports are as follows:**

From the US Census Bureau Report

- More young people today live in their parents' home than in any other arrangement: 1 in 3 young people or about 24 million 18 – 34 year old's, lived in their parents' home in 2015.
- More 18 – 34 year olds are living with a parent than with a spouse. In the 1970's, young people were more than twice as likely to live with a spouse. Almost 9 in 10 young people living in their parent's home a year ago, are still in the same arrangement, making living with parents the single most stable living arrangement for young adults in the years following the housing implosion of 2007/2008.
- In 2005, the majority of young adults lived independently in their own household, which was the predominant living arrangement in 35 states. A decade later, in 2015, the number of states where the majority of young people lived independently fell to just 6.

From the Fidelity Report

- We are in the midst of a vast transfer of wealth from baby boomers to millennials…92 million Americans were born between 1980 and 2000 and an estimated $41 trillion in assets will have been transferred to these younger heirs from baby boomers by mid-century.
- Millennials are much more focused on technological advances; they seek complete transparency in product and service options via technology.
- Millennials are much more interested in experiential interactions—seeing, doing, collaborating and forming social networks. This is true with regards to consumption habits, communicating, investing, volunteering and giving.
- They are intrigued by the concept of "social impact investing "….investing in ways that are consistent with their core values (for instance in companies that exhibit best practices in corporate governance, supply chain management, diversity and hiring policies) or in investment opportunities that positively impact their community, the environment, and wellness.

RiverPoint's Investment Team Thoughts about Implications of this Data:

- **Housing Recovery—we see pent-up demand and opportunity.** We view the US Housing recovery as a latent one and still in the early innings. One of the most accurate, decorated US economists, Ed Hyman at Evercore ISI was quoted in Barron's last month saying that "millennials are coming on like locusts", suggesting that they are emerging from this dormant stage of living in parent's basements and enjoying brisk gains in employment. **We like housing recovery as a theme…**very few industries can claim double digit new orders and volume growth, implement mid- single digit price increases, and point to expanding margins while sporting Price to Earnings ratios well below the market. Homebuilders such as **D.R. Horton** can. We also find specialty retailers, such as Lowes , and home building/remodeling suppliers, such as **Fortune Brands Homes Security**, to be very attractive and benefit from this theme. A continued and accelerating renaissance in housing with its multiplier effect on GDP could be a huge contributor to kicking the pace of our economy up a notch. We're "looking and listening".
- **Technology and the "Experiential"**—With regard to technology preferences and social media, this has driven our involvement is such stocks as **Amazon, Disney, Google, Broadcom, Mellanox, and Facebook**. We continue to look for ways to capitalize in smart fashion in this sphere. We also have been steadfast in believing consumers are spending but just in different ways. We have continued to find consumer discretionary business models that focus on experience—**Carnival Cruise, Disney, Marriott**, for example—much more attractive than brick and mortar retailers and this focus has been to the benefit of our clients
- **Social Impact Investing**—We will just tease you with this one for now. Suffice to say, we have constructed a platform of investment options that focus on US and global companies and funds that have high social impact scores earned for such reasons as their corporate governance practices, diversity, work in industrial/residential redevelopment, sustainable agriculture, clean energy etc. Capital markets and investment opportunities are expanding and evolving in very positive ways for investors so inclined. Look for us to discuss this more in future issues.

Thanks for your confidence and ongoing support. All the Best for this Memorial Holiday from all of us at RiverPoint!

Thanks,
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