PMV Month In Review

August 2017

Macro

Equity markets hold gains despite growing concerns

The U.S. equity markets were more mixed in August, relative to the unabated march higher we have seen in equities in recent months (and years). On the heels of a disappointing jobs report, ongoing tensions with North Korea, debt ceiling concerns, and fears over storm damage, investors gravitated toward safe havens, driving the 10yr yield down to its lowest level since prior to the November election. And even with all this geopolitical uncertainty, the Russell 3000 ended the month down a whopping -0.04%, as growth stocks largely offset a pullback in value indices (what else is new?).

Earnings

Portfolio picked up ground during relatively quiet month

While Q2 earnings have generally been choppy for the Mid Cap portfolio with a tough July, we picked up ground in August with consumer and industrial sectors leading the way. Most notably, we had a good EPS report from Michaels, our lone retailer. The company beat Street estimates and raised guidance for 2017, but most importantly went from slightly negative (-1.2%) to slightly positive (+0.6%) same-store-sales growth. The delta was not that significant, but it seems some of the company's initiatives are paying off which resulted in a nice relief rally. In addition, Spirit AeroSystems gapped higher following strong Q2 results with better than expected revenues, strong margins, and management raised their outlook for free cash flow generation (a key issue with the stock). Conversely, other names drifted lower, including UHAL, as higher expenses and capex have investors waiting for management to shift into cash flow mode and Brinker, as negative traffic headlines more than offset a beat and raise quarter.

Portfolio

Finding pockets of opportunity in an otherwise frothy market

Portfolio transactions picked up in August as we remain disciplined in selling holdings that reach PMV or our thesis changes, while also finding pockets of opportunity. Within health care, for example, we sold Cardinal Health due to fundamental concerns and a lack of confidence in their margin profile, while Quintiles IMS hit our PMV (45% gain in just over a year) when it was added to the S&P 500, and at 12x EBITDA the risk/reward was no longer favorable in our view.

Concerns over the auto cycle ("peak SAAR") continue to give us opportunities to buy quality companies which we believe are fairly insulated. Following July's purchase of KAR Auction Services, we purchased Snap-on Inc. SNA is a leading commercial and industrial tools provider specializing in tools & diagnostic equipment for auto mechanics. The company has built a dominant #1 share position in the U.S. due to its superior quality, brand, scale, and mobile van delivery franchise model. Although their demand cycle is different than other auto-related companies, the stock has been caught-up in the industry down-draft. We believe increasing auto complexity, penetration into C&I markets, and a significant growth opportunity in Asia (10% of revenues) should help the company's PMV grow for many years to come.

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Another watch list name that hit our 30% discount to PMV was Cirrus Logic. This semiconductor leader continues to demonstrate strong technology and design wins with over 2,700 patents and increasing content in the Apple iPhone. CRUS has an R&D driven business model and works closely with their customers' design engineers to integrate into the technology ecosystem. Their expertise is high-performance, low-power IC's for audio & voice applications which continue to grow with wireless video/music and voice activated devices. However, rumors of some slight delays in the iPhone 8 caused the stock to trade off and give us our opportunity to step in at a 7.5x EBITDA and 10% FCF yield.

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