



# PMV Month In Review

November, 2017

## Macro

*Tax reform, a catalyst for rotation from growth into value; will it last?*

The relative outperformance of growth and momentum vs. value stocks has been well documented this year (Russell Midcap Growth Index outperforming Russell Midcap Value Index by over 1250 bps YTD as of 11/30/17). Indeed, the forward P/E spread between growth stocks and cheap value stocks is at the highest level in this cycle according to a recent report from J.P. Morgan. While this momentum-fueled market appears to have been begging for some mean reversion, the question remained, when?

It now appears that tax reform could be the catalyst. As the likelihood of passage of the Tax Reform Bill increased in the Senate, the market saw extreme rotation from Growth back into Value late last month (see figure below). As of this writing, there appears to be follow-through since the Senate passed the bill on December 2. Recall, tax reform should act as a catalyst for value companies given their higher mix of domestic profits and tax rates compared to growth companies. As a disciplined value manager, we are certainly benefitting from this recent reversal. The Mid Cap PMV portfolio owns strong U.S.-based companies, which on average generate 81% of revenue domestically. Most importantly, our investment team has resisted the temptation to chase performance and has not wavered from our valuation discipline.

As of November 29, 2017

Factor		November 29, 2017			YTD
		Q1	Q5	Perf (%)	Perf (%)
Value	<i>Cheap vs. Expensive</i>	0.8%	-0.3%	1.0%	-13.5%
Volatility	<i>Low vs. High</i>	0.0%	0.1%	-0.2%	0.6%
Integrated	<i>High vs. Low</i>	-0.1%	0.1%	-0.2%	3.5%
Size	<i>Large vs. Small</i>	0.1%	0.4%	-0.3%	0.7%
Balance Sheet	<i>Strong vs. Weak</i>	-0.3%	0.1%	-0.4%	11.2%
SI Days	<i>Low vs. High</i>	-0.2%	0.3%	-0.5%	2.0%
Financial Returns	<i>High vs. Low</i>	-0.1%	0.4%	-0.5%	4.0%
Growth	<i>High vs. Low</i>	-0.4%	0.9%	-1.2%	14.1%
Momentum (6m)	<i>Leaders vs. Laggards</i>	-0.7%	0.9%	-1.6%	9.6%

Source: Goldman Sachs Global Investment Research

## Earnings

Solid portfolio earning reports offset by one negative outlier.

With Q3 earnings season winding down, we are happy to report that positive earnings surprises increased in breadth for our portfolio relative to a challenging Q2. Indeed, by tracking our holdings' average 2017 EPS estimate throughout earnings season, we identified 14 winners vs. only 5 losers. Consumer earnings later in the month helped, including J.M. Smucker and Michael's which both rallied on solid results. Unfortunately, these good reports were offset by the significant sell-off in Envision Health earlier in November on weak Q4 guidance. In hindsight, their

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physician model and contracts definitely have more sensitivity to volume trends than we realized, but that still does not fully explain the sudden drop in profits and cash flow. Ultimately, we sold the stock given key questions that management could not answer as the stock became too speculative for our quality standards.

## Portfolio

*Transactions remain muted with one new buy.*

We initiated a position in rocket propulsion system provider Aerojet Rocketdyne. While this stock has been a significant contributor to our Genesis PMV strategy, their Q3 report was mixed and the stock gave back some prior gains, allowing the Mid Cap PMV portfolio an entry point. Having spent the last ten-plus years outside of the purview of most mainstream investors and uncovered by any major Wall Street firm, the company garnered attention this summer due to three key events. First, management reported strong Q2 earnings growth driven by long-awaited margin expansion. Second, missile tests and related rhetoric out of North Korea has led to an increase in demand for the missile defense systems that rely on Aerojet's rocket boosters. In addition, maybe most important of all, one of Aerojet's competitors was acquired for a valuation multiple far above Aerojet's current trading multiple. As a result, the stock has re-rated higher as investors begin to appreciate the company's earnings power and strategic geopolitical importance.

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