# CM Market Update

While our average investment portfolio has seen a decline in market value over the past several months, we continue to believe that the equities we own across our various investment strategies hold good values in an overall market environment that we do not see as cheap. Our research indicates that the energy sector and related securities are the most undervalued sector and sub-industries, not only in absolute terms, but also relative to other sectors. It is for this reason that we maintain our over-weight position in energy.

We are not alone in this line of thinking. As shown in the chart below, according to analyst forecasts compiled by Bloomberg, price targets for companies listed in the S&P 500 index envision a 24 percent rise for energy shares in the next 12 months. That's more than double the estimated 10 percent advance for financial firms and the forecasted 9 percent gain for the consumer discretionary sector that includes everything from apparel to automobiles. With that said, as part of our diversification, we do hold sizeable amounts of our portfolios in the financial, consumer, and materials sectors, which, as you can see on Chart 1, are suggested to be some of the higher performing sectors over the next 12 months.

Chart 1



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Chart 2 drills down into the sub-industries within the S&P 500 energy sector. Here we can see the analyst forecasts compiled by Bloomberg are most bullish about exploration companies, followed closely by drilling specialists and equipment suppliers. Oil refiners and service providers that do everything from fracking to pouring cement around the edges of new wells are at the low end of expectations. That being said, even these service companies, the energy sub-industry with the lowest 12-month return expectations (roughly 15%), are still higher than the other 10 primary sectors that make-up the S&P 500 Index (See Chart 1).

Chart 2


As we all know, the best performing sector in the market year-to-date has been technology. To be sure, there is certainly no shortage of market bullishness for the future of technology. However, we believe this is reflected in both earnings and multiple estimates for this sector, as both appear to us to be fully priced into these stocks.

Additionally, much of the gains in the technology sector and the market as a whole this year, have been narrowly focused. For example, through the first week of June 2017, Facebook, Amazon, Apple, Google (parent of Alphabet), and Microsoft have accounted for roughly 41% of the S&P 500's return this year. And according to Bank of America Merrill Lynch's equity strategist, actively managed large-cap mutual funds are now overweight in technology by the biggest extent ever.



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As a result of this enthusiasm, Chart 3 shows that the increase in **market value in 2017 alone** for Apple, Google, Amazon.com, and Facebook has already surpassed the **entire market value** of the following 20 companies, which include such names as Boeing, Schlumberger, United Parcel Service, Goldman Sachs, and Starbucks.

Chart 3

**The Increase in Market Value in 2017 Alone!**

| Company | Increase in Market Value |
|---|---|
| Apple Inc. | $192,485,851,136 |
| Google | $148,403,912,704 |
| Amazon.com | $126,571,184,128 |
| Facebook | $116,011,171,840 |

Source: Bloomberg. The ending period is the highest market capitalization that occurred during the week ended June 9, 2017. Google is the parent of Alphabet. Market Value is the same as Market Cap.

| Company | Entire Market Value |
|---|---|
| Boeing | $114,698,500,000 |
| Schlumberger | $96,818,700,000 |
| United Parcel Service | $92,876,700,000 |
| Goldman Sachs | $91,965,400,000 |
| Starbuck's | $90,057,000,000 |
| Bristol-Meyers Squibb | $88,549,600,000 |
| Nike, Inc. | $88,250,000,000 |
| Morgan Stanley | $83,073,700,000 |
| Texas Instruments | $80,602,600,000 |
| Lockheed Martin | $80,175,700,000 |
| Costco Wholesale | $79,113,500,000 |
| EI du Pont de Nemours | $71,877,000,000 |
| Colgate-Palmolive | $66,927,100,000 |
| Caterpillar | $62,403,000,000 |
| MetLife Inc. | $56,852,300,000 |
| Charles Schwab & Co. | $55,210,200,000 |
| Federal Express | $55,186,200,000 |
| Monsanto | $51,852,300,000 |
| Marriott International | $38,806,000,000 |
| Southwest Airlines | $35,953,200,000 |

Source: Bloomberg. Market cap as of June 9, 2017.

Many investors have treated these cyclical growth stocks like steady consumer staples companies. On Friday, June 9, Goldman Sachs wrote a research note citing the low volatility of these tech companies, even relative to a historically calm market. Drilling down on the FAAMG stocks, they said “that if Facebook, Apple, Amazon, Microsoft, and Google were its own sector, it would screen as having the lowest realized volatility in the market.” They concluded by saying that “we believe low realized volatility can potentially lead people to underestimate the risks inherent in these businesses.” Given the strong performance these stocks have had this year, at their current levels we believe they are vulnerable to an outsized reaction if earnings fall short or growth slows unexpectedly.



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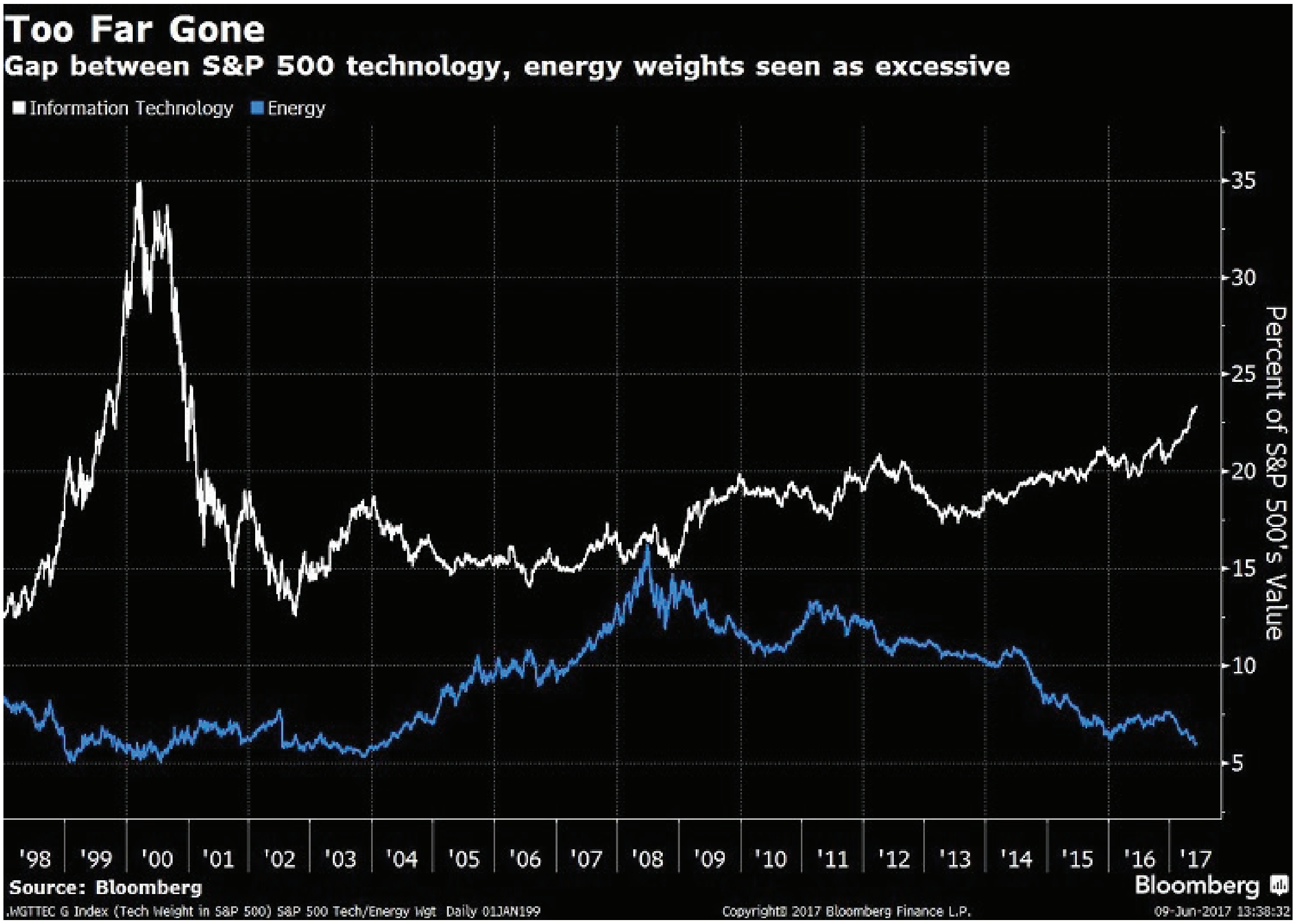
Conversely, there is no shortage of bearishness when it comes to energy markets (i.e., oil and gas). We believe this bearishness is reflected in the conservative earnings estimates and tame, if not subdued, multiple expectations for the majority of energy related companies. As a result, we believe the energy sector offers some of the best investment opportunities as we look forward.

Currently, energy makes up just 5.9% of the S&P 500 index, half its weighting in 2001. According to Barron's, the total market value of the 36 energy companies that make-up the S&P 500 energy sector is less than the combined value of Apple and Google (parent of Alphabet), the S&P 500 index's two largest components.

Chart 4 compares the relationship between the S&P 500 information technology sector and the S&P 500 energy sector over the past 20 years and how their weighting in the S&P 500 index has changed over time. Currently, we believe this relationship highlights just how oversubscribed and disconnected the tech sector is relative to the energy sector. According to data compiled from Bloomberg, the weight-gap between them (i.e., their percentage of the S&P 500's value) is the widest since 2001 when an internet-driven surge in technology shares ended. If these two sectors just revert back to their 10, 15, or 20-year means, both sectors stand to have meaningful reversals in their performance. In other words, there would be some level of decline in the tech sector and some level of increase in the energy sector.

Chart 4



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While our focus on absolute values can often run counter to the crowded and popular trades of the day, similar to what we saw in 1998 through 2000, it has been our experience over the past 42.5 years that over time, in the majority of cases, value eventually becomes realized. As Benjamin Graham (widely known as the father of value investing) famously said, “Through all their vicissitudes and casualties, as earth-shaking as they were unforeseen, it remained true that sound investment principles produced generally sound results. We must act on the assumption that they will continue to do so.”

Sincerely,

Arnold Van Den Berg
Founder, Portfolio Manager

Scott Van Den Berg, CFP®
President, Portfolio Manager

James D. Brilliant, CFA
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