Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors June 2, 2017

Stocks rose sharply yesterday following strong economic data. The ADP survey predicted a sharp climb in jobs, manufacturing activity improved in May, and auto sales were better than expected. Even retail sales appeared to be improving after some dismal earnings reports last month from major department stores.

While the front page story of President Trump's decision to withdraw from the Paris Climate Accord got most of the media attention, its economic impact over the next several years probably will be modest. Oil prices fell as traders presumed that decision could increase inventories but that probably is more of an emotional decision than one based on any reality. Others talked about America ceding world leadership to China and others and it becomes increasingly isolated politically by choice. Again, time will tell whether such instant reactions are accurate or not. For equity investors, however, the impact of the decision is hardly measurable. Thus, yesterday's rally is all about the economy today and not the environmental impact that may result from the Paris accord tomorrow. As I have noted often, equity markets are brutally unemotional. They are moving higher amid a combination of better earnings and low inflation. I will have more to say about that when I talk about today's employment report.

Before I do, I thought I would spend a few moments discussing when one should sell a stock.

Let's start by discussing what happens when you buy a stock of a corporation in the first place. You do that because (1) you believe that the company will generate a growing stream of cash flow and dividends and (2) you believe the values of those streams are fairly valued or undervalued in the marketplace. One must always remember that you are buying a stream of cash flows. There are a lot of great companies that, at times, are extremely overvalued, i.e. markets overprice the stream of future cash. Bubbles happen when too many buyers want the same asset and some are willing to pay extreme and unsustainable prices to own that asset.

Thus, when buying a stock, one must be disciplined to pay a fair or discounted price. Otherwise, even if the company grows, the asset price may not.

Now that we understand that we are buying a stream of future cash flow and not simply the hype surrounding a company, when do we sell? If you buy with discipline, you have, what you believe to be, a fair value in mind. That is a function of the company's growth rate and a discount rate. Getting even less technical, you have a price in mind that you believe is full value. If the stock reaches or exceeds that number, it is time to think about selling a stock.

Second, a company may not live up to expectations. The new product you were hoping to be a blockbuster fizzles. A competitor comes up with something better. Laws change that obsolete what your company does. Management simply screws up. If the reason you bought the stock simply isn't valid anymore, it is time to consider selling.

Third, you own a portfolio of stocks, not just one security. No company, no matter how great you may think it is, is immune to bad news. At some point, your best stock gets to be too much of your overall portfolio. Big fund managers may limit a position to 5% of total assets. As an individual you probably can use a higher number. That number is up to you but if you own the best stock of the last 10 years and now it is 40-50% of your portfolio, what is going to happen to your net worth if we go into a huge bear market or something emerges to disrupt the value of your huge winner? Portfolio management means limiting systemic risk. Lack of diversification exposes that risk.

Finally, while your best performers are usually stocks that outperform expectations (i.e. you were right and the market was wrong), there are times when you are too enthusiastic and the market is right. It can be very painful to be pig headed. Listen to the market because when you and the market disagree, it's the market that is often right. IF your stock is lagging persistently and falls 10-20% behind the market, you have to force yourself to reexamine what might be wrong in your thinking.

Most companies underperform due to bad execution. One of the big mistakes investors make is to get overenthusiastic about a product instead of betting on management. Go buy a Rubik's Cube if you want but don't buy the stock based on a one-hit wonder. This warning is particularly true for IPOs. Companies coming public are often immature and are riding the wave of one product or service. Successful companies ultimately offer multiple products and services, often layered on the success of the initial offering. Therefore, listen to management's future plans. Do they make sense? Can a company take advantage of an early product success to make a family of products? Can it develop a brand and loyalty that ensures future success?

OK, now back to the employment report. Job growth in May was only 138,000, about 40,000 less than expected. However, the unemployment rate fell to 4.3%. Average hourly earnings rose 0.2%, again showing no signs of any acceleration in inflation. Jobs fell in the retail and government sectors. While the numbers were a bit below consensus and prior month's data was revised lower, there really isn't any cause for concern in these numbers. We remain on a 2% growth glide path. As full employment is approaching filling jobs is taking longer. The lack of any wage growth, however, says that inflationary pressures remain muted and therefore interest rates remain low.

Once again, rising earnings and low interest rates are good for stocks. The path of least resistance continues to move higher.

Today, Wayne Brady is 45.

James M. Meyer, CFA 610-260-2220

Additional information is available upon request.
* - Boenning and Scattergood may act as principal in buying this stock from or selling it to the public.
# - The author of this report or accounts under his management at Tower Bridge Advisors owns this security.