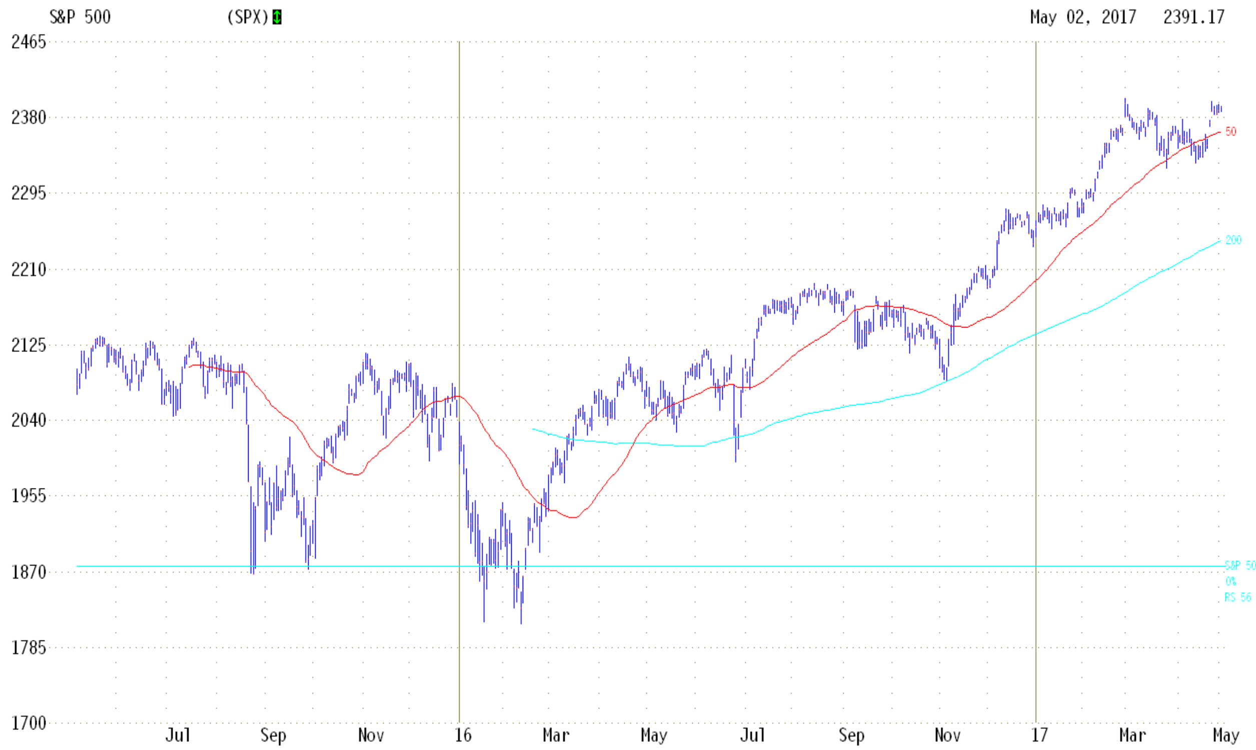
F&V Capital Management, LLC
805 Third Avenue, 12th Floor
New York, NY 10022

H. Terrence Riley III, CFA
May 3, 2017

Contact: Karin Mueller-Paris
+1(212) 326 9533 [**kmm@fvcm.us**](mailto:kmm@fvcm.us)



Momentum Stocks Advance in 2017

Leadership has shifted but the S&P 500 has continued its upward trend, with a total return of 7.2% through the first four months of the year. As shown in Table 1 below, the areas that have done best are not the ones that initially jumped upward after the November 8th election. For example, "old world" areas like Industrial, Financial and Telecommunications stocks had a nice move upward in late 2016. But it has been "new world" companies that have completely dominated the index thus far in 2017. The Technology sector has been the best performing group with a 14.9% return (see Table 1 on the following page). Even the Consumer Discretion sector, which was the second best performing sector with a 10.6% return, was dominated by emerging growth areas. For example, while the Consumer Discretion sector includes industries like auto and motorcycle manufacturing and department stores, stocks in those industries actually declined during the first part of 2017. The companies driving the Consumer Discretion sector upward were Amazon.com, Priceline.com and Netflix.

Table 1

S&P 500 Total Returns (Year-to-date)		TTL RTRN	TTL RTRN
(as of 30 April 2017)	% OF	% CHG	% CHG
Sector:	SPX	1 MTH	YTD
INFORMATION TECH	22.5%	2.4%	14.9%
CONSUMER DISCRETION	12.5%	2.4%	10.6%
HEALTH CARE	14.0%	1.5%	9.5%
MATERIALS	2.9%	1.4%	6.7%
CONSUMER STAPLES	9.3%	0.8%	6.5%
UTILITIES	3.2%	0.7%	6.2%
INDUSTRIALS	10.1%	1.7%	5.8%
REAL ESTATE	2.9%	0.0%	2.7%
FINANCIALS	14.1%	-1.0%	1.1%
TELECOMMUNICATION	2.3%	-4.4%	-9.2%
ENERGY	6.3%	-2.9%	-10.0%
S&P 500	0.0%	1.0%	7.2%

Source: Baseline

Five companies, in particular, have been responsible for the gains in the S&P 500 thus far in 2017 (see Table 2 below). These five companies alone contributed about 2.5% of the 7.2% gains over the four month period. In comparison, the bottom 400 companies in the S&P 500 contributed only 0.4% to the total index performance. Looking at the characteristics of these five leading companies, clearly they cannot all be categorized as either growth or value stocks. For example, Apple might be considered a value stock, with its P/E ratio of 17.2 times trailing earnings, but its revenues and earnings have fallen quite steeply over the past four quarters and cannot be described as a growth stock. Facebook and Amazon, in contrast, are clearly growth stocks, and both trade at high valuations. Alphabet and Microsoft fall more into the middle Growth at a Reasonable Price (GARP) category. So what's the common theme to these five?

Table 2	Total Return Y-t-d	Contribution to S&P 500 Return	P/E Ratio	Revenue L4Q vs Yr Ago	Earnings L4Q vs Yr Ago
APPLE	24.0%	0.9%	17.2	-7.2%	-11.0%
FACEBOOK	30.6%	0.5%	35.4	54.2%	86.0%
AMAZON.COM	23.4%	0.4%	173.9	25.7%	119.0%
ALPHABET (a/k/a Google)	17.4%	0.4%	26.7	21.5%	13.0%
MICROSOFT	10.8%	0.3%	22.7	2.6%	13.0%
Data as of 30 April 2017					

Source: Baseline

While the five stocks in Table 2 cannot be categorized as either growth or value stocks, they all can be described as Momentum stocks. In other words, investors are less interested in fundamental factors like sales and earnings growth (e.g., Apple) or valuation (e.g., Amazon), and are more focused on buying the big popular names that are going up, regardless of the reason. While momentum investing can obviously be successful over some periods, it is a dangerous strategy, especially if they have stratospheric valuations, because it's more like a popularity contest where sentiment can shift quickly. Hence, Amazon and Facebook have P/E ratios too high for our GARP strategy even though their business models are performing well. Apple, on the other hand, is the largest capitalization stock in the world and is running into growth problems. There are very high expectations for the new iphone to be released later this year that will need to be met. Alternatively, Alphabet and Microsoft both fall into that range where we're seeing high earnings growth and yet the P/E ratios do not appear to present great risk.

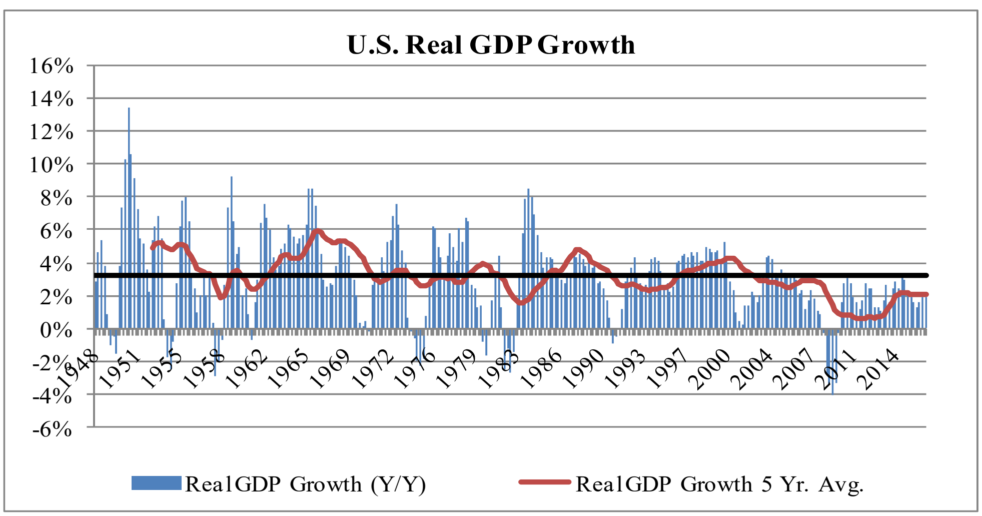
2017 May See Yet Another Shift

During the last two months of 2016, cyclical businesses bounced upward because they were perceived to benefit from the stimulative fiscal policies proposed by the Trump administration. Along with that bounce in cyclical type stocks, expectations of faster economic growth caused interest rates to also increase in November and December 2016. However, Trump has run into resistance within his own party and, of course, the Democrats are opposing him at every turn. The shift from the "Trump Trade" back to momentum stocks occurred when expectations for quick action on Trump's policies had to be dialed back.

Looking forward, a reversion to the Trump Trade is likely--eventually. Trump and the Republicans in Congress have been unwinding business regulations at a rapid clip since the election, and these changes are likely to have some long-term positive impact on economic growth. However, the markets are now waiting for concrete action on healthcare and especially tax reform. Action on those two issues likely will be necessary before investor interest shifts back to cyclical and industrial companies, as well as banking. As it now stands, the conservative members of the "Freedom Caucus" and the more moderate members of the Republican Party have not been able to reach an agreement on healthcare reform, and the politics of tax reform are more difficult without getting the healthcare completed first. Frankly, visibility on the legislative process is very low. However, the Republicans do have majorities in both houses of Congress. It would likely be political suicide if they were unable to achieve legislative victories on these two issues in 2017.

Passage of both healthcare and tax reform, while uncertain, would bring investor interest back to more cyclically sensitive stocks and away from the momentum stocks. Because of the high level of political risk, equity portfolios are probably best hedged with a blend of popular momentum stocks and defensive stocks, which will do well if growth expectations disappoint, and attractively valued cyclical stocks, which should move strongly if Trump's fiscal policies are passed. This approach is somewhat unsatisfying because it will tend to lag the overall market either way the political process works out, but it should also help protect the portfolio against volatility if the political process breaks down.

Chart 2

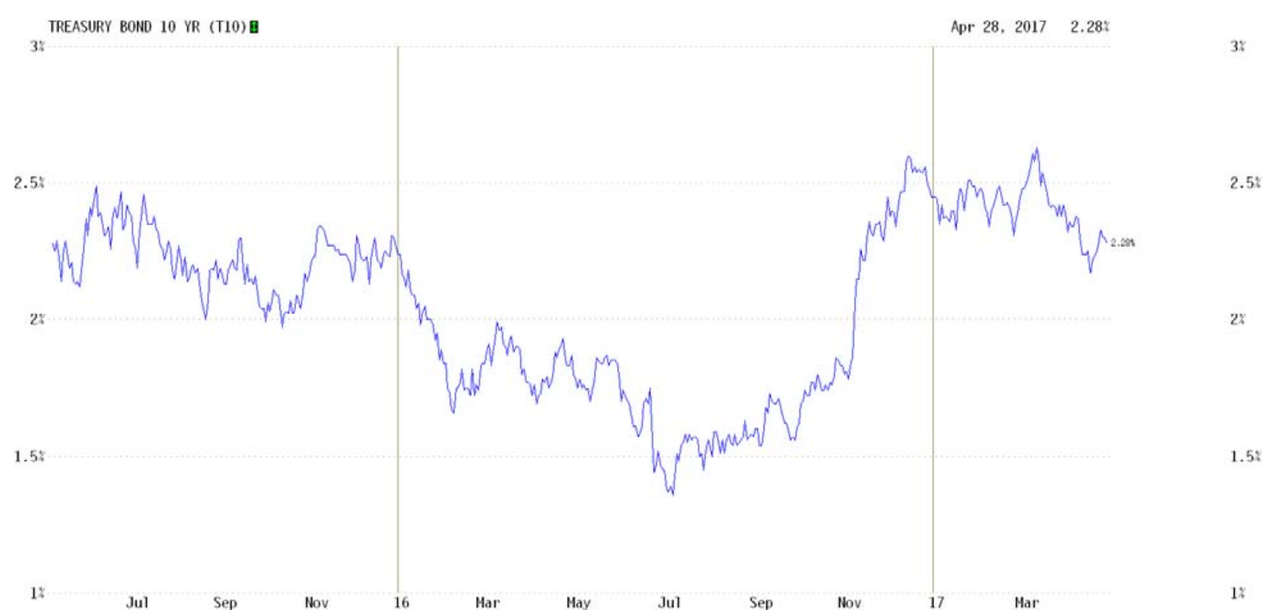


Source: Federal Reserve, FVCM

If the Republicans push Trump's pro-growth initiatives through, stock prices should continue in an upward trend during the two-to-three years ahead. However, a failure to pass the legislation could lead to a market correction. During the expansion since the end of the 2008-9 recession, real economic growth in the U.S. has averaged only 2.1%, well below the post war average of 3.2% (see Chart 2 above). The S&P 500 jumped about 250 points (12%) after the election based on the premise that Trump's policies of tax cuts, healthcare reform and regulatory reform would provide the environment for business activity to reaccelerate toward historic levels. If the politics for the new policies fail, investors would begin to discount the possibility that growth remains stuck at about the 2% level and stock prices would become vulnerable to a correction. Conversely, passage would renew expectations of faster growth in the economy and earnings.

Fixed income and currency markets also may experience greater volatility because of politics. As shown in the chart below, the 10 year U.S. treasury yields jumped sharply from 1.86% on November 8th (election day) to 2.60% on December 15th on expectation that new growth oriented legislation was coming. Passage of a new tax policy, in particular, is likely to put upward pressure on interest rates. A 3% yield on the 10 year bond is possible. The dollar's f/x value is also likely to rise in that scenario. Conversely, if gridlock grips the U.S. Congress, we would expect bond yields to trend back lower and the dollar could trade back to the upper end of the $1.05-to-$1.15 range it has been in with the Euro for more than two years.

Which way will it go? At this point we still expect Trump's growth policies to be enacted, since members of the Republican-controlled Congress will not want to face their constituencies empty-handed in 2018. However, we can't say that with much confidence. Since passage of a tax reform would be greatly positive for the equity market, we still recommend staying fully invested for now. However, as mentioned before, we would advise to do so with a blend of momentum, defensive and cyclical stocks to protect the portfolio to some degree against the political risk.



The information contained in this report is intended solely for the clients of F&V Capital Management, LLC in the United States, and may not be used or relied upon by any other person for any purpose. Such information is provided for informational purposes only and does not constitute a solicitation to buy or an offer to sell any securities under the Securities Act of 1933, as amended, or under any other U.S. federal or state securities laws, rules or regulations. Investments in securities discussed herein may be unsuitable for investors, depending on their specific investment objectives, risk tolerance and financial position.

The information is obtained from specified sources and is believed to be reliable, but that accuracy is not guaranteed. Any opinions contained herein reflect F&V's judgment as of the original date of publication, without regard to the date on which you may receive such information, and are subject to change without notice. F&V may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance.