

DM Monthly Report

MAY 2017

PORTFOLIO ACTIVITY

No new positions were added to and none were removed from DM's equity mandates in April.

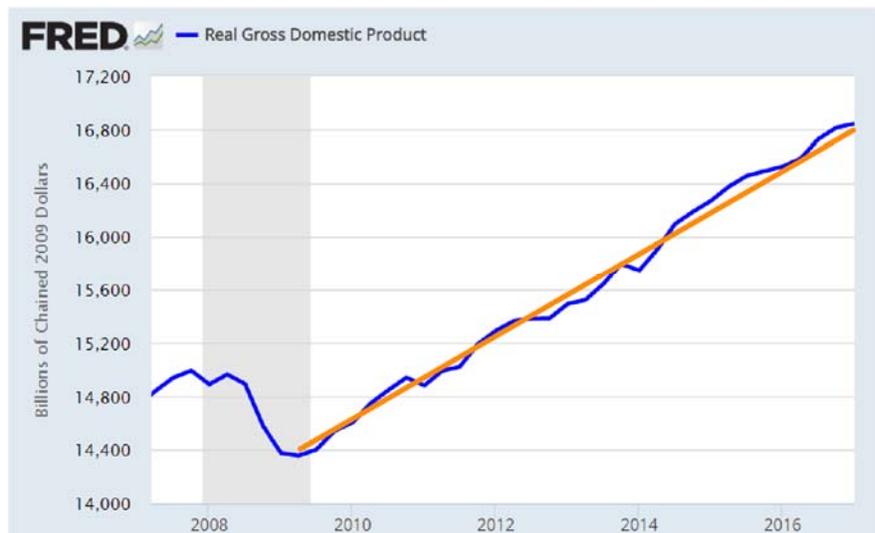
FEATURE STOCK

Alphabet Inc. (GOOGL)

At the end of April, Alphabet Inc. (parent of search engine Google) shot through estimates by posting quarterly earnings of \$7.73 per share vs. the \$7.39 that analysts were expecting. When we first acquired shares of GOOGL in DM Foreign Equity, we were drawn to the ongoing shift from traditional to online media, opportunities for the company to improve its operational discipline, and its entry into the fast growing area of cloud computing. These drivers were well identified in GOOGL's Q1-17 earnings report and subsequent analyst call. Specifically, management highlighted rapid growth in YouTube revenues, with video advertising accounting for much of the gain. In terms of efficiency, the company reported a 53% jump in free cash flow generation year-over-year, along with a meaningful drop in capex as a percentage of sales. Elsewhere, GOOGL's cloud operation was identified as one of its fastest growing business segments and made a tangible contribution to overall growth. These attributes have helped the stock to gain more than 20% year to date.

MOST IMPORTANT ECONOMY GRINDS AHEAD, STOCKS FOLLOW

While recently perusing the Federal Reserve Economic Data (FRED) website, we were struck by a chart showing real (or ex-inflation) US GDP growth over the past decade. As expected, output plunged in 2008/09 as the financial crisis unfolded and businesses and individuals collectively retrenched. Since economic activity bottomed in mid-2009, however, the recovery has been remarkably consistent, with American growth tracking along an almost perfectly straight upward tilting path (as highlighted by the orange trendline we've added to the Fed's chart below). This steadiness is all the more remarkable when the list of economic hurdles and uncertainty faced over that time is considered, ranging from near government shutdowns, to experiments in monetary policy, to record high energy prices (followed by a precipitous crash), and now threats to the international trade structure that has underpinned the US economy for decades. Just as businesses have largely shrugged off these concerns, however, so has the market to a large extent, with North American stocks inching higher by the quarter. In fact, the CBOE Volatility Index (commonly known as the "Vix") recently posted its lowest close in more than 24 years, reflecting the market's uncommon stability. Some may say that this nonchalant metric represents an unhealthy level of complacency amongst investors, but perhaps its more a reflection of a relatively sanguine backdrop, where interest rates remain low, economic growth is steady but not overheated, and companies are posting solid earnings gains. Should economic news take on a more dynamically positive tone in the near future, which many are forecasting, it will be interesting to see how the market digests such an uptick in fundamentals.



Source: Federal Reserve Economic Data website