DELTA INVESTMENT MANAGEMENT

Delta Insights
a weekly commentary on investing

Delta Investment Management is a registered investment advisory firm headquartered in San Francisco.
Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new partner.
Delta manages portfolios at TD Ameritrade and Schwab.
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May 4, 2018

Looking Down From the Peak

What do Procter & Gamble (PG), Coca-Cola (KO), PepsiCo (PEP), Walmart (WMT) and Philip Morris (PM) have in common? They are blue-chip stocks. They all have "A" investment-grade credit ratings. They are the top five holdings of the S&P 500 Consumer Staples ETF (XLP). They are slow-growth stocks. They are down year-to-date an average of -16.5% through May 2. They help explain why the broader market is not rising on record first quarter earnings.

Highlights of first quarter 2018 earnings season:

- With about 80% of the S&P 500 companies having reported, 80% have posted upside earnings surprises. This is on-pace to be the highest beat rate since FactSet began tracking this metric in 2008.
- 74% of the reporting companies exceeded revenue expectations. The amount by which companies are beating revenue estimates is also the largest since FactSet began tracking this metric.
- Earnings growth is now at 24%, up from 17% about two weeks ago. This is the fastest rate of growth since Q3 2010.
- S&P 500 companies have announced $800 billion in stock buybacks this year – a record level and substantially higher than the 2017 buyback amount of $530 billion.
- The top five companies in the S&P 500 which collectively represent 14% of the index reported significant revenue and earnings upside: Apple (AAPL, $100 billion share repurchase and 16% dividend raise), Microsoft (MSFT), Amazon (AMZN), Google (GOOG, GOOGL) and Facebook (FB, $9 billion share repurchase increase).

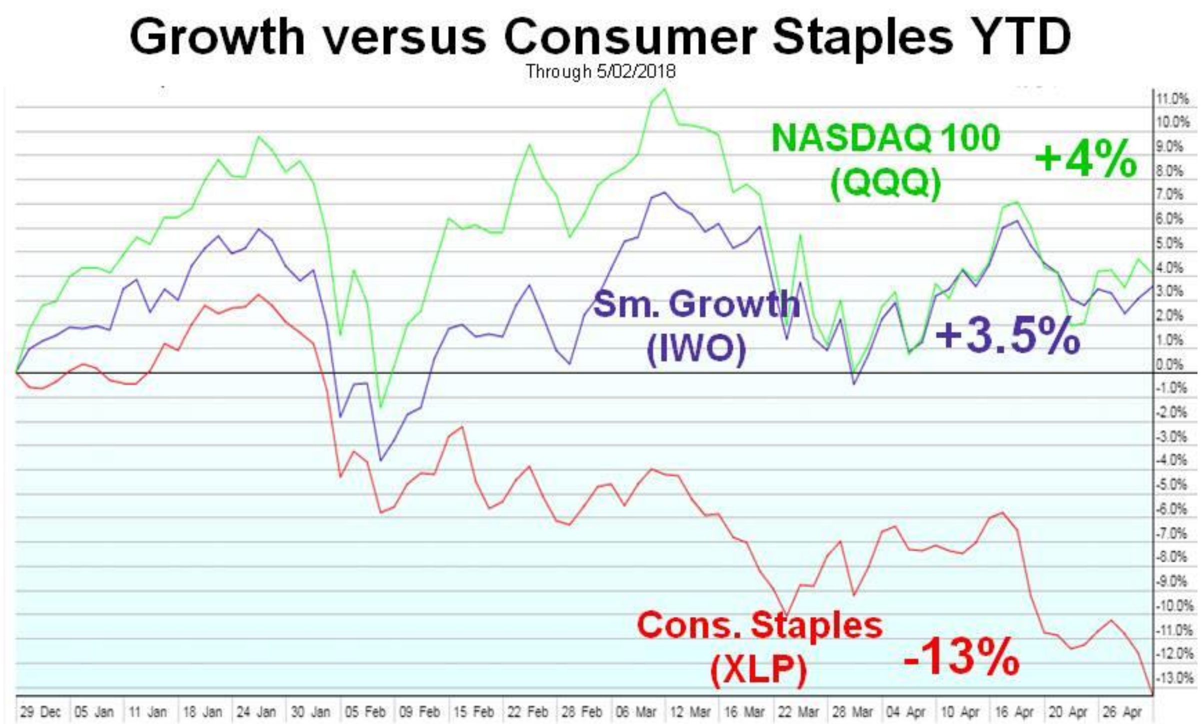
Since 1Q2018 earnings season began on April 13, the S&P 500 is down -1% through May 3.

There are only so many ways a market can depreciate. The simplest is there are more sellers than buyers. If this is the only factor, it is usually a short-term issue. Over the longer-term, fundamentals matter. Fundamentally, the market may depreciate because of a reduction of anticipated future earnings, a rise in the risk premium or a rise in the risk free discount rate.

What explains the lack of market appreciation on positive earnings? Whether it is tariffs, inflation, interest rates, one-time effects of the tax change and/or we may just be in the final innings of a long, slow growth cycle, the market is signaling we may be at peak earnings. Caterpillar (CAT) beat earnings on April 24 and then said on its conference call that first quarter earnings will be the "high water mark" for the year.

The CBOE volatility index (VIX) and high yield spread are flat to down recently. Small-cap growth stocks (considered higher risk) are outperforming. A rising risk premium does not explain the market's depressed behavior. The Federal Open Market Committee (FOMC) held rates constant this week. The risk free discount rate is a constant for now.

If we have seen peak earnings, growth is king. Slow-growth stocks are struggling in an environment characterized by perceived diminishing growth prospects.



If nothing else, the rise in earnings and lack of movement in price has caused the S&P 500 market valuation to fall to 15.9x on forward 12-month earnings which is slightly below the twenty-five-year average of 16.1x.

It is entirely unclear if we are at peak earnings or not. Now we need patience. Market fears often turn out to be unwarranted. As the year progresses, we will see what happens to earnings growth. With no recession in sight, better earnings in the books and below average valuation, a wait-and-see approach is prudent.

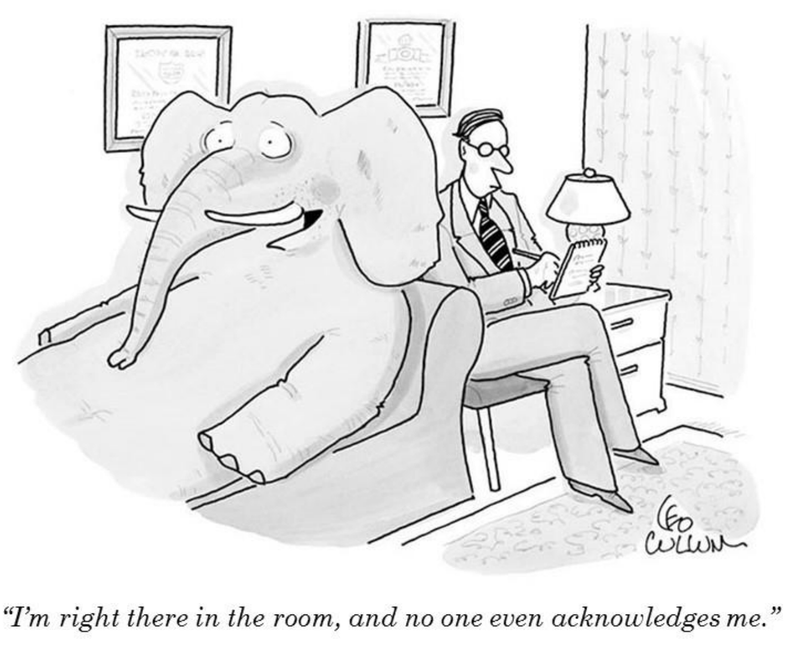
SPECIAL ANNOUNCEMENT: Stand Up for Heroes coming to San Francisco

Stand Up for Heroes (SUFH) is slated to make its West Coast debut in San Francisco on Thursday, May 17 at The Masonic featuring extraordinary comedy performances by Dave Attell, Bill Burr, Jeff Ross and other special guests and hosted by Bob Woodruff.

Stand Up for Heroes has been one of New York's most anticipated nights of hope, healing and laughter benefiting our nation's veterans, service members and their families for the past ten years – we have attended many of them.

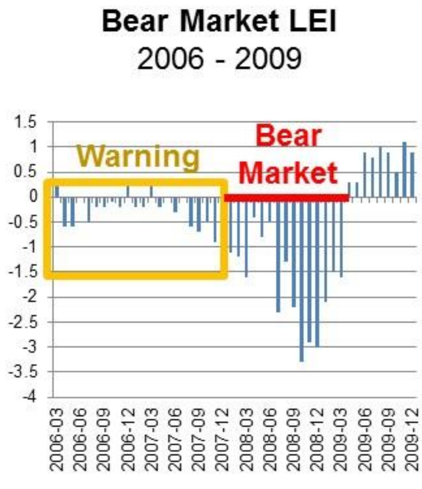
We would like to highlight the incredible work of our friends Bob & Lee Woodruff helping injured heroes. In 2006, Bob was seriously injured by a roadside bomb while covering the war in Iraq for ABC News. His miraculous recovery inspired his family to help injured heroes get access to the high level of support and resources they need. You can learn more about the Bob Woodruff Foundation at bobwoodrufffoundation.org

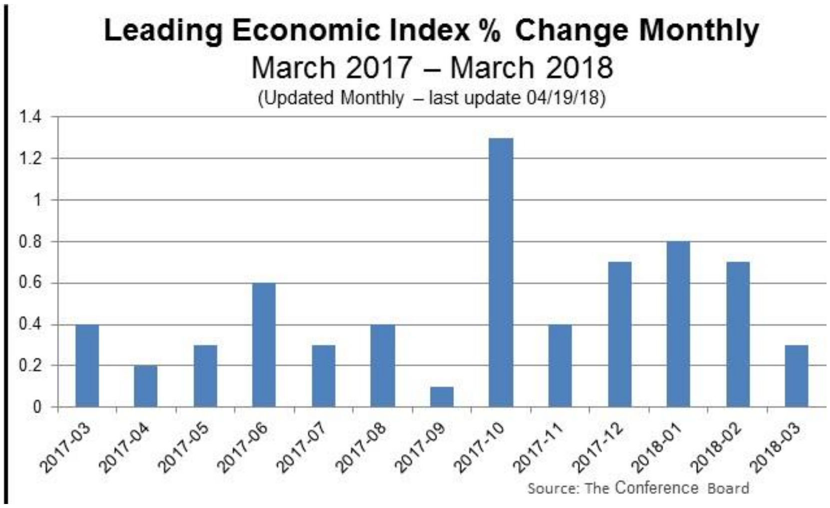
Tickets are available at Ticketmaster.com - we hope to see you there.



"I'm right there in the room, and no one even acknowledges me."

Delta Stock Market Dashboard





MARKET SENTIMENT IS

BEARISH

THIS WEEK'S NUMBER IS

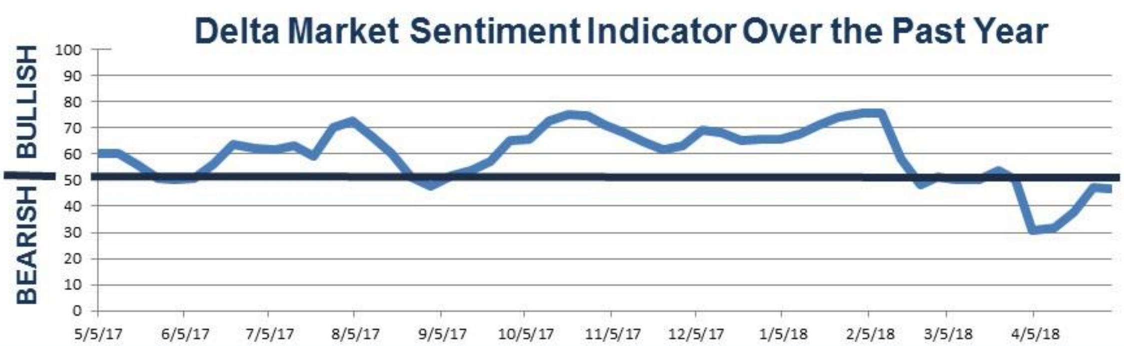
45.9

Our technical indicator decreased this week from 46.7 to 45.9

INDICATOR STATISTICS

Consecutive Bearish Weeks:	6
Cycle Inception Date:	3/29/2018
Range:	30.7 – 47.0
Mean:	40.0
Bullish Weeks YTD:	12
Bearish Weeks YTD:	6
*S&P 500	-1.4%
*DJIA	-2.1%
*NASDAQ	-0.8%

** Percentage change during current cycle*



(Delta MSI is published every week in ***Barron's***)

Give Us a Call Today

We invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com if you have questions about how we can assist you in managing your investment accounts.