



# ARMORY

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## The Buttonwood

Our Thoughts On Investment Trends,  
An Informational Newsletter

2nd Quarter —2017



### The World as One

As the second quarter came to a close we continued to read about how stocks globally have risen in unison in the first half of 2017. An article in the July 1<sup>st</sup> edition of the **Wall Street Journal** mentioned that 26 of the 30 major indexes that represent the world's largest stock markets have risen in the first six months of 2017. This represents the best start to a year since the great recession ended in 2009. Furthermore, in the past 20 years there have been only 4 occasions where stocks have done as well or better in the first half of the year. We follow a larger list of world stock market indexes that includes many of the large indexes and some smaller ones. Of that list of 58, only 4 posted negative results in the first half of the year.

International stock market observers suggest that the rise is due to stronger corporate earnings, improving economies and dovish central banking policy worldwide. Sentiment readings in Europe last week jumped to the highest levels since before the financial crisis in 2008. All of this has been accomplished despite challenges in Washington and political uncertainty in England and Brazil. We mentioned in the Q1 Buttonwood that the Standard & Poor's 500 Index enjoyed its least volatile quarter since the third quarter of 1967. This lack of volatility continued in the second quarter in the US, Asia and Europe. Graeme Bencke a global portfolio manager at Pinebridge Investment, London stated "we're really seeing a synchronized global recovery take shape this year...everything is looking better...we've never seen a period like this".



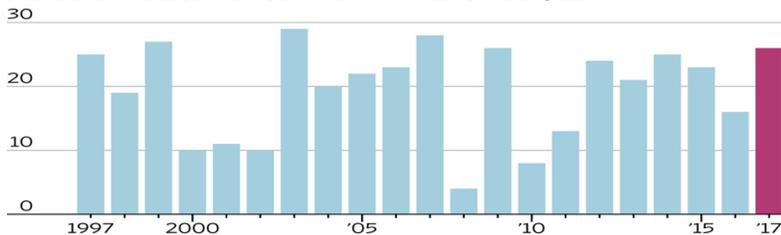
#### History of the Buttonwood

On May 17, 1792, twenty-four merchants gathered under a Buttonwood tree at 68 Wall Street. There they signed the Buttonwood Agreement, creating the first investment community, which later evolved into the New York Stock Exchange.

#### Positive Territory

Twenty-six of the world's top 30 stock-market indexes have risen this year, a first-half performance unmatched since 2009.

Number of indexes that rose in the first half of each year



Source: FactSet

THE WALL STREET JOURNAL.



### ***What's Next***

When the news is this rosy, it is usually wise to assess where we've been, where we are now, and most importantly, where we might be headed. As you can see from the chart on page one, the world's largest markets did not fare well after strong performances in 1999 and 2007. The strong performance in 1999 gave way to the technology bubble bust which presaged three years of tepid growth worldwide. Much of the strength in this year's market rise can be attributed to technology stocks in the US and abroad. This fact has the financial media pundits comparing today to 1999. We don't see much in the way of a relevant comparison.

For starters, the NASDAQ Index is up 14% year-to-date which is its best start since 2009. That 14% gain compares to the gain of 22.50% in the first half of 1999 and while we cannot predict what the full year performance might be for 2017, we don't think the NASDAQ will be up 85.59% as it was in 1999. We also don't see the excessive valuations today that we saw in 1999-2000. The chart below illustrates this point. With respect to the 2008 slow down, we are not in the midst of the excessive real estate valuations we saw back then when compared to today. In fact, the banking sector, which was pummeled as a result of the real estate crisis, continues to report good news with respect to earnings and dividend increases.

<b>S&amp;P SmallCap Information Tech Sector</b>		
	3/9/2000	6/16/2017
Closing index price	379.17	648.62
Market capitalization	\$124b	\$116b
Trailing 12m sales	\$44.3b	\$82.2b
Trailing P/E	379.2x	36.7x
Price/sales	2.8x	1.4x
Trailing 12 net profit margin	0.7%	3.8%
<b>Source: Charles Schwab</b>		

Looking at 2003 and 2009 we can see a different end game. The rally in 2003 did give way to a decline in 2004 worldwide but that set the stage for very solid growth from 2004 to 2007. In the US, the Standard & Poor's 500 averaged 13.16% total return from 2003 to 2007. The same pattern repeated itself in 2009. While worldwide performance was strong in 2009, there was a downturn in 2010 which led to solid worldwide improvement from 2010 to 2013. The Standard & Poor's was up an average of 18.42% from 2009 to 2013 on a total return basis.

If worldwide markets finish 2017 at or near where they were on June 30<sup>th</sup> then we have to ask "are we due for a decline in the next several years like we saw following 1999 and 2007 or might this be a solid base from which we can expect good returns similar to those following 2003 and 2009?"

### ***3 Steps and a Stumble***

Part of the answer may lie with the direction and aggressiveness of monetary policy both domestic and worldwide. As Barron's pointed out in an article by Randall Forsyth in the July 3<sup>rd</sup> edition, "various prominent central bankers last week took to various stages to declare that the time had come to normalize interest rates". From where we sit, that makes sense when one considers where rates are at present both in the US and abroad. We are stating the obvious when we say that historically low or negative interest rates have nowhere to go but up. We agree that there are signs of an ebb to the deflationary pressures we saw early in 2016 as well as some signs of reflation worldwide. However, as we have long contended, modest inflation is a good thing and deflation is a very bad thing.

## The Buttonwood—2nd Quarter —2017

Here at home we are beginning to see what we feel will be a secular (long-term) increase in interest rates. This is something that we have not seen since the early 1980's. Sometimes we forget that the prime rate peaked at 21.50% in December of 1980. Since that time the long term trend has been down with some shorter term spikes up. Now, however, the Federal Reserve has been very transparent in stating that they are intent on returning rates to normal levels. Because rates are at or near historic lows, that process is likely to take a long time. This is something we've stated before.

However, at some point, rate increases will have an impact on stock prices. In the past the old Wall Street adage "three steps and a stumble" was heard any time the Federal Reserve raised rates. Conventional wisdom suggested that when the Fed raised the federal funds target rate, the margin interest rate or reserve requirements three consecutive times without a decline, the stock market was likely to go down to varying degrees. On June 17<sup>th</sup> of this year the Fed raised rates for the 4<sup>th</sup> consecutive time. Thus far "three steps and a stumble" hasn't kicked in mostly because this is not your typical garden variety interest rate environment. The other variables working in the stock markets favor, and in turn keeping the "stumble" at bay, are the very solid earnings increases we've seen lately, low inflation, solid jobs growth and reasonable stock valuations.

<b>Economic &amp; market performance during interest rate periods, based on Fed tightening</b>						
<b>Start date</b>	<b>Fed rate</b>	<b>End date</b>	<b>Fed rate</b>	<b>S&amp;P total return</b>	<b>Coincident index *</b>	
Apr. 1946	1.00%	Dec. 1952	1.75%	11.7%	3.8%	
Apr. 1955	1.75%	Jul. 1957	3.00%	15.1%	3.0%	
Sep. 1958	2.00%	Aug. 1959	3.50%	24.8%	13.8%	
Jul. 1963	3.50%	Nov. 1965	4.00%	16.2%	5.4%	
Nov. 1967	4.50%	Mar. 1969	5.50%	9.2%	4.4%	
Jan. 1973	5.00%	Mar. 1974	7.50%	-13.9%	2.2%	
Aug. 1977	5.75%	Jan. 1980	12.00%	12.6%	3.5%	
Sep. 1980	11.00%	Apr. 1981	13.00%	15.5%	2.7%	
Sep. 1987	6.00%	Jan. 1989	6.50%	-2.4%	4.0%	
Feb. 1994	3.25%	Jan. 1995	5.50%	3.6%	4.6%	
Jun. 1999	5.00%	Apr. 2000	6.00%	8.3%	4.2%	
Jun. 2004	1.25%	May-06	5.00%	7.6%	2.6%	
				<b>Average</b>	<b>9.0%</b>	<b>4.5%</b>
				<b>Median</b>	<b>10.5%</b>	<b>3.9%</b>
				<b>Gain per year over entire history</b>	<b>10.8%</b>	<b>2.5%</b>

\* Coincident index includes: employment, real earnings, average weekly hours worked, unemployment rate

Source: Charles Schwab

When the US markets might stumble as a result of rate hikes, will play out in time. The bet here is that it may take some time before that happens. As the chart above shows, stocks have gone up despite rate hikes and it helps to remember that rate increases will lead to far better opportunities in the bond market. The bottom line – the return to more normal rates over the near term should be expected, the process will likely take some time and not result in too big a stumble.

### The Rest of 2017

May 25<sup>th</sup> marked the 100<sup>th</sup> trading day of 2017 and we uncovered some interesting data on market performance during the first 100 days and through year end. The year-to-date gain (price return) for the S&P 500 on May 25<sup>th</sup> was 7.9% which was the fourth best 100 day start in the last 20 years. Why might this be relevant data? According to LPL Financial, the S&P 500 has never finished an entire year down after such a strong start. As the chart below shows there have been 23 years when the S&P has risen 7.6% or more in the first 100 trading days. From the 101<sup>st</sup> trading day to the end of the year the market has been down only 3 times. There were slight losses in 1975 and 1983 during this time frame and a significant loss in 1987. The '87 loss makes sense because of the record one day loss (-22%) in October of that year.

### Years S&P 500 Was Up > 7.5% as of Day 100

Year	Day 100	S&P 500	Day 100 Return	Day 101 To Year End	Full Year Return
1950	5/25/1950	18.69	11.3%	9.3%	21.7%
1954	5/25/1954	28.93	16.6%	24.4%	45.0%
1958	5/22/1958	43.78	9.5%	26.1%	38.1%
1961	5/24/1961	66.26	14.0%	8.0%	23.1%
1963	5/23/1963	70.10	11.1%	7.0%	18.9%
1964	5/22/1964	80.73	7.6%	5.0%	13.0%
1967	5/24/1967	90.18	12.3%	7.0%	20.1%
1971	5/25/1971	99.47	8.1%	2.5%	10.8%
1972	5/23/1972	109.78	7.7%	7.5%	15.8%
1975	5/23/1975	90.58	32.1%	-0.4%	31.5%
1976	5/24/1976	99.40	10.3%	8.1%	19.1%
1983	5/24/1983	165.54	17.7%	-0.4%	17.3%
1985	5/23/1985	187.60	12.2%	12.6%	26.3%
1986	5/23/1986	241.36	14.2%	0.3%	14.6%
1987	5/26/1987	289.11	19.4%	-14.5%	2.0%
1989	5/24/1989	319.14	14.9%	10.7%	27.3%
1991	5/23/1991	374.97	13.6%	11.2%	26.3%
1995	5/24/1995	528.61	15.1%	16.5%	34.1%
1996	5/22/1996	678.42	10.1%	9.2%	20.3%
1997	5/23/1997	847.03	14.3%	14.6%	31.0%
1998	5/27/1998	1092.23	12.6%	12.5%	26.7%
2003	5/27/2003	951.48	8.1%	16.9%	26.4%
2013	5/24/2013	1946.60	15.7%	12.0%	29.6%
2017	5/25/2017	2415.07	7.9%	?	?
			Average	9.0%	23.4%
			Median	9.2%	23.1%
			Higher	20	23
			Lower	3	0

Source: LPL Financial, 5/28/17

Never in any of these 23 years has the S&P 500 finished down for the entire year. The average gain from day 101 to year end was 9.0% and for each year overall the gain was 23.4%. These statistics in concert with continued low market volatility are usually very good signs. Through June 30<sup>th</sup> S&P 500 performance had improved to 8.2%.

When combined with continued low inflation, improving jobs data, a slow normalization of interest rates and favorable market performance worldwide we think we have a good chance that the balance of 2017 will help you **"GET RICH SLOW"**.



For more information about our investment philosophy and approach, please visit [www.armorycm.com](http://www.armorycm.com).

## CONTACT US



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## 7 Key Tenets to Successful Long-Term Investing

At its core, we believe that successful investing requires a consistent investment philosophy and discipline. We believe that buying and holding quality investments over a long period of time is the foundation for a successful investment program. Here are our beliefs for successful investing:

1. GET RICH SLOW
2. BELIEF IN CAPITALISM, FREE ENTERPRISE, & AMERICA
3. A DISCIPLINED INVESTMENT PHILOSOPHY IS CRITICAL
4. DON'T OVERPAY FOR UNDERPERFORMANCE
5. COMPARE PERFORMANCE CORRECTLY
6. TAXES ARE IMPORTANT
7. MANAGERS MANAGE

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### Patient Investing. Steady Returns.

**Successful investing is an elusive reality for many people. It should not be that way.**

Investors who are willing to embrace a long-term time horizon, adhere to a conservative investment philosophy, and seek proper guidance will be rewarded. In the short run, the markets may seem volatile, in the long run, the trend is favorable for those willing to hold quality investments over time.

At ACM we believe that the underlying principles of sound investment should not alter from decade to decade. The likelihood for success is overwhelmingly in your favor if you have the required patience and proper guidance.

Please call us, we'd like to help you *Get Rich Slow*.