JAG
CAPITAL MANAGEMENT LLC

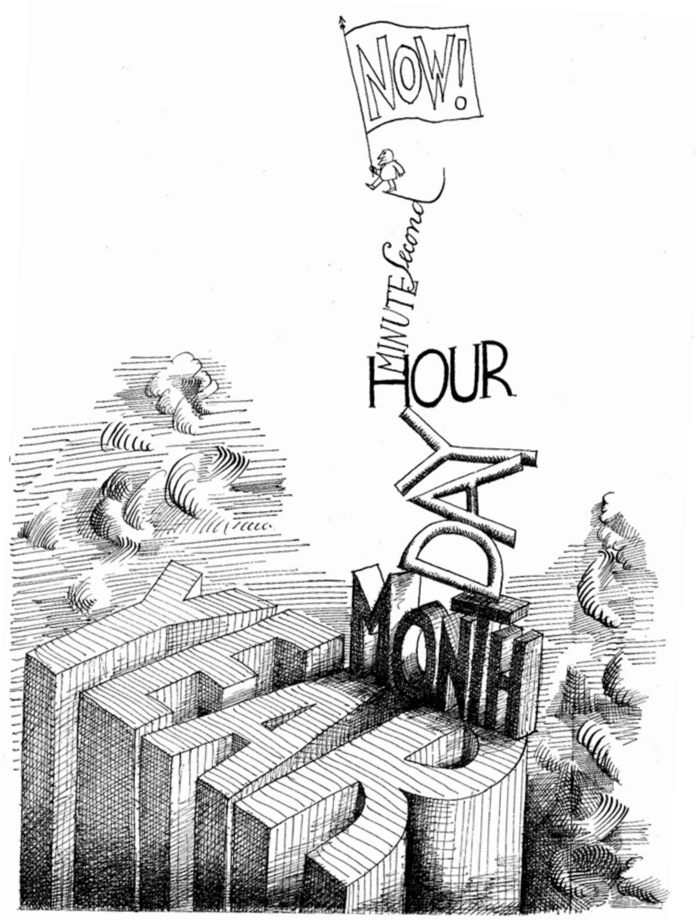


# 2nd Quarter 2018: Reviewing the Big Picture

Norm Conley | CEO & CIO

The US stock market rebounded during the 2nd quarter, despite chaotic news flow highlighted by rising energy prices, a flattening Treasury yield curve, turmoil in emerging markets, President Trump's tariff policies, and growing fears of a trade war between the US and China. The S&P 500 successfully navigated all this noise to generate a quarterly gain of roughly 3%. This left the benchmark index with a 2.7% year-to-date return, albeit still roughly 5.5% below its January peak.

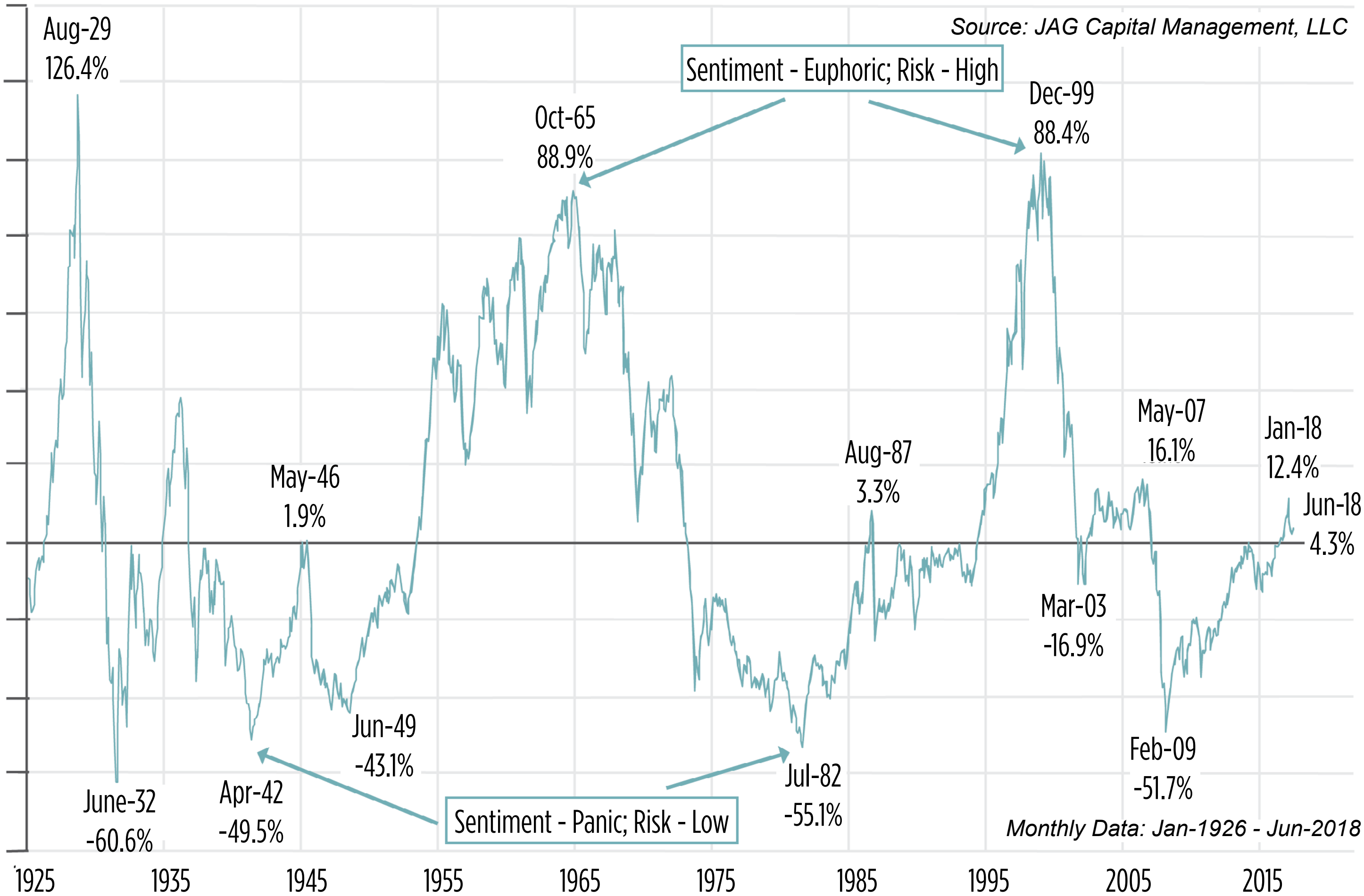
As measured by the 10-year US Treasury bond, interest rates have moved .5% higher since June 2017, leading some forecasters to proclaim that we have entered a "bear market" for bonds. We think that characterization is a bit overly dramatic. It is true that bond prices have declined modestly over the past year as a reflection of the inverse relationship between bond prices and interest rates. But so far, rates show few signs of rocketing materially higher over the coming months. In fact, we do not see a lot of fundamental reasons for bond yields to move much up or down from current levels over the next 12-18 months. Bond investors with portfolios comprised of high-quality bonds and a laddered structure of short- to intermediate-term maturities can reasonably expect relatively stable returns and cash flows. And happily, short-term fixed income instruments like money-market funds and shorter-term bonds are finally offering reasonable yields. After years of zero rates, the ability to earn even a meager return on cash equivalents should be a breath of fresh air for savers and investors.



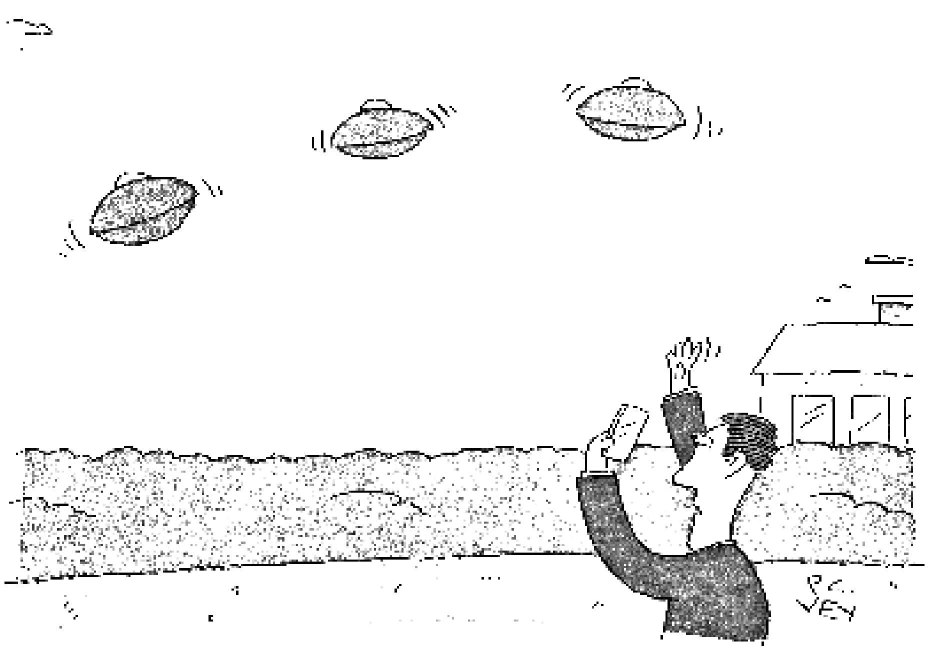

As is usually the case, we have a generally optimistic big-picture outlook on the economy and the investment markets. Over the last several years, one has not had to look very hard to find lots of pundits who disagree with us. Most recently, we have been reading and hearing a lot of commentary that notes how "extended" the current bull market is. We find a different (and clearer) picture when we compare the inflation-adjusted S&P 500 with its long-term trend since 1926. There have been three true stock market "bubbles" in the past 93 years: the 1929 mania, the Nifty 50's in the 1960's, and the Internet bubble craziness in the late '90's (Remember that the 2008 Great Financial Crisis was a global liquidity collapse in the financial markets, rather than the popping of a classic bubble in stocks). Note that each of these three events occurred when the S&P 500 was trading more than 80% higher than its long-term inflation-adjusted trend line. The current reading shows that the market is only 4.3% above this trendline. Does this mean we can be certain that stocks are not on the precipice of a bear market or a big correction? No! In the short term, markets can do whatever they want to do, whenever they want to do it. However, we can say with a high degree of confidence that the stock market is not showing the signs of euphoria that it showed at past bull market "bubble" tops.

.

## S&P 500 Returns: Deviation From Long Term Trend

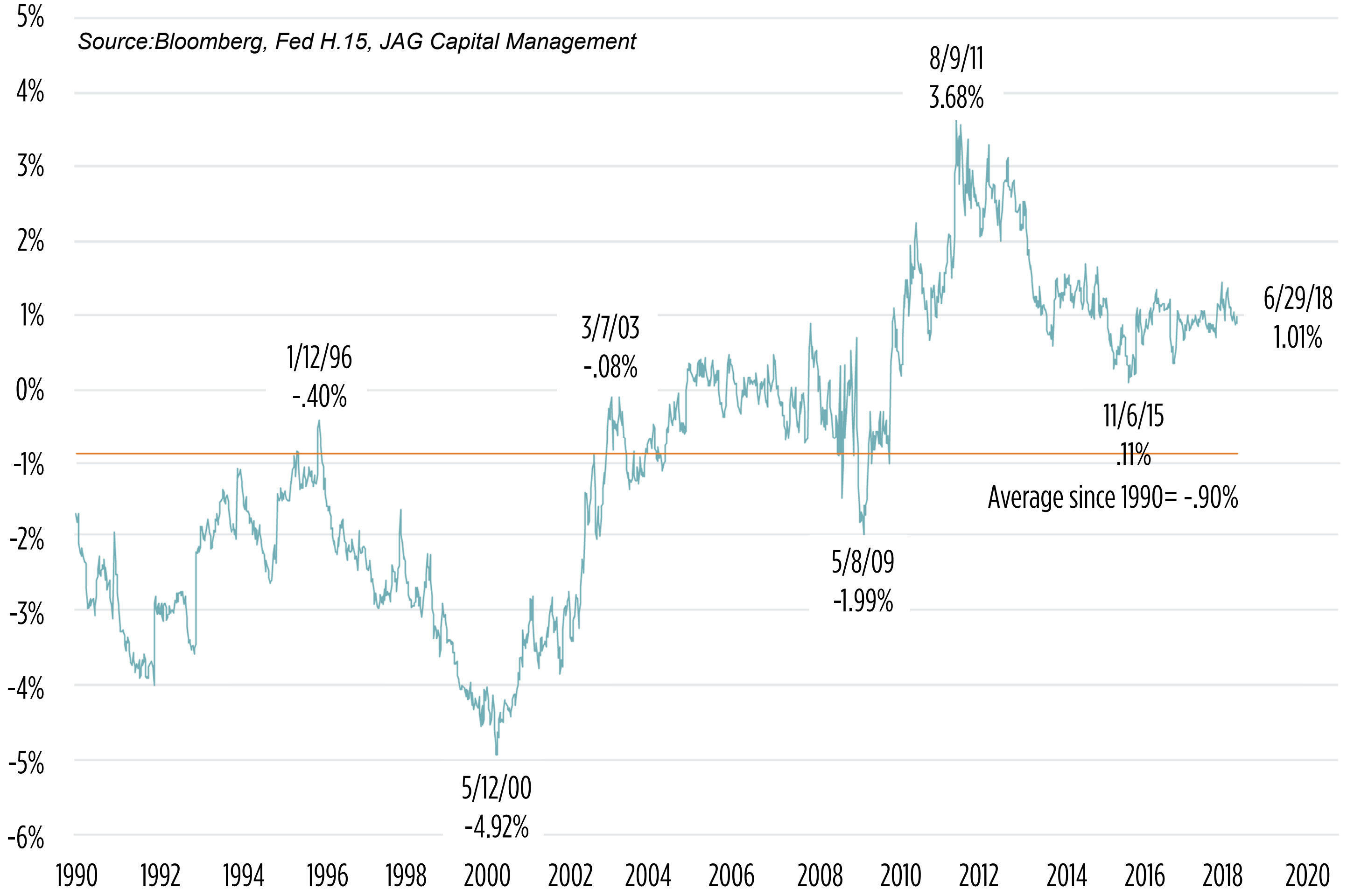



From a relative valuation perspective, stocks are no longer as cheap as they were during the summer of 2011, but they continue to be relatively attractive on an earnings yield basis. This chart compares the S&P 500's forward earnings yield to BAA-rated bond yields. The S&P's 5.9% forward earnings yield is 1% higher than BAA-rated bonds yielding an average of 4.85%. This implies that stocks remain reasonably valued when compared to corporate bonds. Of course, this measure assumes that corporate earnings continue to be strong, which is far from a guarantee. But it also refutes the commonly-cited narrative that stock valuations are historically high. If earnings continue to be reasonably robust over the next year, and bond yields do not spike significantly from here, we think there is valuation support for higher stock prices over the intermediate term.

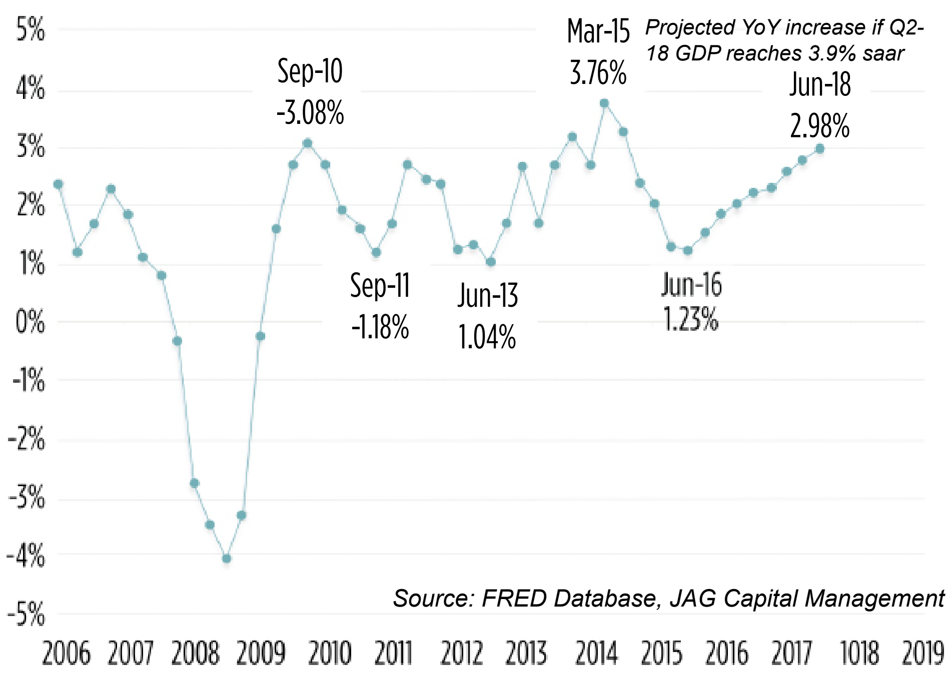


*"Get closer together, closer together."*

## S&P 500 Fwd Earnings Yield - Baa Yield



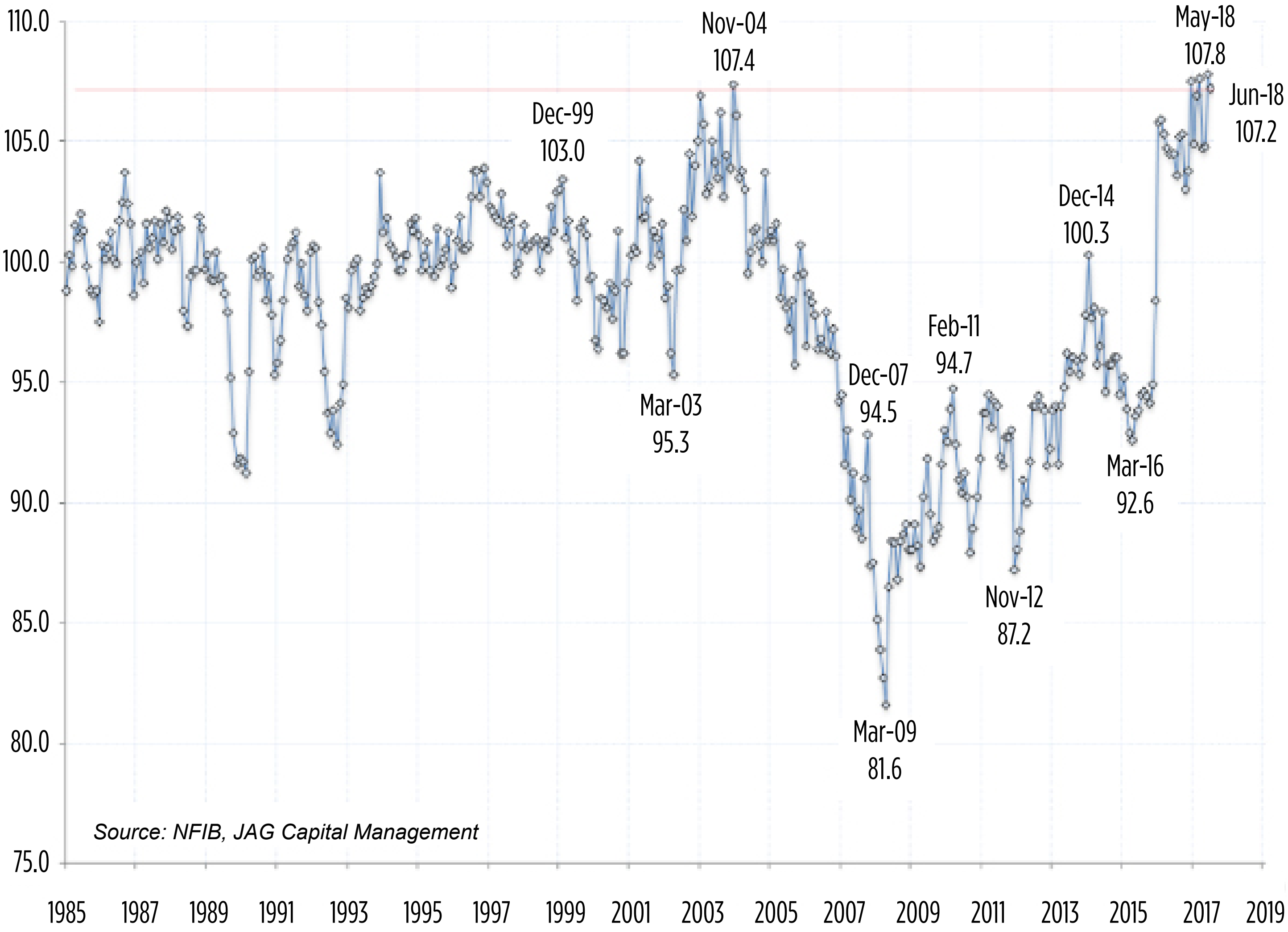

## Real GDP - YoY Pct Chg



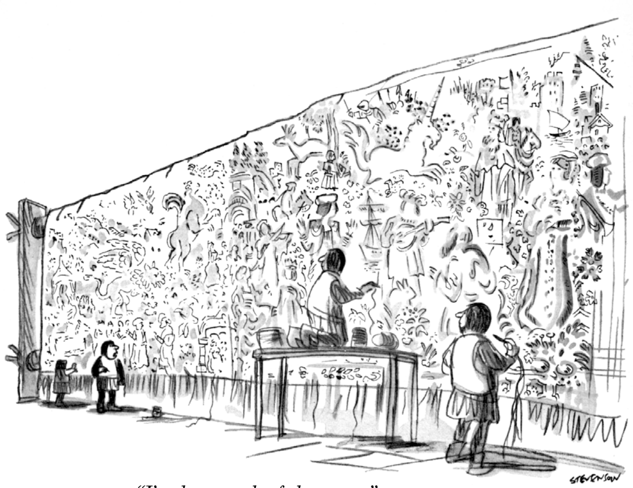

In mid-June the Atlanta Fed forecast an increase of 4.8% (seasonally adjusted annualized rate) in GDP for 2Q 2018. The estimate has slipped some in recent weeks to 3.9% which would still be the highest growth since 3Q 2014. It would also represent 2.98% year-over-year growth in real GDP, continuing the trend of economic acceleration that began in mid-2016.

Small businesses employ over 50% of the private nonfarm workforce in the United States, so they are very important to the labor force and the economy. According to the June 2018 NFIB survey, small business owner optimism is near all-time highs. To the extent that small business owners continue to express such an optimistic view of the future, it bodes well for economic growth and employment trends.

## NFIB Small Business Optimism Index




We are living in an age of extraordinarily rapid technological change. One example of many is the revolution in personal transportation, courtesy of ride-hailing services like Uber and Lyft. As recently as early 2015, taxi and rental car receipts represented a combined 75% of all corporate ground transportation travel reimbursements in the U.S. By late 2016, Uber and Lyft reimbursements had grown to more than 50% of the total. Less than two years hence, the market share of taxi and rental car receipts have collapsed to less than 30%, while Uber and Lyft's combined shares have exploded to 71%. Although neither Uber or Lyft are public companies (yet), we think there are still some important takeaways for investors.

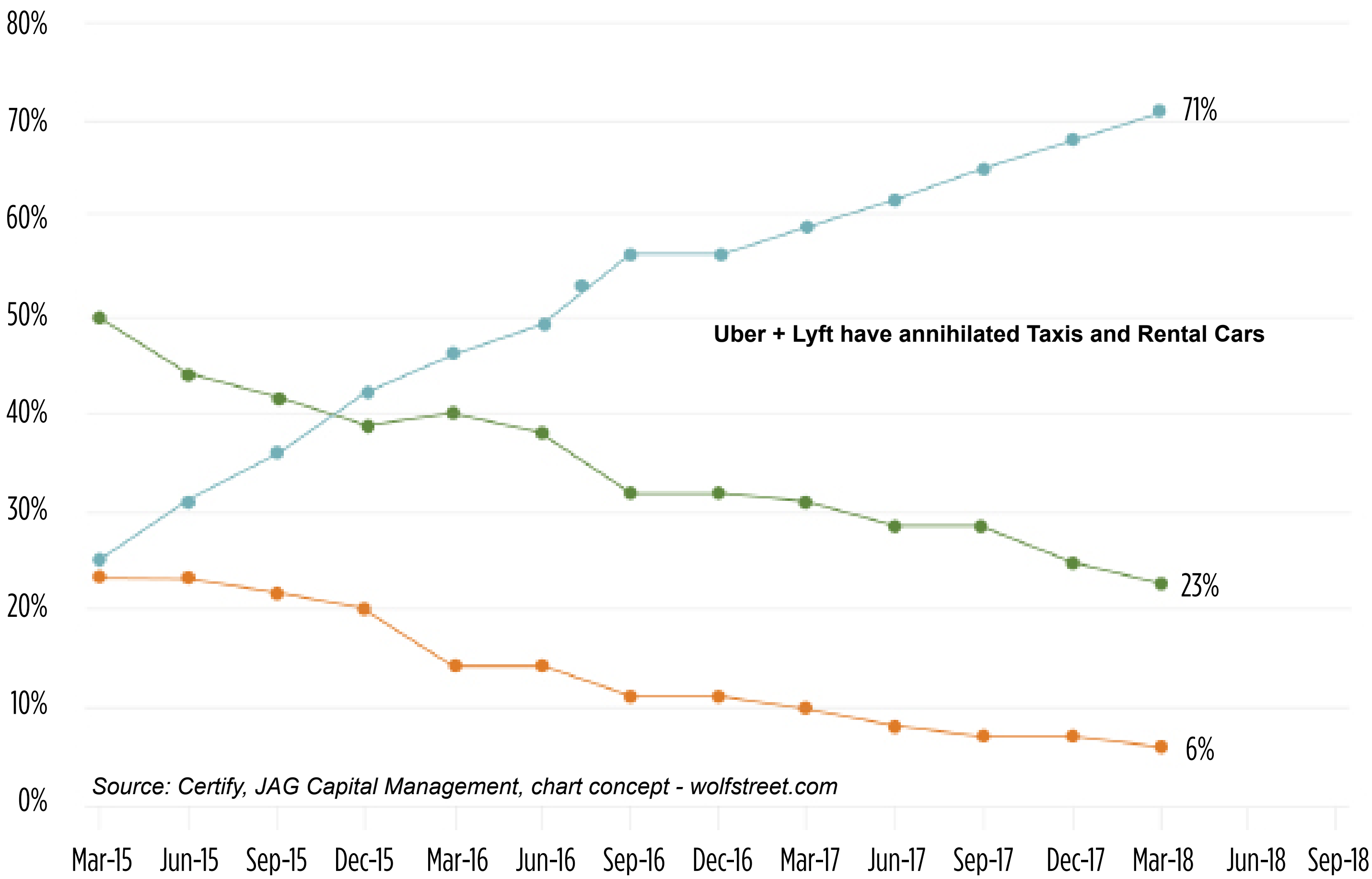


*"I've lost track of the story."*

First, given that the shares of both Hertz and Avis-Budget have vastly lagged the broader equity market over the past three years, investors should be careful when evaluating apparently "cheap" stocks that operate threatened business models. Secondly- and more broadly – we think technological disruption is arguably occurring faster today than at any time in the past. If we are correct in this opinion, it is likely that investors should expect more incumbent business models to be quickly cast aside by technological advances in the future. This will create both phenomenal opportunities and risks for long-term investors. Stated another way, true disruptors could experience outsized gains, while "disruptees" could experience rapid and dramatic valuation declines.

P.S. According to the Wall Street Journal, the auction prices of New York City taxi medallions fell below $200,000 apiece in early 2018, less than five years after peaking at roughly $1 million.

**Uber + Lyft (blue line), Taxis (orange line), Rental Cars (green line)**
**Percentage of Ground Transportation Travel Reimbursements**




All of us at JAG wish you a safe and happy summer!

Norm Conley
CEO & CIO

**DISCLOSURES**

These comments were prepared by Norm Conley, an investment advisor representative of JAG Capital Management, LLC, an SEC registered investment advisor. The information herein was obtained from various sources believed to be reliable; however, we do not guarantee its accuracy or completeness. The information in this report is given as of the date indicated. We assume no obligation to update this information, or to advise on further developments relating to securities discussed in this report. Opinions expressed are those of the advisor listed above as of the date of this report and are subject to change without notice. Opinions of individual representatives may not be those of the Firm. Additional information is available upon request.

The information contained in this document is prepared for general circulation and is circulated for general information only. It does not address specific investment objectives, or the financial situation and the particular needs of any recipient. Investors should not attempt to make investment decisions solely based on the information contained in this communication as it does not offer enough information to make such decisions and may not be suitable for your personal financial circumstances. You should consult with your financial professional prior to making such decisions. For institutional investors: J.A. Glynn Investments, LLC, and JAG Capital Management, LLC, both have a reasonable basis to believe that you are capable of evaluating investment risks independently, both in general and with regard to particular transactions or strategies. For institutions who disagree with this statement, please contact us immediately.

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. ANY INVESTMENT CONTAINS RISK INCLUDING THE RISK OF TOTAL LOSS.

This document does not constitute an offer, or an invitation to make an offer, to buy or sell any securities discussed herein. J.A. Glynn & Co., JAG Capital Management, LLC, and its affiliates, directors, officers, employees, employee benefit programs and discretionary client accounts may have a position in any securities listed herein.

JAG
CAPITAL MANAGEMENT LLC

9841 Clayton Road | St. Louis, MO 63124
800.966.4596 www.jagcapm.com