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NEWSLETTER SECOND QUARTER 2017

Inside This Issue

Welcome

Welcome to the inaugural issue of the MONTAG Newsletter. We plan to use this new initiative to share some deeper insights into the markets, details about upcoming MONTAG events, and other topics we hope will be of interest to you. We welcome your thoughts and feedback. Please send us a note at info@montagwealth.com or call our office at 404-522-5774

Event Calendar

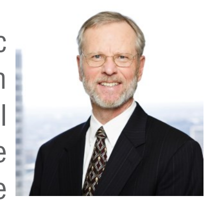
- **October 17, 2017 – Executive Breakfast**: Join us for breakfast at 7:30am as one of our Portfolio Managers details an economic observation and takes questions from 30-40 attendees at the Cherokee Town and Country Club.

- **November 8, 2017 – Facts and Finance for Women** : Please join us for a morning of presentations from MONTAG staff members, Henry Bowden of the Bowden Spratt Law Firm, and Joseph Bankoff, Chair of the Fulton County Arts Council. Lunch will be served.

If you are interested in attending these upcoming events or would like more information, please RSVP by emailing us at info@montagwealth.com or visit us at montagwealth.com

Observations on the Markets

By: Thomas R. Frisbie, CFA



Those investors who thought at the start of 2017 that the Trump administration's economic agenda would spark inflation have yet to see their expectations met. The most recent data on the personal consumption expenditures index, the measure of inflation favored by the Federal Reserve, was a gain of only 1.4 per cent year over year and an actual decline of 0.1% during the month of May. Interest rates across the spectrum of U. S. fixed income securities fell, and the search for meaningful high quality yields remains extremely challenging.

So what is going on with an economy that is eight years into an expansion begun in 2009 and that has yet to produce any meaningful upward pressure on resources, labor and therefore on prices? The answer is... it remains what it has been for the past eight years. The Fed dropped its short-term Fed Funds rate of interest to virtually zero in 2009 and held it there until late in 2016.

Nevertheless, this unprecedented policy has not coaxed businesses and individuals to borrow even more. *(Actually, the total amount of "nonfinancial" debt in the system, meaning debt that you and I use for personal or business purposes, has fallen from $4.8 billion in 2009 to approximately $3.6 billion currently. However, the Fed's policy to cheapen the cost of borrowing has been catnip to investors wishing to buy securities with borrowed money, also known as total margin debt. This amount of borrowing has tripled from $173 billion at the 2009 lows to $540 billion currently. It is concerning when borrowings to build or buy things are way down while borrowings to speculate on securities are way up.)*

You may hear bankers and the central bank talk about money supply growth. The thinking is that the bankers want us to borrow money and then spend and re-spend that same money at a faster clip. This helps to drive economic activity or “GDP” higher. How do you think it is working so far? Well, for the 12 months ended May, 2017, the supply of “money” (credit) has grown at a 4.0% rate. However, the pace at which that money is being circulated through the economy, again and again, has FALLEN at a 4.3% rate. The phenomenon might be akin to inflating a balloon with hot air, only to see the air inside the balloon cooling just as fast as additional air can be pumped into it. The net result is no progress. Money “supply” (new debt) has been growing at a steady but very slow pace for years, while money circulating through the economy continues to slow. Apparently, there is little that the Fed can do to stimulate growth in economic activity which may be part of the reason that the Fed has now made small hikes in the Fed Funds rate three times since last fall.

There could be a bright spot forming as help for the economy may be on the way from the private sector and young adults. The back story for this is that normally, the annual rate of household formations in the U.S. has slightly exceeded population growth rates, as the number of dwellings per family increased. However, since 2007, the trend of young family members moving out to form their own households has slowed, with more young adults living at home for longer, instead of going out on their own. Perhaps it is due in part to tougher labor markets employing fewer young adults and paying less, or perhaps it is due in part to stifling levels of student debt after graduation, but in any case, housing has remained remarkably weak relative to historical norms. The rate of household formations for the period of 2010 through 2015 averaged only 900,000.

We may be turning the corner if Fred Furlong, of the San Francisco Federal Reserve Bank, is correct. Mr. Furlong has quoted the Census Bureau as forecasting a return to a household formation rate of 1.5 million annually through 2020. If this forecast is even close to correct, the housing industry, a large employer and a large part of overall economic activity in the U.S., will begin contributing to higher levels of GDP growth and a stronger overall economy.

As always, life and economics are both uncertain, so the smart investor (and his or her advisor) should make adjustments along the way.

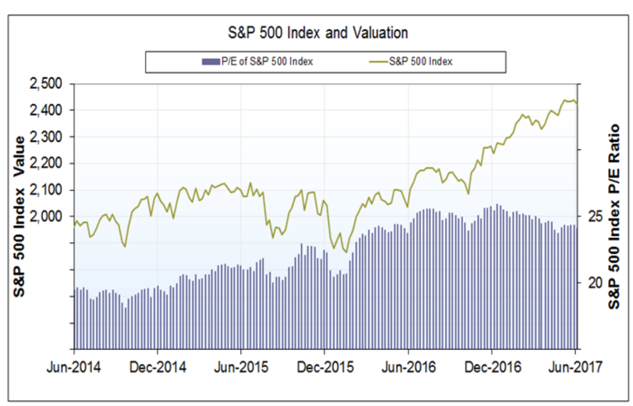
Market Health

By: Kent Shaw, CFA

The S&P 500 Index reached another all-time high in May and June but the pace was noticeably slower. The slowing pace is not necessarily cause for concern because measured increases tend to produce longer trends than sharp increases. The market has still not experienced a 5% decline in almost 8 months as of this writing. Such conditions do not guarantee that a correction or slight pullback is ahead, but it reminds us to not be surprised when a return to more normal volatility occurs.

Earnings growth for the first quarter, which was reported during the second quarter, was strongly positive as the companies of the S&P 500 Index reported aggregate earnings growth of 13% with 75% of those companies beating earnings forecasts, according to Strategas. Growth for the remaining quarters is expected to be more muted.

The aggregate Price/Earnings ratio—the ratio of stock price over earnings per share—of the S&P 500 (represented as bars on the chart at right) is high but there has been some improvement. As of the end of the second quarter, the trailing P/E of the S&P 500 is 24, down from its peak over 25 last year as earnings have grown. The valuation metrics of stocks are also relatively high when measured by their own P/E ratio, but we are seeing an improvement as many companies are showing improved earnings. We are still finding interesting companies at attractive valuations and prefer to concentrate most of our new purchases in such ideas. The flexibility to buy and sell individual stocks allows better control for valuation in markets like these.



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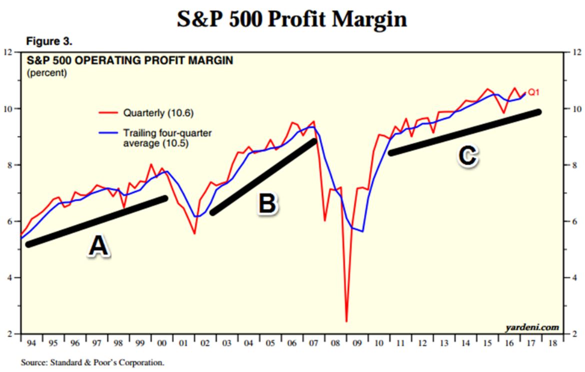


We know that P/E ratios, while imperfect in many ways, reflect expectations and also quality. Companies with higher profit margins and which are more efficient users of capital tend to have higher P/E ratios than their peers. In the last two decades, margins for many companies have reached new highs due to a mix of benefits from technology and from outsourcing. In the chart on the left, which represents data from 1994-2017, this change is represented by segment C plotting on a line much higher than segment A.

Our process includes reading and analyzing research from well-respected investment services. We recently noticed that a well-respected professional money manager, Jerry Grantham, has publicly suggested that a permanently higher valuation range for the S&P 500 index could be warranted given the higher profit margins relative to prior decades. If he is correct, this would change the perspective that many investment managers would need to look at when analyzing market valuations in the future. As we are always open to changes in the market environment, we can ponder this in our analysis.

Healthcare Accountability: Will It Start Soon?

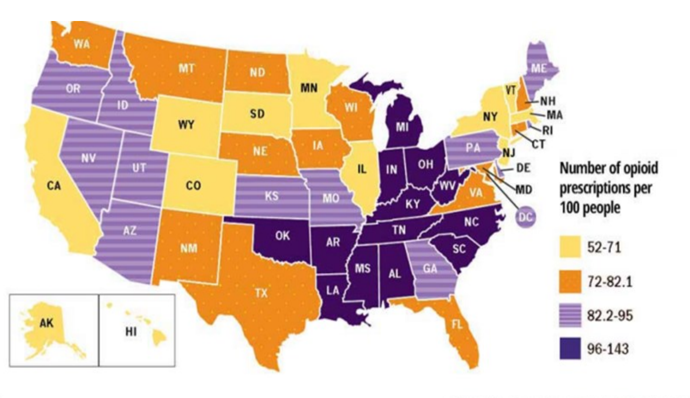
By: Kent Shaw, CFA

A story that seemed to get lost in the daily noise of the frenetic news cycle is a lawsuit filed by the State of Ohio against a number of pharmaceutical companies that produce opioid or synthetic opium-based pain management drugs. It is similar to a lawsuit filed by the State of Mississippi earlier in the year. The synthetic nature of these drugs makes them up to 50 times stronger than a similar amount of the natural opium component. Both lawsuits assert that the drug manufacturers understated the addictive nature of their products and overstated the benefits in order to increase sales. It's important to note that the State of Ohio hired the same lead attorney from the class action case against the tobacco companies many years ago. As expected, the five drug companies deny all charges.

Some troubling statistics are listed below:

- The CDC reports that available evidence does not support the claim that opioid drugs can improve chronic pain, function, and quality of life.
- The CDC reports that opioid prescriptions vary widely across different states, while the health issues opioids are expected to alleviate do not vary across states. In 2012, the highest prescribing states wrote almost 3 times as many prescriptions as the lowest prescribing states.
- Ohio's Attorney General reported that 80% of heroin users report first using prescription opioids.
- The death rate of synthetic opioids other than methadone, which includes drugs such as tramadol and fentanyl, increased by 72.2% from 2014 to 2015. (The Centers for Disease Control).

The map below uses data from 2012 and illustrates the massive disparity among states regarding prescriptions:



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Why are we reporting this in a newsletter to investors? First, this is a human problem and the drug addiction epidemic has vast implications to society, including state and local government spending. Second, it draws attention to public policy that may impact healthcare companies. In addition to the risk of losing these lawsuits, one of the proposed changes to the Affordable Care Act is a drug pricing policy that sets prices based on effectiveness. Also, a similar pricing methodology could eventually be applied to other types of healthcare, which would likely have negative impacts on profit margins and the future returns for the stocks of affected companies.

Protecting Your Online Identity

By: Stacey Godwin

With people conducting more business and personal tasks electronically, identity theft is now the fastest growing crime in America, with someone's identity being stolen every 2-3 seconds. The financial sector continues to be a very attractive target. Here are seven primary ways you can be vulnerable:

- EMAIL ACCOUNT TAKEOVER: Also called e-mail hacking and is the most common way personal data is stolen. The criminal then impersonates you through the hacked account to make wire transfer requests, steal passwords, etc.
- PHISHING: Criminals pose as a trustworthy source requesting personal information via e-mail. Approximately 70% of cyber-attacks use a combination of phishing and hacking strategies.
- MALWARE: Malicious software is installed on a computer or network when a user clicks unsafe links, opens infected file attachments, or visits websites containing malicious adware.
- CREDENTIAL REPLAY: Cybercriminals obtain re-used usernames and passwords, test them in large numbers against financial institution websites and request fraudulent transfers with successful logins.
- SOCIAL ENGINEERING: This tactic involves manipulating or impersonating others to persuade the target to divulge sensitive, private information, and then demanding financial transactions be executed to avoid consequences.
- CALL FORWARDING: Cybercriminals take over your cell phone number, reroute calls to their cell phone and subsequently impersonate you in an attempt to steal money.
- SPOOFING: Cybercriminals use fake e-mail headers so the message appears to be from a legitimate source with the goal of tricking recipients into opening or responding to the email.

Here are some tips to keep you from becoming another target for cybercriminals:

- BE STRATEGIC WITH USERNAMES AND PASSWORDS: Create passwords that are long with a variety of characters and mixed case letters. Avoid personal information in passwords that can easily be found online such as family names, birthdates, addresses, etc. Change your password often and use two-factor authentication when available.
- SURF SAFELY: Only use protected and trustworthy wireless networks. Never use a public computer to access personal or financial information.
- PROTECT YOUR FINANCIAL ASSETS: Review your credit card, cell phone and financial statement records as soon as they are available and contact the appropriate party about suspicious activity immediately.
- LIMIT WHAT YOUR SHARE ONLINE: Be selective about information you share on social media sites and be sure to check privacy and security settings on social media sites frequently to monitor what's being shared.
- SAFEGUARD EMAIL ACCOUNTS: Never click on links, ads or attachments in unsolicited e-mails. Viruses or malware can be embedded in forwarded jokes, attachments or news article links, even from friends and family.
- KEEP EQUIPMENT UP TO DATE AND SAFE: Be sure the most up-to-date anti-virus, anti-spyware and patching software is installed on any device connecting to the internet.

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