Argent Capital Management LLC

At Argent we look for change. That is core to our investment process. Change, we believe, creates uncertainty and increases the potential to identify mispriced assets. Those stocks that we include in our portfolio are undergoing positive change, which we believe will drive upward pressure on the stock's valuation and, consequently, the trajectory of the stock's price. In May the market saw change, but it was not of the positive variety.

Our President, rightly or wrongly, backed away from a trade deal with China. Prior to that event, consensus expectations were for the U.S. and China to ink a trade agreement during the G20 meeting in June. Then the change – no deal – happened and the market reacted. For the four weeks of May the markets fell each and every week. The valuation of the market fell as well. What played out was the mirror image of what we pursue in our investment approach - we seek change driving *betterment*. This was change, unfortunately, driving…*worsement*? The silver lining we guess was that it validated our investment approach – change certainly does impact stock pricing.

The impact of the thunder cloud in May was what that change wrought on stock prices. The average U.S. stock fell by around 6%, with the final thunder clap for the month occurring on May 30th when the President surprised the market again, saying he would slap tariffs on Mexico because Mexico was not doing enough to slow illegal immigration into the United States.

So where does this change leave us? Last month we showed our Rule of 20 graph, based on the belief that investors should pay a multiple for each dollar of earnings calculated by taking the number twenty and subtracting the current yield percent, or interest rate, on the U.S. 10 Year Treasury bond. As May closed and June began, the 10 Year Treasury bond was yielding a little over 2.2%. Doing the quick math, that implies that the market – or the S&P® 500 Index – should be trading at 17.8x (20.0 – 2.2) forward 12 month earnings. Instead, the S&P 500 Index closed the month of May trading at a 15.6 times forward earnings multiple, implying that that market is undervalued by over 12% today.

Investor caution - skepticism - is implied in this discrepancy between the market's actual and theoretical valuations. Within that, skepticism particularly abounds for those companies that are more closely tied to the ups and downs of economic cycles, otherwise known as *cyclical companies*. As an example, think homebuilders, or auto and machine manufacturers.

Why should this group of stocks be particularly cheap? There are several explanations, and I will list two. One reason given is that we are in the tenth year of a recovery and recoveries only last for so long. Another reason given is that the world economy is slowing and slowing economies make successful execution for cyclical companies more difficult. Both reasons are valid and both may come to pass. But we will only know those answers in the future and the future is unknown to all. In the present time, what we are finding in the cyclical stocks we are adding to our clients' portfolios are companies with good growth prospects trading at valuations that appear to assume a recession in the near-term, a forecast that is at odds with the majority of economic forecasts. How this will all play out and what will be the next change, positive or negative, to affect the markets – stay tuned.

We have four successful equity strategies – Large Cap, Small Cap, Dividend Select and Mid Cap. If you have questions on any of these options, please call us.

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