SEVENS REPORT *alpha*

Webinar #3: Interview with Ali Motamed

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Guest: Ali Motamed, PM Balzer Invenomic Fund (BIVIX)

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- Goals for Today’s Webinar

  - “What Do You Think About Markets?”

  - Ali Motamed
    - Background
    - View on the Markets – Cautious Because of the Fed Taper
    - Pockets Of Risk – Over Owned, Over Valued Sectors At Risk
    - Pockets of Strength – Free Cash Flow Yield Is the Key

  - Q&A

"What Do You Think About the Market?"

- New Highs – All Good?
  - Is the reflation finally taking hold?
    - Tipping point two week's ago with global inflation turn?
    - Banks stage massive rally
    - Bond yields, dollar at one month highs
    - But – need to beware of head fakes

- Key Signals to Watch
  - BKX (KBW Bank Index) needs to break out (above 100)
  - 10 Year Yield needs to move above 2.40% (key resistance)
  - We still need a positive catalyst to help spark an extension of the 2017 rally, and there are two places it can come from:
    - Tax Cuts (they will raise 2018 EPS to at least $145/share)
    - Economic acceleration/Earnings (rising tide will help push stocks higher)

Ali Motamed

- Background
  - Morningstar Alternative Portfolio Manager of the year for 2014.
  - Previously Co-PM of Boston Partners flagship long/short fund.
  - Delivered compounded 25% + annual returns from 2007-2010 period – through the crash.
  - Ali's team had the best performance of all '40 Act Alternative funds throughout his tenure and delivered 11%+ after fees vs a 7% return for S&P while carrying a large short book of about 50% on average.
    - So, hedged exposure but better returns!

Ali Motamed

- View On the Markets
  - Why is Tapering of Fed Balance Sheet, which starts next month, an underappreciated risk?
    - **Reason 1: Higher Rates:** Tapering of the Fed Balance sheet will put upward pressure on interest rates as the Fed removes demand for bonds.
    - 1) Higher rates = Higher interest expense, taking earnings down
    - 2) Higher rates makes other investments more attractive as bonds decline/yields rise (kills TINA trade). This is especially important for utilities (XLU) and REITS (VNQ).
    - 3) Higher rates leads to larger discount rates and equities are longest duration assets – resulting in declining present value of stocks

    - **Reason 2: Reduction of demand for equities.**
    - Rough math is taper is going from $10-$50bn a month or $120 - $600bn a yr.
    - That's important because stocks are driven by two things:
      - 1 Investment and 2. Supply and demand.
      - It seems like with the taper we no longer have either reason.
    - Looking at GDP and savings and calculate that normal demand for equities is around $200bn yr. This basically consumes all of that demand.

Ali Motamed

- Pockets of Risk

  - In the 200 year history of US capital Markets market has only been more highly valued 1 year (in 2000).
    - This is according to both Cyclically Adjusted P/E Ratio (CAPE) and Market Cap to GDP.

  - Tech: Tech stocks have had a great run, but continued growth expectations for some companies are unrealistic: Some FANG Stocks like Google and Apple, Semiconductors, Capital Equipment / CRO's (contract research for pharma – biotech) are all vulnerable.

  - Small Caps. Liquidation fears & Cost of Capital. No buyers in the market as ETFs go to liquidate. Also their cost of capital is much higher than the big caps. Rising rates hurt small caps disproportionately.

  - I see similar credit ratios among companies but the big and mega caps have 3-400bp lower financing costs. This is a powerful advantage and will leave small caps vulnerable if we see a pullback.

Ali Motamed

- Pockets of Strength
  - Free Cash Flow Is the Key.
  - Large cap, market leaders with huge discounts and massive FCF.
  - Examples include 1) Leading hospital operator in US 2) Leading Semiconductor manufacturer 3) Leading Canned foods company 4)Leading Networking equipment manufacturer 5) Leading steel distributor
  - Key metric: Free Cash Flow Yield over around 8%ish. In a pullback environment, these high quality names will outperform. Key is the cashflow.
  - S&P 500: 75 Stocks have FCF over 8%.
    - **30 in Financial Services (XLF)**
    - **16 in Consumer Cyclicals (XLY)**
    - **Healthcare, tech, energy make up the balance.**

Q&A