Good afternoon, everyone, and welcome to our third *Sevens Report Alpha* webinar. I am happy to say that since I spoke to you last, the effects of Hurricane Irma are mostly gone. Things are back to normal down here, although obviously our thoughts are with the folks in Puerto Rico and throughout the Caribbean still dealing with a lot of difficulty, but at least here I am not nearly as nervous about the technology as I was the last time we had a webinar. So, that is a nice improvement. Today I am really excited to have a unique guest on with us, Ali Motamed, who I have already sent you the bullet points on his bio, but Ali is a very successful, very accomplished portfolio manager, and his job quite frankly is to generate alpha and beat the markets, however he needs to do that within the confines of his fund. So, I am very excited to get his unique insight on the markets, and Ali, thank you very much for joining us.

Ali Motamend (AM): Thank you for having me, and I thank you all for tuning in.

Tom Essaye (TE): Absolutely. We just will get done with a couple of the particulars here. Obviously, the disclaimer slide that we have is always in all of our presentations, and then as we also do, the goals for today's webinar. I always like to give a bit of a rundown of what people can expect. So, we are going to do our, "What do you think about markets?" which is my audio version of a lot of what we are talking about in the *Sevens Report*. That will be a few minutes of our time, as usual, and then we are going to get right into it with Ali. That is the reason he is here to discuss markets and to get his unique view on what is going on and what the risks are actually out there in the markets, and that is what I am most excited about because he is going to be talking about stuff that we frankly have not heard a lot about, and a lot of the mainstream research and a lot of the street research I have been reading. So, I am very excited to get to that, and that is what we are going to spend the majority of the session on. To break it down a little bit, we are going to go through Ali's background and then his macro view on the markets, and you guys have seen through the emails I have sent that he is nervous because of impending Fed tapering, something that I think he is spot on about, and then we are going to go through where there are risks and where there are opportunities and the key metric that he is looking at to show – to find investments that he thinks can outperform in a potentially difficult environment, and then we will wrap up with Q&A both for me and for Ali.

With that, we will get to the, "What do you think about markets?" which is again my intro monologue here. This is the same headline that I had 2 weeks ago. New highs all good. It is, you know, you could be forgiven for asking that question, frankly, and the sub question of what we have been talking about in the report is, "Is the economic reflation finally taking hold?" Unlike two weeks ago, there is some evidence of that. I mean, we may be seeing a global turn in inflation starting with the Chinese numbers from two weeks ago followed by the British numbers and then US CPI. Banks have staged a massive rally, massive rally. I mean two weeks- three weeks ago, we were talking about whether or not banks were just going to break down horribly, and they have completely reversed along with bond yields and the dollar. Both the 10-year Treasury yield and the dollar are trading at one-month highs. Obviously still down a lot for the year but seeing a little pocket of strength here. If I just gave those things to you by themselves, you could be forgiven for thinking that, yes, a reflation rally is taking hold, but as we have seen three separate times this year, there can be big head fakes, especially in the data where we get what looks like a pop in inflation, but it really is just a statistical anomaly. So, while things look like they could be getting better, it is much too early to say, “Okay, the coast is clear, we are getting an economic reflation, and let’s just take on a ton of risk.” They key signals we are watching which I have described in the report – two things - #1) the BKX which is the KVW bank index. We want to see that break out to validate what we have been seeing in the data. We want to see that break above 100. That will be a new high for the year, and I think that will be a decent signal that potentially banks can lead this market. Secondarily, we want to see the 10-year yield move above 2.40%. Okay, 2.40% has been key resistance now for months. It is knocking on the door. I am not sure where we are as of this print, but I think we were at 2.33%, 2.34% right before I came on the webinar. Tomorrow’s core PCE price index is going to be important. If it surprises to the upside which in all fairness core PCE price index almost never surprises to the upside, but it can happen, then you are going to see 10 year yields push that 2.40% resistance level, and then things will start to get very interesting. More broadly, I still think that we are in need of more before you can say, “Hey, there is a decent chance that you could see a rally into year end.” Okay, I think we need to have some sort of a positive catalyst. Chinese inflation, British inflation, US inflation, showing some signs of firming is one thing, but it is not enough to carry stocks away when we are at these evaluations. Tax cut package that we saw yesterday, it is not going to get passed in its current form, but if it is better than expectations and if it looks like it can actually pass this year or early in 2018, that could be a positive catalyst, but I still think we need more before I am going to say, “Look, I think we have some legs into year end.” So, while there have been some improvements and certainly some important sector rotations that we have been covering a lot in the reports, at the same time, still more needs to be done, and that is my take on the markets.

Now with that, Ali, I would like to bring you back in here. I have sent the subscribers, you know, the bullet pointed version of your bio, but why don’t you give them a little bit of a description of your career so they get to know you a little bit better?

AM: Sure, thank you. So, my career I have always wanted to do this. I have always wanted to be in this business. I was at Boston Partners for 14 years prior to starting my own firm here. I helped create and develop the strategy and run their flagship long-short products which put up the #1 returns over my tenure of any liquid alternative fund, one some nice accolades including winning the Morning Star Alternative Manager of the Year award. Now I have founded Invenomic Capital Management and partnered with Balter, which is a firm that distributes liquid alternatives. So, basically hedge funds in a mutual fund format, and we have put together a fund that can be bought as a mutual fund for investors. So, we have launched the firm. We have been live for about 2-3 months at this point, and we hope to replicate the same success we had in the past where we were able to, I think as Tom showed you in the slides, we were able to outperform the S&P by about 400 basis points after fees over a period extending beyond 10 years, and that is while carrying a big short book that enabled us to prevent pretty major drawdowns for investors.

TE: Absolutely, I mean just looking and doing some of my research for this call, part of the reason I wanted you to come on is because you are going to experience basically in hedging, as well. It is that you are not just sitting there all along. You achieved these returns by being both long and short. So, I can assume that the volatility of the fund was lower than just a straight long strategy, and that is why I am excited to have you talk about it because you are not just spending your day thinking about what can work in the environment. You are also thinking about what won't work and how do we best position a portfolio to take advantage so that we are making money on both sides of the trade.

AM: Sure, and I think a lot of times making the most money really depends on being able to put yourself in a position to be aggressive when everyone is running. You know, when we went into the '08 period, we certainly were down, but we were down about 20-25%, and that all kind of came in the end of '08, but the reason we were is because right when everyone was truly giving up and there were no buyers left in the market, we started buying things hand over fist with massive balance sheets, great sort of structural businesses. So, you know, we came off in '08 like that and had an 85% up year in '09. So, what I want to stress to everybody is the importance of capital preservation, and it is not so you make less money. It is so you make more money. It is so you put yourself in a position to be a buyer. I remember how scary it is for people to try and buy stocks when everything is imploding right around them, but that is when you get the best shots. That is when you get the 10 baggers, and that is when you really differentiate yourself. When there is time to be, you know, the old saying goes, "Be greedy when people are fearful and be fearful when people are greedy", but it is really hard to be greedy when people are fearful. If you don't be fearful when people are greedy and protect yourself, and so that is kind of what I want to stress today.

TE: That actually segues in perfectly to your view on the markets because you think now is a time to be, I mean I don't want to be overly dramatic, but you think now is a time to be somewhat fearful, right? You think that the outlook going forward is not that fantastic.

AM: Yea, I would say that this is definitely a time to be fearful. As I look at stocks and I look at, you know, what drives them; generally it is based on investor demand for investments that generate cash flow and returns, right? So, people buy a stock because they say, "I'm going to make this much cash flow in the future, and so I am happy to hold it forever or for a long period." That is not why people are buying stocks right now. If you look at the evaluations in the markets, they are at levels that are truly unprecedented.   I mean, in the 200 year history of the financial markets in this country, we have had one year where they were pretty much universally more highly valued than now, and that was in the year 2000. If you look at the cyclically adjusted PEs, they in the low 30s at this point. If you look at the market cap to GDP, again you are pushing 140%, and that is the old Buffett Rule which is kind of funny that he is sort of bullish now when his own rule says be careful. So, I think the markets are very extended, and I know a lot of people's argument has always been especially when you look at the Tape number, the Tape is considered the best forecaster of history, and everyone says well when '08 falls off and that 10 year average does not have those negative earning years, things will change. Well, they actually don't change that much. All that ends up happening is that you go from the second most overvalued market to the third most overvalued market, including the Great Depression. So, I do not think they have set up well, and then on top of that is the idea of the supply and demand of stocks. So from an investment level, I would say be careful. Now, people do not always buy stocks on that basis, right? They save money, and they put it way, and they say, "What am I going to do with it?" So, they allocate it to different assets like stocks. Well, if you look at what is going on with the taper at this point, you know, just some

TE: Are you talking about – hold on one second, Ali. So, what you are talking about is the taper, tapering of the Fed balance sheet, which is something we have been talking about a lot in the Report that basically the Fed is going to stop reinvesting the cash it gets from bonds it bought during QE. So instead of getting that cash into its accounts and then going out and re-buying basically the same duration bonds or same type of bonds whether they are Treasuries or mortgage backs, instead the Fed is now going to start taking that cash and is just not going to do anything with it. So, what 100% will happen is there will be a reduction in demand for Treasuries and mortgage-backed securities.

AM: Exactly, and the size of the taper, so they are starting at $10 billion a month, and they are going to accelerate that up to $50 billion a month. So, if you look at GDP in this country, it is about $20 trillion. If you look at savings rate, it is roughly 5%. That means there is about a trillion dollars worth of money that comes into investing every year. Now, effectively what is happening is the Fed is selling those bonds is translating into the elimination of the incremental buyer, right? Where every year there is an incremental buyer that comes from their savings that they have put in. That is going to be gone and consumed by the Feds. So, I think what happens is you kind of take the investment case off the scenario, and then also we are in position where I would be wary of just even the supply and demand dynamics of stocks being helpful.

TE: Well, it is interesting, and what you are doing, you are giving sort of a very analytical explanation. I think something that from a 10,000-foot view people that have been in the market a while are nervous about. So, it does not take a genius to look at a chart of the S&P 500 and say, “Boy, we were all the way down here when we started QE, and now we are all the way up here.”, and they have done QE programs and they have kept reinvesting and kept reinvesting and kept reinvesting. Well, what happens when they stop? I think that what you are doing is that you are getting sort of a granular explanation of what happens when they stop, and a lot of, you know, me included and a think a lot of people in the markets are sitting there saying, “What happens when they stop? Is that going to kill the rally?” You are giving a very analytical reason as to why it could. One of the things I want to touch on a bit more to is the higher rates. Why higher rates sort of sapped demand for equities, you know, because a lot of people think about oh gee, you know, higher rates are bad for the economy, etc, etc. Well, to a point they are. In the beginning, not necessary right away, but they do sap demand for equities. So, if you think about in the capital markets stocks and bonds are constantly competing with each other for capital. One of the reasons the stock market has just roared as you said is that the TINA trade, which we have talked about, “There Is No Alternative” for equities. Where are you going to go? Bonds pay you nothing. You get nothing in the bank. So, you know, we will go into Florida Power and NextEra Energy that pays me 4%. Extrapolate that out a lot, and you have got a TINA trade, but what you are saying is that as rates begin to move higher in part because of this taper, that there will be alternatives to stocks, i.e. higher yielding bonds, correct?

AM: Sure. You know, we ran some simple analysis that sort of - right now, let me step back. Right now, corporate balance sheets are about as levered as they have ever been. I think even in excess of the ’07 period. So, when you look at that, that one line item that goes into earnings that people need to think about is interest expense. So, when rates are low, even though you may have a lot of debt, it does not represent itself in lower earnings because interest rates are lower, but if you take the rates and move them up a couple of hundred basis points, then you are reducing the earnings of the S&P by at least 10%. So, the impact right off the bat is that the EPS goes down which makes the multiple go up. So, right then and there what will happen is that bonds will get more attractive, yields will go up, but yet equities will become less attractive, and you can see that swing, right? So your bonds all of a sudden are yielding 200 bps more, and your equities all of a sudden are yielding 10% less. So, there is a pretty dynamic and fast shift that happens that people may not appreciate.

TE: Absolutely. It does not happen overnight, but once the ball gets rolling, you know, it is pretty hard to stop that momentum.

AM: Absolutely, and then if you look at equities just generally speaking as rates go up, the discount rate. There has been a lot of sort of growth in momentum equities that have driven the market, and if you look at how you discount out those earnings. You know, you look at Amazon, and people are finally not generating much cash flow and having sort of a very long duration asset. What happens is in that scenario when rates move back up, that discount rate moves up, and people want to have cash flow closer. So, it impacts a lot of those stocks that have my multiple in the market to.

TE: I want to sort of shift. We have got about, a little under 15 minutes left, and I do want to get to questions. I want to get to a little bit more granular now that we have sort of covered the macro and get to some of the sectors that you think are particularly overextended in our sort of pre call, we talked about pockets of tech, not all of it, but pockets of it, and then small caps you are also concerned about. You go through that.

AM: Sure. So, let's just start, you know, I will start with Google and Apple because everybody loves them, and I think that is very misplaced to some extent here because if you look at Google, their whole business is based on search, and search volumes have started deteriorating. All they have been doing is, they have been growing YouTube which is wonderful, but that is low margin, and as you look at artificial intelligence and what everyone is so bullish about, it just entirely destroys the need for search. So, you look at a company that popped up over the past 20 years to become almost a trillion dollar company on one premise, and then you look forward into the future and say, "Well when I say to my phone or whatever device, 'What is the beset Italian restaurant in town?', and it tells me the name, it does not tell me 20 ads and then another 30 options that I pick through that say Google." So, I think the premise of Google is something people should be wary of a little bit, especially at 30 X trailing earnings. The other one is Apple. If you look at, let's say of a 6 billion population, a billion people end up having iPhones on average, and they replace them every three-to-four years, well Apple's earnings have peaked out at $10 bucks. They do not have anything else that is coming up. The company is going to start struggling to find any level of growth. They have moved up pricing, but it just structurally has hit a maximum point, and then you look at people like Google coming in to the hardware market with the Pixel phone, and that share there is no guarantee that Apple is going to have a billion installed base going forward when their share is not higher than 18% on new purchases. So, it has kind of peaked out at that point. So those two I would be a little wary of just generally speaking. There are some other sectors I think, like semiconductor capital equipment. China has been on a big push to drive semiconductor expansion in China, and so that has led to a bubble in capital equipment. It will probably last another 12-18 months, but the problem is when you create these sort of expanded demand bubbles, it is a pig through a python, and when you come out the back end, it is often not that nice. A couple of other sectors would be contract research for pharma, because, you know, we look at the bubble we had in biotech. The money is running out. They are burning out. So, that research, you know, they do not have the money for that research, and then going to small caps. I think we still have a big rally in small caps yesterday. Everyone is sitting there saying, "Oh, you know, all domestic companies lower taxes." It is totally false because I ran an analysis of taxes paid by the Russell 2000 in aggregate compared to aggregate market caps, and do the same comparison for the large caps, and it is totally out of whack with what everyone says because the reality is that I think a third of the Russell does not make any money.

TE: That's right.

AM: If you look at the stated PE on the Russell, it's over 100 to gap PE. Well, most of the time they pay taxes based on those gap numbers. So, really they are not actually going to save anything. Everyone just got jazzed up on the sort of basic premises that faulty. So, I would be cautious on small caps and further because when the pullbacks happen, they are not going to be buyers for any of these small caps. I remember stocks when they would go down, you know, they would go down to $10, and then they would hit $5, and literally they were going down to $1 for just the fact that there was not anyone that cared. If you look at the S&P 600, SmallCap 600 and the Russell and you combine them, the aggregate ownership of any stock that is in those indexes is, you know, well over 30% pushing 40% then combined insiders, and there is just not a lot of stock left there, right? So, what ends up happening is maybe two or three institutions are watching that name. As they go sell or as the market pulls back, no one else cares. When you have sellers into a market where no one cares, then there are big vacuum pockets that open up, and that is what I want everyone to kind of pay attention to, right? You want to be the buyer when there is no buyer. You want to be the one with money when no one else has money because when those vacuums open up, you make monster returns. You don't make pennies picking up pennies on an oncoming train.

TE: No, that is right, and I think that is a good point, and it is interesting with the exception of small caps, which have lagged this year, and now I think are just playing a bit of catch up frankly on a short-term momentum swing, a lot of the sectors you talked about, you know, the FANG stocks, semiconductors, biotech/healthcare, they have been the massive outperformers this year, and they are extended, and now we have seen over the last couple of weeks as things have sort of shifted a bit, you have got yields starting to move up a touch. You are starting to see those come in. If that continues from a yield standpoint, I think it absolutely will continue from a sector standpoint, as well.

Now, I want to shift and get to pockets of strength, and basically when we were having our pre call, you know, you are obviously a single-stock guy, but the #1 thing that you think is most important, the most important attribute for whether it is single stocks or broadly sectors – I kind of get into a little bit of that at the bottom, the most important attribute is very strong free cash flow, correct?

AM: Yes. You know, companies that generate strong free cash flow are creating value under you, you know, regardless of what happens. If their share price goes down and they are able to generate cash in that period, they could buy back stock. They could buy back weaker competitors, and they put themselves in a really nice position. So, that is the one thing I would pay attention to, and then looking at that in context of sort of what happens in distress periods in the market? How does that affect the cash flows for that companies? Is it too cyclical to where even though they are doing well now they won't be at the times of distress when cash flow matters the most? The other thing is I do like large caps in market leaders, right? Because if you look at the financing costs for these large caps, they are just so much lower. Look at the same company from a leverage ratio perspective, if that company is going out doing a $1 billion or $2 billion bond issuance versus a company doing a $200 million issuance, they big company gets the 300 or 400 basis point rate reduction, which is a huge advantage. So, you know, I do like the big companies, the big free cash flows, and what is interesting is, you know, many of those companies are not on those sort of WRIP and growth rates, but they keep chopping away, right? 8% free cash flow yields for market leaders like, you know, the biggest hospital operator in the country. Even semiconductor companies that are half the ones you see are on an absolute rope, but then stop and think about whom is the biggest most successful semiconductor company. You could buy them at 8-10% free cash flow yield because no one seems to care, and their competitive issues are way overstated by the markets. It really does not get it. The other thing [25:34 Plex Field] Distributors. Just kind of go through industries, find who are the big leaders, right? Who are the ones who truly just have better financial performance, better metrics, better cash flow, better balance sheets, and you can put them away and put yourself in a pretty good position I think, and that is what we have done in our [___25:53]. We have a huge cash flow generating stream of those types of names, and then obviously you do find these really special unique small cap names that can be monster homeruns still in this environment, but you kind of want to mix it. You want to kind of barbell that to some extent.

TE: Sure, sure, and it is interesting. After our pre call, I went through, and I did a screen on the S&P 500 for stocks that had over 8% free cash flow, and I am going to be sending out that list to subscribers along with the recording of this call, and I was shocked to find that 30 of the 75 names that had over 8% free cash flow were financials, and another 16 were actually consumer cyclicals. So, it is interesting. All of the stuff you are talking about on a sort of very analytical and granular level, we have also been talking about from a totally different way in the report, in so much as, you know, we have had a great run in tech. We have had a great run in healthcare, biotech. You have had a great run in these super-cap internet stocks, and they have done very well this year, but you are seeing more and more signs, not just on an individual sort of corporate balance sheet items or income statement items, but also from the macro, as well, that there is a potential shift occurring, and some of these companies that have free cash flow yields over 8% that have lagged year to date are now starting to really pick up some momentum. So, I did not know that was going to be the case when we started doing the research for this presentation, but it sure is what ended up happening, and I thought that was a very interesting anecdotal agreement.

With that, we have got a few minutes left, and I want to make sure we get a couple questions in. So, are you ready for a little Q&A?

AM: Absolutely.

TE: OK, great. So, let's see. So, the first one is basically about your fund. So, Tim just asks, "Could Ali explain more what the current strategy of the fund, the mutual fund that you are running is and how advisors are using it in their bag of tools?"

AM: Sure. So, right now we are running a relatively hedge portfolio. We are about 95% invested on the long side and about 70% on the short side. So, we are running about 20% market exposure, but our shorts from what I described, they are much more beta shorts. So, they really act neutral. The days we had pullbacks earlier this week, we had nice days and a day like yesterday we were flat. So, we are setting ourselves up to be able to try and drive sort of stable returns regardless of what the market does. We are running a very diversified book. We have about 120 names on the long side, and we have about 160 on the short side, and generally speaking the way advisors are using it is they take depending on the risk tolerance of the underlying investor, so someone that, you know, is perhaps closer to retirement, a little bit older, a little less risk tolerant, this becomes almost a bigger weighting of their equity book. For people that are more aggressive, this becomes a smaller weighting, but it kind of fits into the ability to balance your US equity exposure, and then the good thing is that we run a variable approach. So, what happens is when those shorts start getting covered and we start buying those stocks and reinvesting, what it does is it helps because you do not have to go back and reinitiate discussion with every client because you know that the people that are closest to the underlying are able and have the latitude to be able to kind of shift the portfolio a little bit to take advantage of opportunity. So, generally speaking, it takes in a piece of equity exposure for people that want to be a little more conservative. In some cases, people take that up a lot. The hedge fund portion of their equity exposure and like I said in some cases it is a smaller piece.

TE: Perfect, great. So, two people wrote in and basically asked the same question. Both Eric and Robert wrote in and they asked about KWEB. This is one of the names we presented to people a couple of weeks ago, and that pulled back on Monday, and they basically were asking, you know, what is going on. Is it still, are you still bullish, etc, etc. The answer is yes. The pullback on Monday from all of our research, it was just basically sort of momentum pullback. Tech got hit. There was the North Korea issue. Obviously anything happening in Asia is going to hit some of those Chinese names harder on a short-term basis, but as far as what happened, nothing happened on Monday that makes me think that the thesis is now invalid. You know, the stock had run up a bit. It has come back in, and now I think it is putting in a base. As long as we don't get any sort of significant, you know, conflict for lack of a better word with North Korea or any sort of material slowdown in economic momentum in China, that name is still good. If you don't own it, I think that now would probably be a pretty good time to pick away at it. If you were looking to buy more, I think now is probably a pretty good time to do that. So, I did not like to see the pullback on Monday like everybody, but nothing there makes me think, makes me change my thesis on the name.

Fitz wrote in regarding [Robo and Sensor and Lit 31:27] and some of the other car automation names that we talked about in the most recent issue of Alpha. Basically to paraphrase his question, he is concerned that they will lag if we see a pullback in tech and sort of wondered if they are more sort of speculative ideas versus the reflation portfolios, reflation basket we talk about in the normal *Sevens Report*.

Fitz, I would not say they are speculative. I would say they are more thematic. Everything that we put in Alpha especially, I view as a long-term opportunity. Getting the timing right on a week-by-week basis of entry into that is obviously always tricky, especially with names that are volatile and, you know, with LIT and some of the others that had really run up, that is why I said, “Hey, if you want to wait a bit, you can. It makes sense”, and sure enough, they did pull back a bit, but I would not characterize them as speculative. They certainly, some of the names are higher volatility, but then conversely if you look at RSP, which we talked about two issues ago, you know, that is really a core holding. That is a core equal rate S&P 500 holding that I think people should just, you know, allocate to and put in their back pocket and be on their way. Conversely, we are going to be coming out with basically a dividend issue next week, and that is going to be another set of core holdings. So, nothing we are going to be talking about in Alpha is necessarily. I do not want to say it is a trading idea because that is not what I think would provide the most value for people, but some will be more sort of higher volatility, and others will be more core holdings. So we will try and strike a nice balance, but everything we are going to come out with in Alpha I do view as a long-term opportunity. So, it is now output in, you know shorter-term price targets for people that would like them, but these are themes and strategies that we think can outperform over the medium and longer term, and I hope that answers your question.

So, we have run a few minutes over today, but I think it was worth it, especially to have this conversation and to get Ali’s very interesting perspective on the markets and what he is looking at from really a hedge fund professional’s standpoint, and I hope everybody found it valuable. Ali, thank you very much for joining us, and just do me a favor, tell folks where they can find you if they would like to learn more about your fund.

AM: Sure. So, our 40 Act fund trades of Bivix, and you can buy it on many of the platforms. It takes a while to get up on all of them. So, I think the Schwabs and the Fidelities and stuff have them at this point, and we are getting on more and more each day. Also, you can call Balter. You can pull up on website, Balter Liquid Alternatives, contact information there, or you can reach out to me directly, and my email is ali@inveonomic.com, kind of invest in economics mix. So, ali@invenomic.com, and you know, we are happy to answer questions and put you in touch with the right people in our organization that can make it work.

TE: Ok, fantastic, and thank you again for joining us, and thank you everyone for joining us, as well. The recording of this will go out shortly, the transcript within about 48 hours, hopefully, and then we will have our next ideas issue out to you next week. So, thank you very much everyone. Thank you, Ali, and everybody have a great day.

AM: Thank you, Tom. Take care.