Jack Adamo's Insiders Plus

Your source for Insider insights and exceptional analysis

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Dear Friend & Client,

Thanks for joining me.

We had a pretty good week. The three major indices averaged a half percent decline, mostly due to pullbacks in the highly overvalued tech giants known as the FAANGs (Facebook, Amazon, Apple, Netflix and Google). Our Main Portfolio rose 1.4% and the High Income Portfolio broke even. Summer is here and things are slowing down. The only news that the market took interest in was ex-FBI Director Comey's testimony before the Senate. That, however, was inconclusive, as everyone who supports the President believed what they wanted and everyone who doesn't, believed the opposite. Welcome to reality TV.

As I've mentioned before, I think the economy and the stock market would do better under Mike Pence than under the incumbent, since Pence would be more likely to bring together some kind of consensus approach to governing and legislating. Hence, the worries about impeachment, scant as they are, are unfounded, in my view.

Economy

I had a chance to look a little closer at last week's Non-farm Payrolls Report. Aside from May's awful figure (138,000 new jobs), March was revised down from 79,000 to 50,000 and April was revised down from 211,000 to 174,000. So, over the past 3 months, job gains have averaged just 121,000 per month. A streak like this is harder to explain away than one month is, but just to make sure we can't reach any firm conclusions, recall that the May ADP private payroll report remained around its year-to-date average of 250,000 new jobs.

Once upon a time I assumed the ADP report was the more accurate, since ADP does thousands of company payrolls every week and should have hard numbers. But as you may recall, I learned that they too use sampling. This is probably because ADP has acquired so many smaller companies that it has never gotten their information technologies compatible. So, it's too cumbersome to do the necessary compiling and calculations to get solid counts.

Still, I think it's likely that ADP's numbers achieve better estimates of jobs created in the private sector. Our government uses its magical "Birth-Death Rate" to imagine what jobs may have been created in smaller businesses. As far as I know, ADP uses nothing like that.

Meanwhile, GDP languishes around 2% or lower. If that number is real, we've got our heads above recession water. However, we're the only country among the developed nations to calculate GDP as we do. The other methods would show a lower rate, possibly negative.

Still, corporate profits have shown robust year-over-year growth for two quarters in a row. With 489 of the S&P 500 reporting, GAAP earnings were up a very strong 27%, albeit off a very weak prior year's showing and driven mostly by the huge turnarounds in the Energy and Materials sectors. Moreover, revenue growth has returned, up nearly 7% year-over-year in Q1, accompanied by a 13% increase in operating margins. But here, again, there are caveats. The revenue growth was helped mostly by the turnaround in Energy and Financials, while operating margins were boosted by more than 100% gains in Energy and Materials.

In short, there's plenty for bears and bulls to latch onto and grapple over.

This week I refreshed my memory regarding historical earnings growth patterns. As I suspected, earnings tend to peak just before market tops. I suspect that's because so much of the late-cycle growth is manipulated by stock buybacks, questionable accounting and job cuts (more of which we're seeing every week now). So, I'm skeptical that the current spate of earnings growth will keep up long enough to make stock valuations palatable or rational. However, only time will tell.

In the meantime, I've been keeping my eye out for real values. Scott Black pointed out in Barron's this week that five stocks with a total weighting of 13% in the S&P 500 accounted for 58% of the index's year-to-date advance through May; growth stocks in general were up 13%, while value stocks were up just 1.8%. Our portfolios are still underwater in the latter area, with a nice gain in **American Express** (NYSE: AXP) offset by drops in **Cameco Corporation** (NYSE: CCJ) and **Teva Pharmaceutical**, **Ltd.** (NASDAQ: TEVA), though the latter had a solid advance this week.

It is the nature of value stocks that they require patience. There is no enthusiasm component in their price. In fact, the only emotional component is negative. When the wrinkles get ironed out, those winds shift and the intrinsic value gets respect and, eventually, sponsorship. While we wait, we have the assurance that there's real value to what we own and sooner or later its value will be realized.

Oil & Precious Metals

Although oil profits are up and sector stocks are beginning to catch a bid, energy pricing continues to look dismal with both oil and gas prices falling again. The reason for the new sector enthusiasm is that with expense, employee and capex cutbacks, more companies can be profitable with sub-$50 oil. (WTI closed the week below $46/bbl.) The problem is, these efficiencies breed further mal-investment, which then brings down prices more. This week's North American oil rig count rose by 31 from last week and *458 from last year*. That's not a typo. The weekly rise (the 21st in a row) was 4%; the year-over-year rise was 128%. Again, not a typo.

Combined domestic production and imports rose 1.9% for the week and 7.7% year-over-year. U.S. crude inventories were not as bad, up 0.6% for the week and 2.3% year-over-year. Whether this is due to higher demand or a lag between production and inventory storage I can't say, but I have to think that the continued growth in the rig count will eventually show up in inventories and then in pricing.

In the precious metals markets, gold fell 0.7% for the week and its more volatile sister, silver fell 1.7%. The miners' indices followed suit with similar sized moves. Nonetheless, we had a strong week for our miners, with **New Gold** (NYSE: NGD) up 4.5%; **Hecla Mining** (NYSE: HL) up 1.6% and **Newmont Mining Corp.** (NYSE: NEM) up 0.8%. Only **Goldcorp Inc**. (NYSE: GG) slipped, and only 0.2%; so maybe we're doing something right.

PORTFOLIO UPDATES

The most news for our portfolios this week came from **Teva**. It's hard to say to what extent each of these factors influenced its 4.1% gain, but here's the list:

The board will replace four members. Two of the nominees have extensive direct pharmaceutical management experience; another one is a managing partner in a hedge fund that specializes in healthcare, and the final one is a managing partner of Israel's Pitango Venture Capital, which has invested in health care and information technology. At the top of the new board's agenda will be finding a new permanent CEO.

Teva also announced the U.S. launch of its generic version of Novartis' eye drop medication, Pataday. It's expected to be a good seller.

Finally, the company announced a successful phase III trial of Fremanezumab, a drug for the treatment and prevention of migraines. The study met all primary and secondary endpoints in dosing regimens, and demonstrated statistically significant reductions in the number of monthly headache days compared to a placebo.

My only concern here is that trying to pronounce Fremanezumab gives *me* a headache, but I suspect the company will come up with a snappier name. Teva Pharmaceutical, Ltd. is a speculative buy up to $35 per share. Risk-tolerant investors may take a 2% position in the Main Portfolio.

We had some backdoor Insider buying in **Ensco plc.** (NYSE: ESV) reported this week. Twelve Insiders exercised options they received. Most received approximately 31,000 shares and most of the recipients kept about 50% of their stock. That's a very good ratio. A couple of fellows sold all their shares, at least some of which went to pay taxes on the exercise. At least one director who got 43,000 shares kept them all.

There is some chance that this is an orchestrated show of faith to influence the market, but I don't think so. It's unlikely the two sellers would have reported at the same time as the majority who kept theirs. The sellers would probably have waited a few weeks and reported the sales late on a Friday. At least that's the sneaky way U.S. companies would do it. Maybe UK companies are less duplicitous or less sophisticated. In any case, I like the fact that Ensco consistently reports its Insider transactions to the SEC, although it's not required to.

I said last week that I was considering taking another position in Ensco. I've decided against that for now, in light of the continued burgeoning horizontal rig count. That should continue to make life tough on drillers whose business is mostly marine based. I did sell a few long-dated put options and buy similar call options. The dollar amount was very small. I would not recommend you follow suit here, unless you really understand the options market and are at least moderately risk tolerant. Hold Ensco plc.

There was also some Insider activity at **Hecla**. However, the reports were confusing. They listed buy prices, but in the footnotes they were listed as grants, which by definition would be free. I'll try to get an explanation out of the company this week.

I'm considering taking the hold off Hecla, but for now we'll stand pat. Hold Hecla Mining.

I'm reducing the buy price on one position of our **M&T Bank Corp. Fixed Rate Cumulative Perpetual Preferred Stock, Series C** (MTB-C) and raising it on the other. This is due to the nearer redemption date on the stock, which negatively affects your return if you pay more than the original offered price. The raised price on our initial position is because the 6.38% annual coupon is a nice return, even if it's just for a few quarters. I don't expect the price to come down to par soon, but you may buy it if it does. M&T Bank Corp. Cumulative Preferred Series C is a buy up to $1,000. Take a 4% position in the High Income Portfolio.

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I've found a few more well-priced stocks that I'm looking at now. I may make a decision on one in particular this week, while a couple of others also look interesting. In the meantime, let the portfolio advice be your guide.

I look forward to talking with you again soon.

Jack

Questions? Write to Jack at: jack@jackadamo.com