Trade War Crisis or Goldilocks?

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Are we in a trade war crisis or a market friendly goldilocks environment? The consensus seems to change from week to week - even day to day. How can active management, defined as 100% human discretion, add value in this environment? Most importantly, how do we create resilient core portfolios that can be held over the long term in this environment of sharp reactions to headline risk?

The elephant in the room is the trade war crisis. Up until the beginning of May, the US administration had been signaling that a trade deal was likely and moving forward. Investors are rightly concerned about the escalation and the potential impact on the US and global economy should this agreement not come to fruition.

Despite a slowdown in global growth last fall, a US government shutdown, and bad weather, the US economic numbers have been better this year than expected, with no sign of a recession or inflation, Q1 GDP was above 3%, and Q2 estimates are positive. While strategists expected Q1 earnings growth to be negative year over year, earnings growth for the S&P 500 is now positive year over year, and revenue growth is now above 5%. Productivity is improving and margins are steady. Absent the trade war, we seem to be in a goldilocks economy – not too hot and not too cold.

So how do investors navigate this environment? At TrimTabs Asset Management we invest in quality companies with strong organic growth that we hope to hold over the long term. For us, the most important consideration is robust free cash flow growth. Our research indicates that free cash flow growth over the long term generates alpha over traditional cap weighted indices. Free Cash Flow provides some cushion to help companies fund future growth and mitigate any unexpected stress conditions.

At TrimTabs Asset Management, we use free cash flow growth as a reality check on reported corporate earnings. It's common knowledge on "the Street" that companies manage earnings. Management has significant discretion in terms of how they report revenues and expenses, along with the valuing of assets. We think of free cash flow as harder to manipulate: fact, not management opinion.

In our multi-factor models we combine free cash flow with strong balance sheets and actual share reduction. Strong balance sheets provide more cushions for our companies to mitigate risk. We look at share reduction because as investors, we want a bigger piece of the investment pie. Ideally, companies are buying their stock with free cash flow and not debt. We want to avoid companies that are leveraging up their balance sheets to engineer earnings per share growth.

In this era of quantitative innovation, automation, and the quest for low-cost solutions, simple factor models often overlook the complexities and multiple dimensions of an investment. As active managers, we can dig a little deeper and looks at risks and opportunities that our models can't anticipate.

As a portfolio manager, I am a big believer in moats – in addition to the ones mentioned above such as free cash flow growth and strong balance sheets. I am drawn to companies with a dominant market share position or brand in their industry. Technological innovation and disruption is a big plus too.

Since last summer, I have been looking at risks related to the trade war crisis. I can look at a company's supply chain, their geographic revenues and currency exposures. This data can be incorporated into our buy, hold, or sell analysis.

The US consumer has been solid over the last year, with record low unemployment, rising wages, and strong balance sheets. If you look at our current core US portfolio (TTAC – the TrimTabs All Cap Free Cash Flow ETF) versus last summer, you would see more consumer and defensive names, more services companies without supply chain risk, and more stocks with US centric revenues.

If you looked at our core developed Ex-US portfolio (TTAI- the TrimTabs All Cap International Free Cash Flow ETF) you would see some stocks such as Lululemon (LULU), Alibaba (BABA), and Yum China (YUMC) that are not in our benchmark. But these companies absolutely meet the criteria and objectives of the fund. While these markets have been in a bear market, we have increased our exposure to companies with moats such as strong global consumer brands, and/or North American revenues. As active managers, we can take a step back and respond to the changing landscape in modern and efficient manner within the parameters of our models.

We thank our shareholders for the opportunity to serve them.

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Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

Click here for the funds top 10 holdings.

Investing involves risk. Principal loss is possible. There is no guarantee that TTAC will achieve its investment objective. Investing involves risk, including the possible loss of principal. Because the Fund is an ETF (rather than a mutual fund), shares are bought and sold at market price (not NAV), may trade at a discount or premium to NAV, and are not individually redeemable. Owners of the shares may acquire those shares from the Fund and tender those shares for redemption to the Fund in Creation Unit aggregations only, consisting of 25,000 shares. Brokerage commissions will reduce returns. Investments in the Fund include risks associated with small and midcap securities, which involve limited liquidity and greater volatility than largecap securities.

The TrimTabs All Cap US Free-Cash-Flow ETF is distributed by Quasar Distributors, LLC.