The View from Thomas Lee (Equity Strategy)

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13 Seasonal New Stock Names for the 2H19; Remain Bullish

Few folks like the number 13. For reasons that go back into the mists of time, 13 is considered unlucky, though few people know why.

Nevertheless continuing in my tradition of being a contrarian—we are dating this issue on the 13th of July—I've got 13 new stock names that could outperform in the second half of 2019. As I've noted before, I'm bullish on the next six months. More on this below.

Employing seasonality is a tactical approach to picking stocks, but no less potentially remunerative for it. I've identified eight potentially outperforming industries to watch in the second half of 2019. The methodology is straightforward: I calculated the average returns of all GICS 4 sub-industries since 1990 and then identified eight sub-industries that had the best outperformance during the June 30-Dec. 31 periods of each year.

The list of eight are: internet and direct marketing retail; home improvement retail; footwear; internet services and infrastructure; household products; data processcing and outsourced services; investment banking and brokerage; and finally railrods. Commonality among the first five would seem to be that they are consumer facing, and with interest rates low, consumers might have more money in their pockets to spend. For example, footwear seems timely with the inevitable back-to-school sales and outdoor summer activities, while home related groups could benefit from home sales in the fall with mortgage rates so low.

Previously, I published two groups of seasonal stock lists for 1Q19 and 2Q19 at the start of the year and at the end of Q1, respectively. Seven of eight 1Q19 seasonal sub-industries identified outperformed the market, but there was less success in 2Q19, when only three outperformed. Like any approach, seasonality has its limitations, but I believe that was mainly due to the "unseasonal" escalation of trade tension.

Drilling down I identified 13 stocks—yes 13—among the membership of those eight groups that are also topped ranked (first quintile) by the Doctor Quant Model. Nearby, I present the tickers of those stocks that were added and those removed, for a net new group of 13. I think these newly added stocks should outperform in the July-December period.

As for the board market outlook, investors know there are many bear case ideas out there: it's late in the cycle; the inverted yield curve, Brexit and falling global PMIs, among others. But from a macro perspective I can't point out enough that there are two oracles telling investors they should be bullish in the 2H19, despite all the negativity.

Figure: Style Tilt constituents before and after rebalance
New constituents effective on 7/12/19

Style Tilt Portfolio As of 4/5/19		Deletions	Additions	Revised	
Growth Quality	**Quality Defensives**			**Growth Quality**	**Quality Defensives**
NKE	MNST	ITW	CBRE	VFC	PLD
LOW	MO	JNJ	CE	NKE	CBRE
BKNG	AMGN	KLAC	CLX	BKNG	MO
LMT	BIIB	LOW	MXIM	LMT	CLX
ROK	WAT	LLY	PLD	ROK	MNST
MMM	JNJ	MMM		ADP	AMGN
ITW	GOOG	VAR		MA	BIIB
ADP	DIS	WAT		V	
KLAC	VAR			MXIM	
XOM	LLY			TXN	
AMP	FB			CE	
MA				XOM	
TXN				AMP	
V				FB	
				GOOG	

Source: FS Insight, Bloomberg, Factset

Figure: Stocks within 8 sub industries with best historical performance from July through December
Per Fundstrat

		Ticker	Company name	Current Price	Mkt cap ($mm)	3m avg daily liquidity ($mm)	YTD perf (relative to S&P 500)	FC Mean (5=Buy 1=Sell) [1]	Mean implied upside [2]	Dividend Yield	Issuer Rating	Short interest % of float	2019E sales growth [3]	2019E EPS growth [3]	P/E ('19E)	ROE
Footwear	1	NKE	Nike Inc -Cl B	$87.65	$137,756	$564.5	-1.3%	4.29	6%	1.0%	AA-	0.7%	8%	16%	30.3x	43%
Internet & Direct Marketing Re	2	BKNG	Booking Holdings Inc	$1,872.92	$81,081	$741.3	-10.8%	4.08	7%	–	A-	2.7%	5%	9%	18.5x	48%
	3	EXPE	Expedia Group Inc	$133.23	$19,838	$191.6	-1.3%	4.26	12%	1.0%	BBB	8.9%	8%	18%	19.3x	15%
Railroads	4	KSU	Kansas City Southern	$119.27	$11,997	$116.8	5.4%	4.26	11%	1.3%	BBB	2.4%	6%	11%	17.9x	13%
	5	NSC	Norfolk Southern Corp	$198.27	$52,733	$285.1	13.1%	3.88	8%	1.8%	BBB+	1.7%	3%	14%	18.3x	17%
Data Processing & Outsourced S	6	ADP	Automatic Data Processing	$164.71	$71,686	$284.6	6.1%	3.64	0%	1.8%	AA	1.0%	6%	20%	30.3x	50%
	7	FLT	Fleetcor Technologies Inc	$290.74	$25,059	$156.5	37.0%	4.44	1%	–	BB+	2.9%	9%	11%	24.8x	20%
	8	MA	Mastercard Inc - A	$277.33	$283,270	$897.1	27.5%	4.79	2%	0.5%	A+	0.6%	12%	17%	36.4x	131%
	9	V	Visa Inc-Class A Shares	$180.40	$360,090	$1,153.9	17.2%	4.68	2%	0.6%	AA-	1.6%	10%	16%	33.6x	40%
Internet Services & Infrastruc	10	VRSN	Verisign Inc	$219.31	$26,138	$116.5	28.4%	3.00	-20%	–	BBB-	1.4%	1%	4%	41.8x	—
Household Products	11	CL	Colgate-Palmolive Co	$73.54	$63,131	$229.3	4.0%	3.23	-2%	2.4%	AA-	1.2%	1%	-4%	25.9x	—
	12	CLX	Clorox Company	$154.53	$19,682	$156.4	-19.3%	2.67	-4%	2.6%	A-	7.8%	2%	0%	24.6x	98%
	13	PG	Procter & Gamble Co/The	$113.81	$285,473	$758.5	4.3%	3.80	-5%	2.6%	AA-	0.9%	1%	6%	25.5x	20%
Average					$110,611	$434.8	8.5%	3.93	2%	1.6%		2.6%	6%	11%	26.7x	45%
Median					$63,131	$284.6	5.4%	4.08	2%	1.5%		1.6%	6%	11%	25.5x	40%
% of stocks positive							69%		69%				100%	92%		100%

Source: FS Insight, Bloomberg, Factset

I believe the stock market in 2019 will look a lot like 2009.

- First, last fall's waterfall decline. Following previous 20% declines in 60 days the market is up an average 31% in 12 months.

- When high-yield bonds have a negative year, as occurred in 2018, stocks average 27% gain in the next 12 months.

Last but by no means least: Obviously, don't fight the Federal Reserve Board, which is expected to reduce rates at the end of this month. After past Fed rate cuts during a non-recessionary period, 100% of the time equities rally afterward, an average of 13%.

What could go wrong? The biggest risk is a correlation event, such as a market meltdown driven by policy error. In addition, risk-on trades driven by a dovish Fed could continue relative outperformance of high beta/momentum trades, which could weigh on thematic performance, such as seasonality.

Bottom line: My base case is 2020 EPS of $184, a 17 P/E and YE target of 3125 on the Standard & Poor's 500 index. I expect P/E expansion in 2H19, so 3125 is probably too low and 3,200-3,300 might be more appropriate. The 2019 strong gains so far argue our mid-cycle view more correct than "late in cycle" consensus.

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Figure: Comparative matrix of risk/reward drivers in 2019
Per FS insight
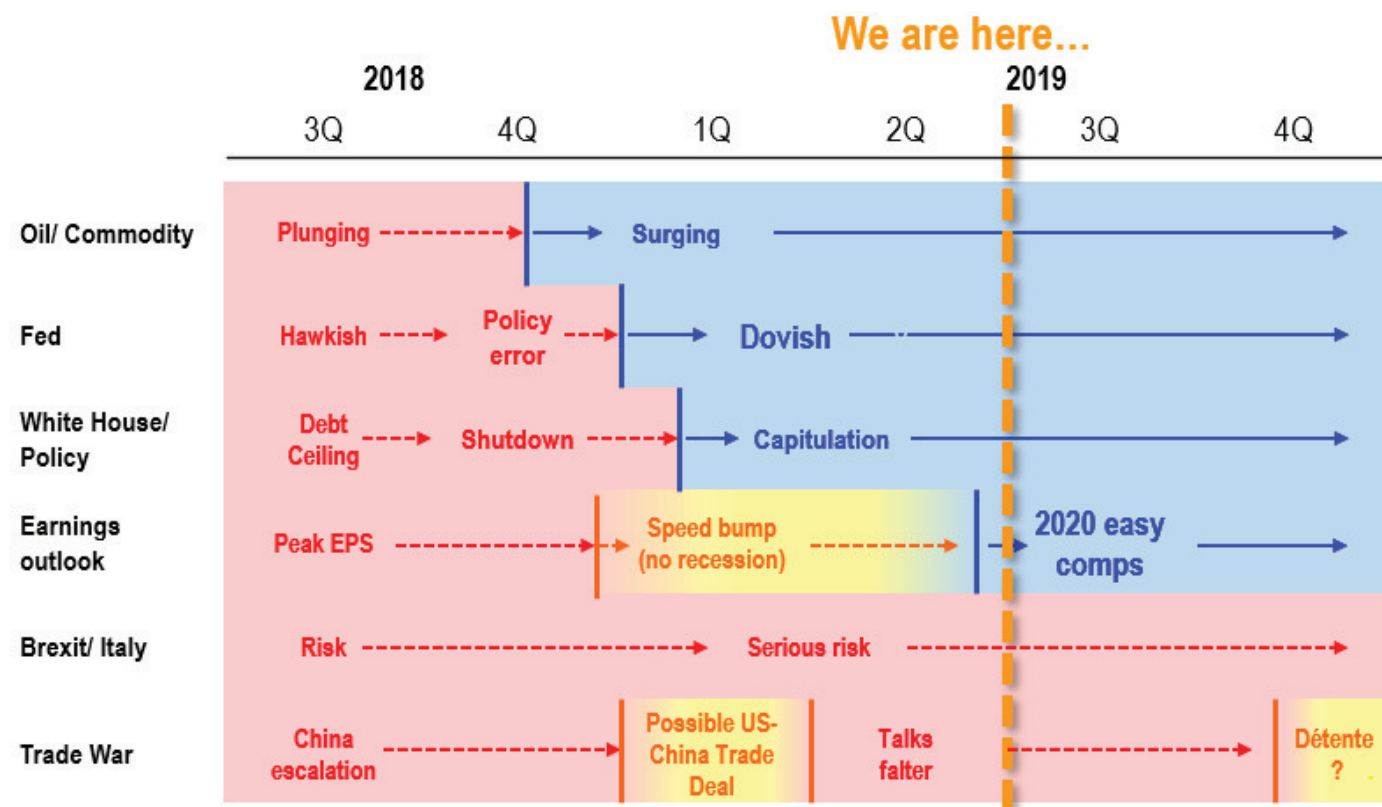
Figure: FS Insight Portfolio Strategy Summary - Relative to S&P 500
** Performance is calculated since strategy introduction, 1/10/2019

Fundstrat Theme	Execution of Strategy	Date added	Feb	Mar	Apr	May	1Q19* (since 1/10)	2Q19	3Q19	4Q19	2019** Portfolio Rel. Return
				Last 4 Months							
S&P 500	S&P 500 Price Index		3.0%	1.8%	3.9%	(1.0%)	9.2%	2.9%			12.4%
				Performance *relative* to S&P 500...							
Tactical — 6-12M											
1 Value / Growth Tilt	Market re-discovered valuation risk. • Quality - Defensive • Growth - Quality	1/10/19	2.0%	(1.5%)	(0.9%)	(0.3%)	1.3%	(1.2%)			0.0%
2 Seasons the *NEW* Seasonality	Overweight groups with good seasonals. CURRENT: Online & Home Impro Retail, Footwear, Internet & Data Srvcs, IB & Brokers, Railroads, Household Products	1/10/19	1.0%	(2.8%)	0.6%	0.4%	0.5%	1.0%			1.7%
3 FANG in odd years	FANG works in "odd" years. • FANG-plus.	1/10/19	(1.2%)	2.7%	(0.2%)	1.8%	1.0%	1.7%			2.9%
Thematic — 3-5 years											
4 Millennials prime years	Millennials driving >50% GDP growth. • Millennial transformation. • Millennial accelerates growth.	1/10/19	2.3%	(1.0%)	(0.2%)	(0.6%)	1.9%	(0.8%)			1.1%
5 Labor shortage— AI/ automation	World is short 78 million workers. • Automation/ AI suppliers. • Beneficiaries of Automation/ AI	1/10/19	2.6%	(0.4%)	0.4%	0.1%	1.6%	0.5%			2.2%
6 Higher inflation— Assets vs OpEx	Inflation trending higher long term. • Assets over OpEx.	1/10/19	2.5%	(1.1%)	(1.6%)	(0.5%)	2.8%	(2.1%)			0.5%

Source: FS Insight, Bloomberg