ESSEX INVESTMENT MANAGEMENT COMPANY, LLC

The Essex Exchange

Winter 2017

Inside this issue:

Where From Here: Risks & Opportunities By Stephen D. Cutler 1-3

The Case for Secular Growth By Joseph C. McNay 4

The Essex Exchange Newsletter

Editors
Michael S. McCarthy
Carly Semerjian

125 High Street
Suite 1803
Boston, MA 02110
1-617-342-3200

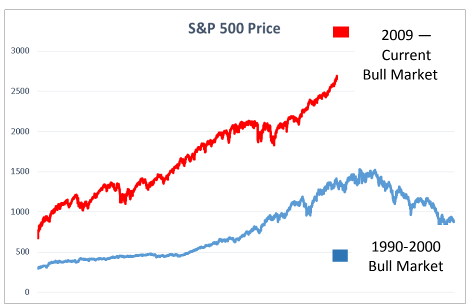
Please see our website www.essexinvest.com for updated insights from our portfolio management and research team.

Where From Here: Risks & Opportunities

Stephen D. Cutler, President & Senior Portfolio Manager

Here we are into the ninth year of a very favorable equity market environment which happens to be the second longest bull market in history.

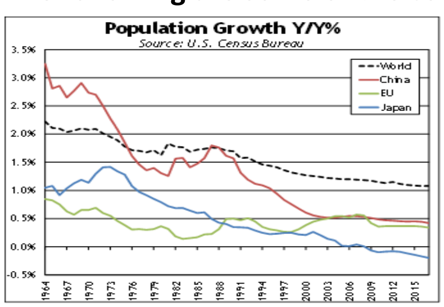
Unfortunately the longest, which ended in 2000, coincided with the end of the dot com era and we all remember what followed! This naturally raises questions and concerns over where we go from here. The current period does not appear to have the excesses of speculation as measured by predictable growth rates (which will be accelerated now that the 21% corporate tax rate is passed) and the fact that interest rates have remained low also provides a cushion to this market as it allows the price paid for earnings to remain high relative to the current low level of yields.



Source: Strategas, Essex, December 2017

If you listen to stock and bond market "experts" on the financial news networks you get conflicting opinions on the outlook. Examining both the bullish and bearish key arguments can lead us to some conclusions that clarify the outlook and the rationale for the decisions we make in your portfolios.

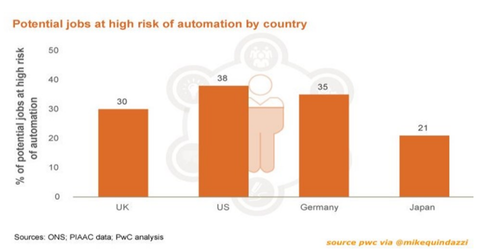
The following are some of the concerns we have:



Source: Merion Capital Group, November 2017

Source: Strategas, November 2017

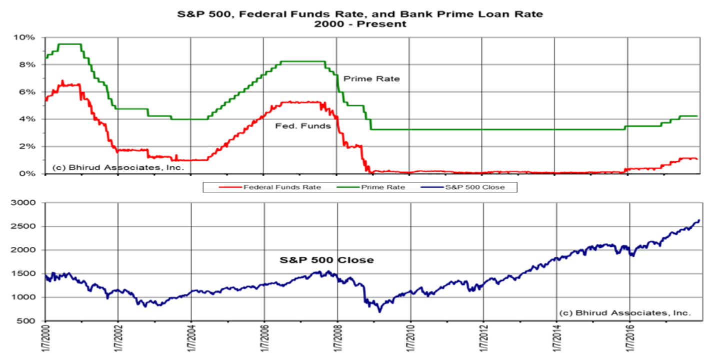
Source: Bhirud, December 2017



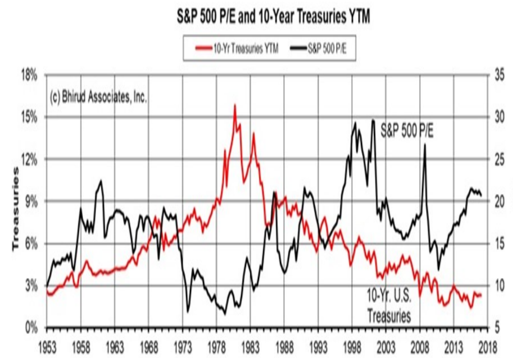
Where From Here: Risks & Opportunities

Stephen D. Cutler, President & Senior Portfolio Manager

Hard to believe but the baby boomers who provided the growth engine between 1971 to 1999 are now nearing retirement. This compounds the negative demographic trend as the population between 64 and beyond does not spend like they did in their high earnings years. Another negative is the fact of income inequality in our country. In fact, although unemployment is at a low 4%, wages have not kept pace with employment. This could be exacerbated by the use of robotics and industrial automation. Whether the tax bill alleviates the problem is open to question. Unfortunately this could ultimately lead to social unrest and the crisis that ensues from that.



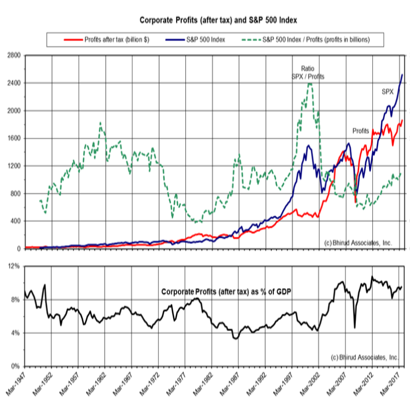
Source: Bhirud, December 2017



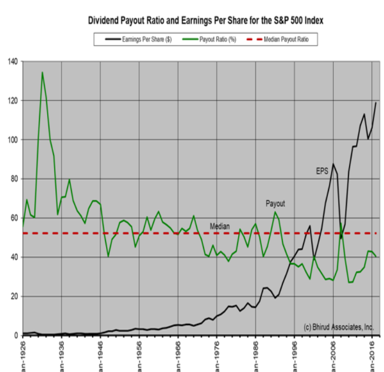
Source: Bhirud, November 2017

While low interest rates have been very beneficial for the stock market, if rates continue to rise (especially with a new Federal Reserve Chairman) the cushion these rates have provided in the past could disappear. This is reflected in the relationship between U.S. Treasuries and the price earnings ratio of the S&P 500. If rates rise the multiples paid for these earnings could decline.

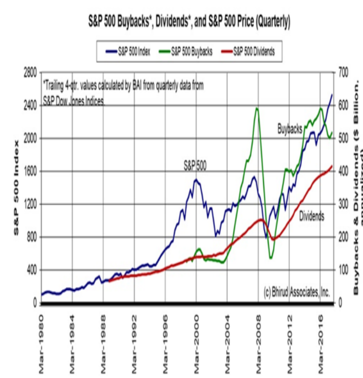
However, before you get too depressed, there are many positive factors to offset the prior negatives:



Source: Bhirud, December 2017



Source: Bhirud, December 2017

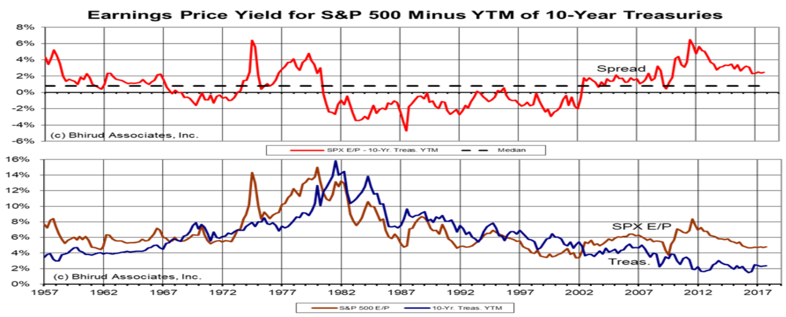


Source: Bhirud, December 2017

Corporate profits continue to rise and will be accelerated by corporate tax rates being reduce to 21%. While earnings continue to grow, the dividend payout ratio has not kept pace. With earnings probably accelerating with the corporate tax cut, it is likely at least some of the cash accruing to corporations will continue to be paid out in higher dividends and or stock buybacks as it has in the past.

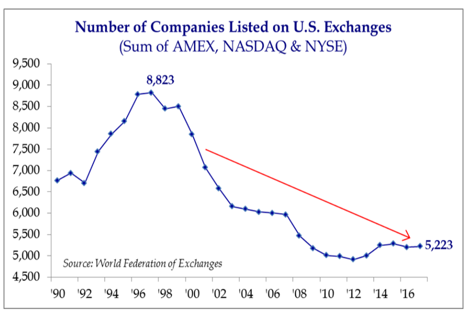
Where From Here: Risks & Opportunities — *Stephen D. Cutler, President & Senior Portfolio Manager*

Finally, the spread between ten year treasuries and the earnings price yield for the S&P 500 is one of the widest. This provides a solid relative value for stocks versus bonds.

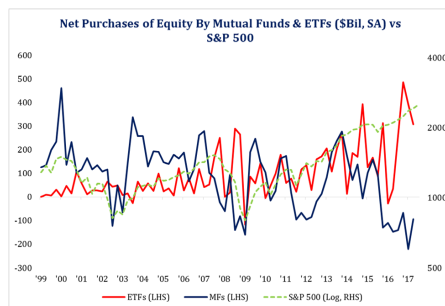


Source: Bhirud, November 2017

It is relatively easy to list the positive and negative factors in the market, but one of the major unknowns is the implication of the growth of passive investing in exchange traded funds, dominance of trading by high frequency traders and growing use by traders of algorithms. All of this is compounded by the decline in the number of publicly traded stocks which accentuates the impact of these growing phenomena. The following charts and comments illustrate the changes going on in the securities markets.



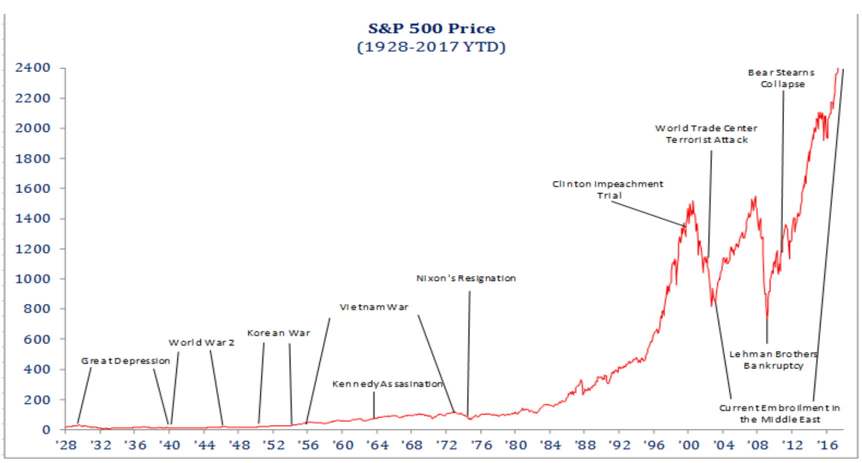
Source: Strategas, November 2017



Source: Strategas, November 2017

Ten years ago passive ownership of ETF's was practically nonexistent but today they hold more than 20% of the shares in the S&P 500. The impact from algorithms is also significant. Some estimate that algorithm traders account for 90% of order flow on the major electronic exchanges. If the algorithm traders decide to sell and if less sophisticated investors, fearful of a serious decline, redeem their passive investments in ETF's and Index Funds in a panic the result could be similar to the "flash crash" event in October 1987 which was driven by quantitative machine based strategies. Since less fundamental research is done, stocks of solid companies would be liquidated, eventually creating great opportunities as seen in the long term chart.

Looking into 2018 and beyond we see potential geopolitical concerns with North Korea and the Middle East as well as domestic concerns with the widening rift among different political agendas in the U.S. And this may be compounded by my concern described above by the growing impact of passive investing by aggressive algorithm traders and high frequency traders who have no regard for the underlying fundamental strength or the valuations of the stocks of companies they are trading. However, while the stock market's growth may be temporarily interrupted it is well to look back through history, see the number of crises which occurred, and recognize the underlying growth and strength of the U.S. economy. In fact if we do get a setback due to exogenous events and it is compounded by uninformed selling it would create a great opportunity to buy stocks of companies where we are convinced the underlying fundamentals are strong and sustainable.



Source: Strategas, Essex, December 2017

ESSEX INVESTMENT MANAGEMENT COMPANY, LLC

Investment Team

- **Joseph C. McNay**
- **Nancy B. Prial**
- **Robert J. Uek**
- **Stephen D. Cutler**
- **William H. Page**
- **Saralyn Sacks**
- **Alex Forse**
- **Marcy R. Carlin**
- **Anne Marie McMichael**
- **Martin P. Cournan**
- **Hector Sanchez-Cano**

The Case for Secular Growth

Joseph C. McNay, Chairman, Chief Investment Officer & Senior Portfolio Manager

As noted in main article of this newsletter, the current bull market is long in the tooth and there are several macro challenges to note. Within the context of the cautiously optimistic view, there are pockets of positive investment opportunity, particularly in areas with new or continuing growth. One example of a secular growth trend is the new opportunity to explore for oil in the far north, with oil exploration supply companies being significant beneficiaries. Elsewhere, we see the rise in interest rates creating a positive backdrop for banks and related financial services companies to grow earnings at a quickening pace. These are just a couple of examples of the great investment opportunities we see in today's markets. On the opposite side of the coin, there are some developments that negatively impact a few of the great growth opportunities. Most recently, the federal government's emphasis on strict oversight of marijuana is an example of one such negative. What appeared to be a new opportunity as medical and recreational marijuana was legalized in California and five other states, the federal government is now going to make it illegal from a federal standpoint.

From a macro standpoint, money on the sidelines is still quite high, creating a great opportunity for a higher move in the markets as that money is invested in growth stocks. The included chart showing money market cash levels illustrates the high level of available money for investment and earmarks the great availability for investing. Nothing on earth brings money in like a rising market. We think that the areas of focus with the best opportunities for secular growth are oil exploration, rising interest rates, new technologies for industrial production such as robotics/factory automation and medical advancements such as new biotechnology products. Finally, get ahead of the world in the oncoming move to electric vehicles; the well-positioned manufacturers and related supply chains will be major beneficiaries and are attractive investments. The array of new and continuing growth opportunities is just wonderful.

Source: Bloomberg, December 2017

DISCLOSURE