WILSON CAPITAL
INVESTMENT ADVISORY

We feel investors should have an information outlet for the financial markets that is thorough, but does not require a prerequisite degree in economics. We hope this makes our commentary informative and educational for all levels of investors. We have also included a glossary at the end of this commentary that defines terms marked with an asterisk (*).

Quarter in Review

Asset Class†	2nd Quarter 2017 Return	Past 12 Months
International Stocks	5.8%	19.1%
U.S. Small Cap Stocks	3.5%	24.6%
U.S. Large Cap Stocks	3.1%	17.9%
U.S. Bonds	1.5%	-0.3%
Commodities	-3.0%	-6.5%

With stock market volatility at record lows, the second quarter of 2017 was rather unexciting, but resulted in a continuation of steady positive returns for stocks around the world along with modest gains for bonds. When strung together, the returns for stocks in the previous 12 months remain eye-popping with double-digit gains across the board. To put the lack of volatility in perspective, for the first 2 quarters of the year there have only been 4 trading days where the return was greater than 1% or less than -1% for the S&P 500, something that hasn’t occurred in consecutive quarters in more than 20 years.

A continuous rise in equity markets with low volatility for an extended period can lull investors into a false sense of security. On the positive side, company earnings, which had slid from late 2014 into early 2016, have rebounded faster than expected and have outpaced the gains in the market itself. This means that for the broad market, company valuations are less lofty than they were a few years ago despite better returns. While bond yields remain low, encouraging investment by both companies and consumers, central banks around the world still remain on a path to raising interest rates which tend run counter to companies profit growth.

The already red-hot technology sector was further emboldened with the announcement that Amazon (Ticker: AMZN) was purchasing Whole Foods Markets (more below). The purchase put a scare in the retail sector as fresh food and grocery stores have been viewed as an area that internet merchandizing could never fully disrupt.

Outlook

As mentioned earlier, the biggest investing news of the quarter was perhaps Amazon's announced purchase of Whole Foods Market. The move certainly helps the online retail giant increase their footprint to their target demographic of urban upper-class consumers, however it does not necessarily broaden its consumer base. This indicates that Amazon's path to capture more sales will be paved by a superior logistics and distributing operation. This route may prove successful, but will likely be challenged on a number of fronts including profitability, consumer purchasing habits, and monopoly.

A large reason how Amazon has been growing their total sales is by offering everything a consumer needs at the lowest price delivered in two days or less, something most retailers lack the logistics to provide and erodes profit margins in the hopes of capturing even more customers. This model works until growth shows signs of decline and investors become weary of an inflated stock price. While Amazons' sales growth is indeed much stronger than competitors like Target, Wal-Mart, or Best Buy, their profitability is a fraction of those competitors. That can continue on this path so long as they keep gaining customers, but that scenario also has its limits.

For the past 12 months as of March 2017, Amazon sold $100 Billion in goods in the US, while the total U.S. consumer bought $4.2 trillion in goods. This is impressive market share especially considering that Amazon focuses almost entirely on the so-called non-durables* products. That segment however, has been growing at a half the pace of the durables segment in the past 5 years. In order to continue their growth, Amazon will need to see changes in the way American's consume products or find ways to gain market share of the durables or services markets. Amazon has made entries in various service areas such as video and cloud computer storage, but those areas have few synergies to package delivery. Similarly, the durables segment by nature requires logistics beyond boxing and mailing, though the day may come when a washing machine is delivered to your door via a powerful Amazon drone†.

Corporate monopolies are largely a historic relic from the days of the Rockefellers of Standard Oil and the Vanderbilts of railways, but the U.S. government still looks unfavorably on companies that take a market share large enough to reduce consumer choice. Acquisitions like Whole Foods do not necessarily eliminate a competitor (a significant hurdle when assessing a monopoly) or directly reduce consumer choice, but they further Amazon's reach into a new business line where it can undercut and possibly force out competitors. Once Amazon has eliminated enough competitors and gained captive customers, below market prices aren't needed and the customer ends up paying higher prices with fewer options. Which is precisely the government's concern when assessing monopolistic enterprises.

With many retail options still available, this scenario is not yet on the horizon, but will be as Amazon continues to gain market share and traditional brick and mortar retailers struggle. How Amazon manages investor expectations while continuing to offer a value proposition for the consumer will be an important question moving forward.

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†At the end of the previous week Amazon announced a partnership with Sears to include Kenmore appliances on the Amazon website. The deal stipulates than Sears will warehouse, deliver and install the appliances.

Glossary

Consumer Non-Durables – goods that are purchased frequently and regularly. Examples include food, gas and clothing

Consumer Durables – goods that have an extended useful life and are typically purchased on a cycle rather than continuously. Examples are appliances and cars

† Indices used to represent asset classes:
U.S. Large Cap Stocks – S&P 500
U.S. Small Cap Stocks – Russell 2000
International Stocks – MSCI ACWI ex-U.S.
U.S. Bonds – Barclays Aggregate
Commodities – Bloomberg Commodity

IMPORTANT INFORMATION