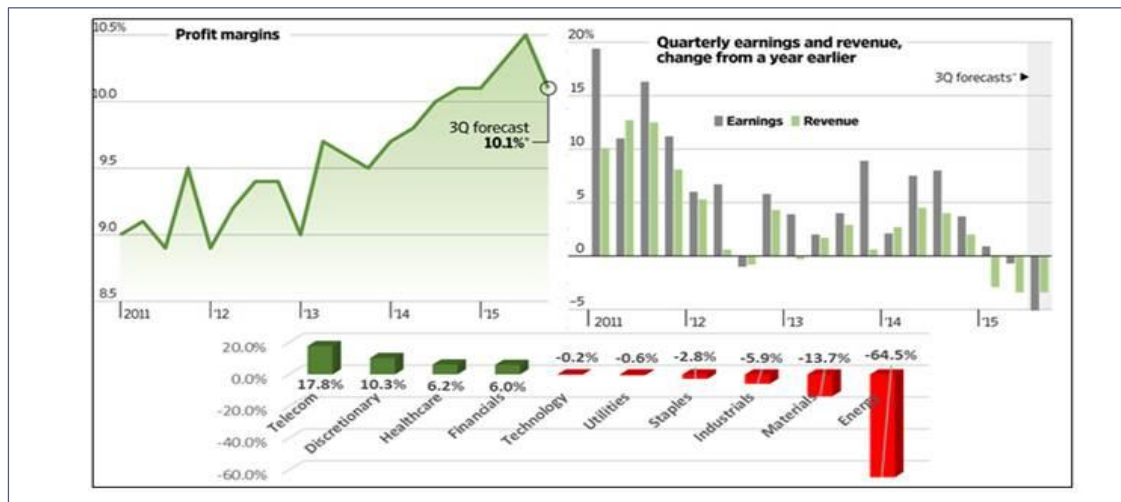


# Market Recap

## Profit Margins Are Under Pressure



Source: The Wall Street Journal, Factset

## From Worst to First



Source: Factset

Since the financial crisis ended, companies have cut costs, refrained from updating infrastructure, and borrowed at low rates, leading to expanding profit margins. In the second quarter of 2015, profit margins hit a record 10.5% for the S&P 500. However, in the wake of stagnant revenue growth (S&P 500 earnings are expected to decline 5.1% year-over-year in the third quarter), investors question whether this margin expansion can continue forever – can companies squeeze out even more profit without boosting top line sales? In addition, as the economy continues to improve, higher labor costs and, eventually, higher interest rates will place further pressure on margins. These concerns are coming at a time when many have argued that stocks, trading at 17.9 times earnings, are already expensive. Narrowing profit margins could put significant pressure on stock valuations if corporate revenues do not accelerate into 2016.

Two weeks into October, the S&P 500 seems to have fought off recent weakness to gain 6.3% on the month through 10/13. Of note in this rally is that the bounce has been led by what had been the most deeply oversold stocks of the year. Broken down into quintiles, the 100 stocks with the lowest returns through September have averaged an 11% gain thus far in October against an average 4.3% gain for the rest of the index. Since 1990, it has been typical for those sectors with the worst performance during corrections and bear markets to actually outperform the market during the first six months of a recovery by an average of 800 basis points. Accordingly, it is not surprising to see Energy, Industrials, and Materials pulling out of prior weakness to return an average of 12% since the correction ended on August 25<sup>th</sup>, against 7.9% for the S&P 500.

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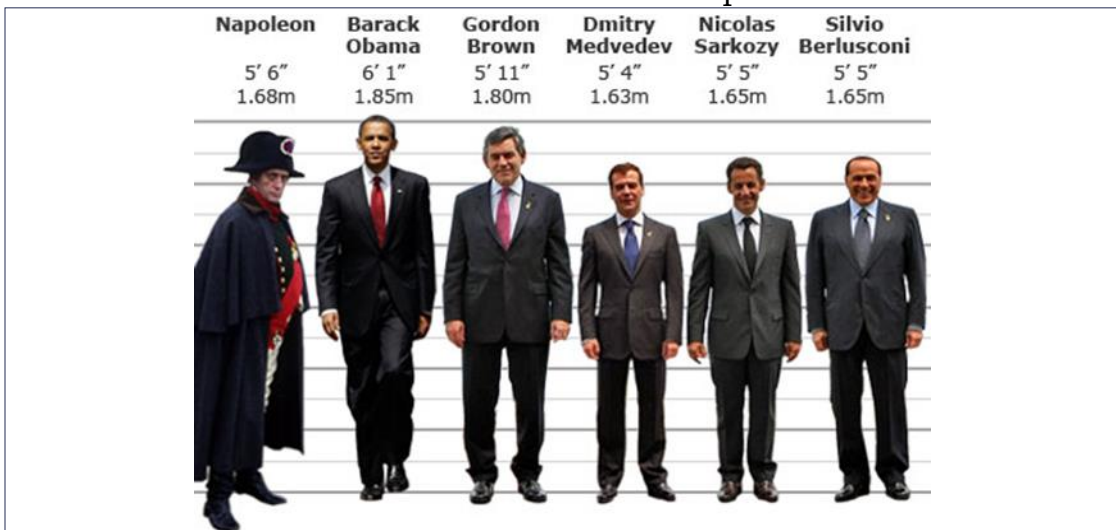
## A Potential Turnaround in Oil?



Source: Cornerstone Macro

While uncertainty over oil supply was the foundation for bearish sentiment in 1H 2015, concerns over demand appeared to take center stage for a good portion of the 3<sup>rd</sup> quarter. Production in the U.S. has begun to drop, with Q4'15 and Q1'16 likely to underscore just how significantly shale oil drilling activity has declined. At the same time, demand hasn't fallen off as much as had been expected in the wake of slower global growth. Now, with demand firming (or at least "less weak" than expected), and supply declining, a scarcity concern could emerge. This would support rising oil prices and may lead to renewed investment across the sector. Mutual funds are currently sitting on high levels of cash, with most funds severely underweight energy (allocations 17% lower than historical average), and the long/short community is still short energy (allocation 44% lower). Rising oil prices could drive heavy buying and support price appreciation throughout the broad energy sector.

## How Leaders Measure Up



While issues and experience should take precedence in constituents' opinions of their leaders, physical stature and appearance often are factors. In fact, in Napoleon's day, his enemies attempted to discredit him by spreading rumors that his height was even less than it was. At 5'6", Napoleon was of average height for the time, and ranks somewhat evenly with many of today's European leaders. For one, former French President Nicolas Sarkozy has been rumored to orchestrate his public appearances in order to mask his 5'5" stature. He once toured a French factory whose representatives later claimed that they were given height criteria for determining which employees should appear on stage with Sarkozy during his speech. Other rumblings of Sarkozy's height-manipulation tactics include wearing special shoes, using footstools during his speeches, and asking his wife to wear flat shoes when appearing with him.

Source: BBC

**Contact:** If you have any questions or comments, please do not hesitate to contact us at 703.992.6164. For more information about Harbour Capital Advisors, please visit our website at [www.harbourcapitaladvisors.com](http://www.harbourcapitaladvisors.com).

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