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Arcataur Capital Management,LLC
826 North Plankinton ▲Suite 300
Milwaukee, Wisconsin 53203

414 225.8200
FAX 414 225.0043
www.arcataur.com

Trends: Investing with few good alternatives

By KATHLEEN GALLAGHER, kgallagher@journalsentinel.com

As stock prices have continued their climb, Ignatius L. Smetek has been trimming his equity exposure.

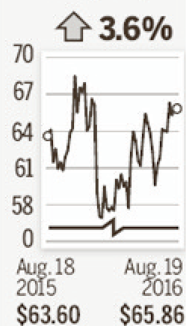
But the head of Milwaukee-based Arcataur Capital Management LLC is not, as he might have in times past, putting the proceeds into bonds.

Ignatius L. Smetek

"We're carrying a little more cash than normal because the alternative to stocks, the bond market, is significantly less attractive today," said Smetek, who is Arcataur's president and chief investment officer.

Experts have been worried for years — without warrant so far — about a bond market crash. But now, with the possibility of a rise in interest rates, there's a higher likelihood that bond prices may decline, bursting the long-lived bond bubble, Smetek said.

Unfortunately, there aren't many opportunities in stocks either. Many individual stocks are overvalued after a long market run that began in March 2009. In fact, stocks are probably due for a "normal" correction of 5% to 7%, Smetek said.



Graphic/Journal Sentinel

Until a few months ago, the market rise was fueled primarily by yield-hungry investors buying into utilities, REITs and other high-dividend stocks. Market leadership has broadened recently as global economic trends have stabilized, Smetek said.

But one group that continues to lag is stocks that would benefit from rising interest rates, particularly banks, Smetek said.

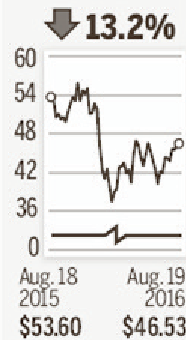
Both of the following companies provide financial services around the world. They have, like most U.S. banks, improved their capital structures since 2009, and would provide particularly attractive buying opportunities following a market correction, Smetek said.

JPMorgan Chase & Co. (JPM, $65.86), New York, is a high-quality bank, but Smetek said he wouldn't buy these shares at their current level in the mid-$60s. He said he would, however, jump in if they pulled back to around $62 a share or lower.

JPMorgan is headed by Jamie Dimon, one of the best bank executives in the business, Smetek said. It has been one of the best-managed banks before, during and after the 2008-'09 financial crisis, he said.

Dimon had throat cancer in 2014, and JPMorgan had billions of dollars of losses earlier this decade incurred by one of its derivatives traders who became known as the London Whale. But Dimon maneuvered through those issues well, Smetek said.

These shares have a 52-week range of $50.07 to $69.03. If an investor bought them at $62 or lower, they would have potential to provide a return of 20% or more over a 12-month period in a rising rate environment, Smetek said.



Graphic/Journal Sentinel

Citigroup Inc. (C, $46.53), New York, is in some ways the opposite of JPMorgan because it was one of the banks hit hardest in 2008 and 2009, Smetek said.

"They've made a lot of changes since then," he said. "They've redefined themselves to be a much more stable bank going forward, and a more global bank."

Citigroup's shares are trading at less than 10 times earnings, but Smetek said he would hold off on buying them until they fell to $42 or lower.

Citigroup in 2015 had its capital plan approved by the Federal Reserve, one of the last companies that took a government bailout during the financial crisis to get such approval. It was, nonetheless, a vote of confidence that allowed the bank to raise its dividend and buy back its shares.

Michael Corbat, who has been Citigroup's chief executive officer since 2012, was key to the improvements that led to the Fed's approval, Smetek said.

These shares have a 52-week trading range of $34.52 to $57.92. If an investor bought them at $42 or lower, they would have potential to provide a return of 25% or more over a 12-month period in a rising rate environment,

The biggest risk for both banks is the possibility of an event that would drive interest rates back down toward their lows, Smetek said.

"Anything that would negatively impact economic growth and cause yields to go down is by far the biggest near-term risk," he said.

About this

The Journal Sentinel focuses on one Wisconsin money manager or analyst in this weekly feature, looking at a trend that helps investment pros make their decisions.

This column examines one stock through the eyes of a professional investor to show how market pros make investment decisions. Neither Kathleen Gallagher nor the Journal Sentinel recommends specific investments or endorses the recommendations of those interviewed.

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