McShane Partners

WEALTH & INVESTMENT ADVISORY

July 2018 Insights

Investment Overview

Dot-Com Déjà Vu

Information Technology has attracted significant attention in the markets and considerable investor assets over the past couple of years, but sector-level exposures appear increasingly concentrated in a select few high-momentum stocks. The ongoing debate over the technology sector's valuations, the soaring "celebrity" status of certain high-profile technology stocks, and the rapidly relaxed financing environment have contributed to an environment wherein current market conditions appear emblematic of the dot-com, information technology bubble. Despite the notable similarities, there is a strong secular case for technology's increased presence in daily life and, consequently, investment portfolios, and while sector-level valuations for Information Technology are higher than other sectors they remain well below levels seen during the dot-com bubble given the dramatic improvement in company profitability.

Information Technology: Weighting in S&P 500®

Technology has become as pervasive in equity markets and indexes as it has in daily living; therefore, to properly estimate technology exposure in the index, a custom sector composition is necessary. As of month-end (June 29th 2018), the S&P 500® Information Technology Sector Index constituted **±26.0%** of the S&P 500® Index: after adding Amazon.com, Inc. ("AMZN"), Netflix, Inc. ("NFLX"), and other component companies of the Internet & Direct Marketing Retail

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Wealth Advisory Overview

Understanding Digital Assets & Planning for Fiduciary Access in Estate Plans

Digital assets are becoming increasingly more important in individual estate plans. One of the most significant non-tax estate planning developments in recent years has been the creation of the Uniform Fiduciary Access to Digital Assets Act ("UFADAA") by the Uniform Law Commission, which has been adopted by 38 states, including North Carolina. UFADAA recognizes the existence of digital property as a property right that can be managed, conserved, and in some instances, accessed by third parties. The formal recognition of this property right requires the consideration of these digital assets in individual estate plans.

Collectively, a person's digital property and electronic communications are referred to as "digital assets," and the companies that store those assets on their servers are called "custodians." Access to digital assets is usually governed by a restrictive terms-of-service agreement provided by the custodian. This creates problems when account holders die or otherwise lose the ability to manage their own digital assets. Although no definition of digital assets is universally accepted, UFADAA defines them as electronic records, not including an underlying asset or liability unless the asset or

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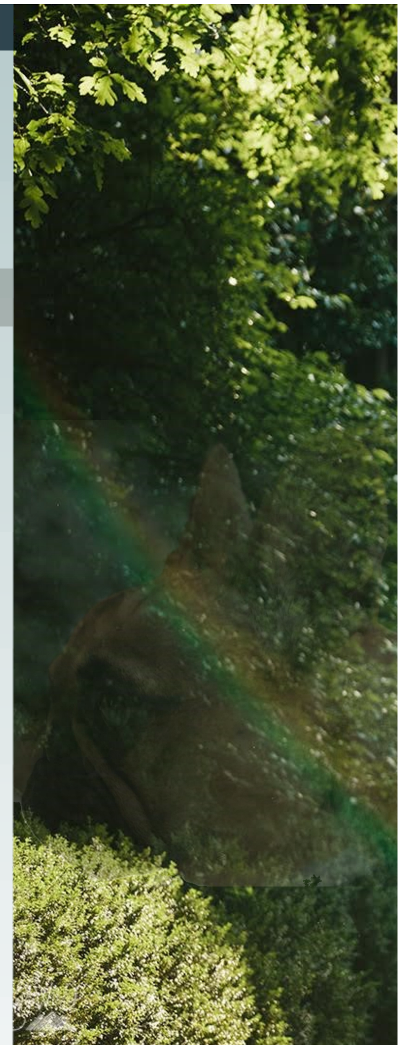

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Special Points of Interest

- Monthly Index Review
- Stock & Strategy Spotlight
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Industry Index, which is currently included in the S&P 500® Consumer Discretionary Sector Index, the "*Adjusted*" Information Technology Sector Index weighting increases to **±30.2%** from the aforementioned **±26.0%**.

Last year, S&P Dow Jones Indices announced plans to reclassify certain stocks from Information Technology and Consumer Discretionary to a newly-created S&P 500® Communications Services Sector Index in September 2018 in an effort to make the sector-level indexes more economically representative by pulling several internet-/technology-related names out of Consumer Discretionary and "combining" them in a new category with comparable Information Technology companies. While this may result in temporary, short-term confusion amongst markets and investors, the reclassification should improve the accuracy and representativeness of the subsequent sector-level indexes relative to their respective underlying component companies, rendering the creation of an Adjusted Information Technology Sector Index obsolete.

Assuming the Adjusted Information Technology sector currently represents **±30.2%** of the S&P 500®, it is roughly **±4.7%** *below* the dot-com market cycle peak of **±34.9%**, which can be roughly defined as the period from late-1996 through late-2002. The substantial weighting and concentration of technology stocks across equity indexes is not isolated to just U.S. markets, as twenty of the largest technology stocks across global equity markets have a combined market capitalization in excess of **±$6.0 trillion**, with the five largest companies - Apple, Inc. ("AAPL"), Amazon.com, Inc. ("AMZN"), Microsoft Corp. ("MSFT"), Alphabet, Inc. Class A & C ("GOOGL"/"GOOG"), and Facebook, Inc. Class A ("FB") - comprising **±60.0%** of that value, or roughly **±$3.7 trillion** *(Source: Goldman Sachs)*.

To better understand and illustrate the predictable behavioral patterns of investors in the Information Technology sector, Chart I below depicts trends in sector-level market capitalization ("market cap") ratios relative to the aggregate market cap of the S&P 500® over the past three U.S. economic cycles. The dark blue line represents the market cap of the *unadjusted* Information Technology sector as a percentage of the S&P 500®, with the orange line reflecting the comparable market cap ratio of the aforementioned Adjusted Information Technology sector that includes the market cap of the Internet & Direct Marketing Retail industry following its formation in July 2002.

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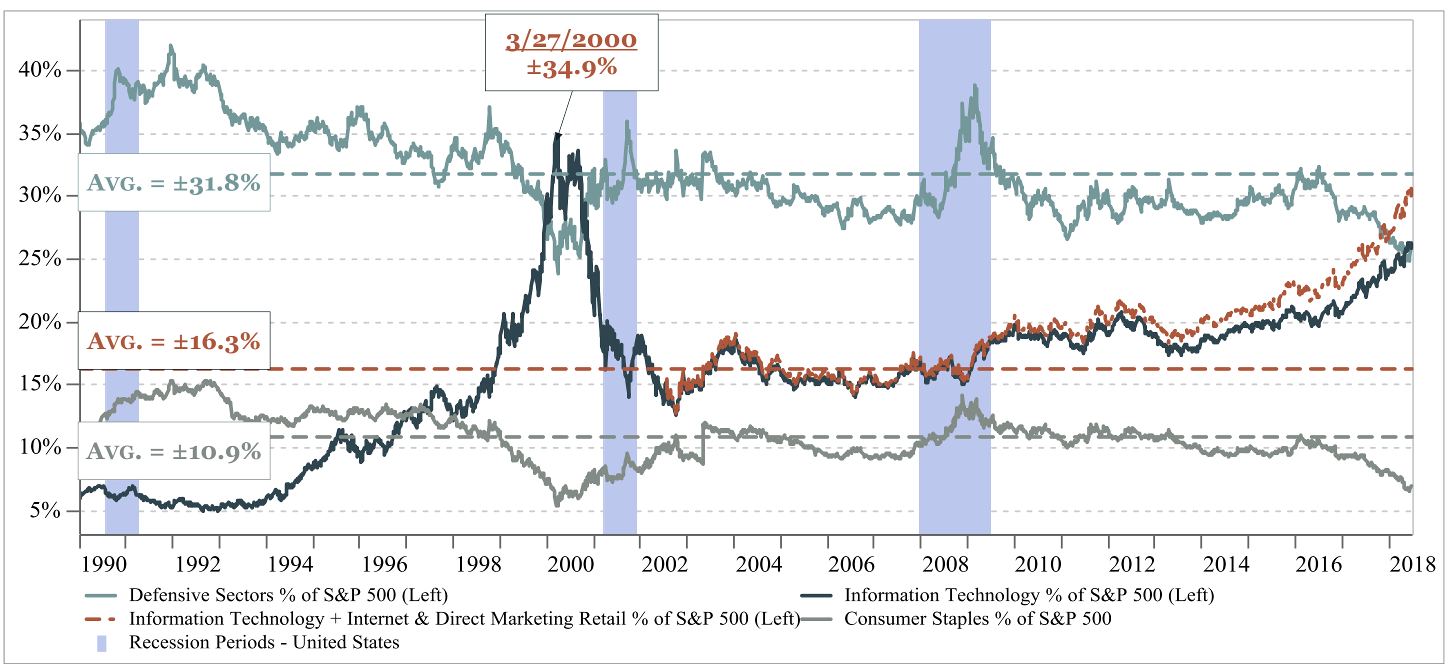
Chart I: S&P 500® Market Capitalization Composition Analysis



Source: FactSet Research Systems, Inc.

INVESTMENT OVERVIEW

DOT-COM DÉJÀ VU

Notably, the orange line breaks away from the dark blue line in late-2012/early-2013, as investors flocked to technology-related Consumer Discretionary names like AMZN and NFLX, which have returned **+577.6%** and **+2,859.3%**, respectively, since the end of 2012!

The Adjusted Information Technology sector is trading at an implied **+85.5%** *premium* to its long-term average market cap ratio (vs. the S&P 500®)- an average that includes the irrational market cap gains enjoyed by the sector during the dot-com bubble years - which seems slightly excessive, even after factoring in the long-term secular tailwinds as a justification for a permanent increase in Information Technology's sector-level weighting within the S&P 500®. Conversely, the market cap ratio of the combined S&P 500® Defensive Sector Index currently trades at a –**18.3%** *discount* to its long-term average, while the S&P 500® Consumer Staples Sector Index trades at a comparable discount of **-35.9%**.

Given the predictable inverse relationship that occurs in the respective sector-level market cap ratios leading up to each of the three most recent U.S. recessions, with the Defensive Sector Index ("Defensives") hitting late-cycle lows and Information Technology peaking at cyclical highs immediately *before* entering an economic recession, the pendulum of investors rotating into higher-risk, economically-sensitive stocks appears to have swung too far, offering investors an opportunistic sector-level *pair trade*, favoring a tactical overweight in Defensives. Conceptually, this relative analysis exemplifies the behavioral element of investing in that investor confidence and willingness to assume additional market risk (i.e., beta) tends to *increase* towards the end of the market cycle: this behavior was notably present during the dot-com bubble and has been similarly noticeable over the past 12-24 months.

INFORMATION TECHNOLOGY: SECULAR STORY - INNOVATION & PROFITABILITY

There is a distinct cyclical similarity in investor sentiment regarding sector ownership, but there are different secular forces behind Information Technology vs. Defensives. The innovation, improved profitability, and accelerated growth trajectory has encouraged a steady, meaningful increase in technology ownership by equity investors and, consequently, broader indexes. Thus, separating and acknowledging the secular adjustment to the index versus the cyclical patterns denoted above is an important fundamental factor in any investment thesis supporting a mean-reverting pair trade in sector-level exposures.

Chart I on the previous page shows the initial decline in the market cap ratio of Defensives from the early-1990s through its record low of **±23.8%** in March 2000; after that point, however, Defensives' relative market cap appears to stabilize from early-2002 until just recently, fluctuating predominantly based on the prevailing economic cycle. On an adjusted and unadjusted basis, the Information Technology sector-level market cap ratio has a distinct cyclical trading pattern, but, through each market cycle, the ratio's respective trading range has continued to move higher and higher, from a pre-dot-com (1990-1998) average of **±8.7%** to a recent long-term average of **±19.4%** from 2003 through June 2018. Clearly, the differential in expected growth rates and relative contribution to global economic growth demonstrated by the Adjusted Information Technology sector warrants larger representation in the index, but the depressed representation of the Defensives seems excessive when paired with historically attractive valuations and stable secular dynamics.

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ABOUT MCSHANE PARTNERS

McShane Partners is an experienced, boutique registered investment advisor dedicated to independent, comprehensive wealth management. Founded over 30 years ago, the firm, from its inception, has had a singular focus: to provide highly customized investment management and financial planning solutions to clients.

Boutique Firm:

Being a boutique wealth management firm allows us the flexibility to provide more personalized service and offer unique investment solutions to clients in a Fee-Only environment.

Team Approach:

Because each client's situation is different, the team of advisors is hand-selected to ensure areas of expertise are appropriately aligned with the client's specific needs and interests.

Proprietary Investment Research:

The differentiating factor of our portfolio management process is the proprietary investment research driving the portfolio construction. All investment research and analysis is done entirely in-house by our Investment Team.

Investment Overview

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Information Technology: Relative & Absolute Valuation

The S&P 500® Information Technology Sector Index consistently trades at a premium to the S&P 500® given the sector's historic and anticipated growth differential. In a growth-starved economy faced with long-term headwinds, such as deteriorating demographics and elevated debt levels, the Information Technology sector is a rare growth asset for investor portfolios, well-deserving of considerable premiums relative to other asset classes; the question is, however, how *large* of a premium is *too large*? For example, when reviewing sector-level enterprise-value-to-revenue next twelve months ("EV/R NTM") multiples, as illustrated in Chart II, the current **±1.1%** premium to the upper band of Information Technology's long-term valuation range relative to the S&P 500®, as represented by one standard deviation *above* the historical average, does not appear excessive. By excluding the abnormal relative valuation levels from the dot-com bubble years as outliers, we are able to calculate an adjusted, *normalized* valuation range using the sector-level EV/R NTM multiple relative to that of the S&P 500®. As a result, the upper band of Information Technology's long-term relative valuation range *declines* from **±1.77x** to **±1.63x**, increasing the current sector-level premium *up* from **±1.1%** to **±9.1%**. This premium appears elevated on a normalized basis relative to historical levels and when compared to other sectors, particularly the S&P 500® Consumer Staples Sector Index, which currently trades at a **-10.8%** discount to the *lower* band of its long-term relative valuation range. This relative discount appears excessive, even after factoring in the sector's significantly slower growth profile, which is reflected in the sector's historical average discount relative to the S&P 500®.

To reiterate, the debate is *not* whether or not Information Technology (Consumer Staples) deserves to trade at a relative premium (discount) to the S&P 500®, but, rather, whether or not the order of magnitude of the respective sector-level relative multiples is temporarily skewed, indicating questionable investor exuberance at this stage in the market cycle. Alternatively, Information Technology's current absolute EV/R NTM multiple is **±46.5%** *below* levels seen during the dot-com, technology bubble, and, furthermore, sector-level price-to-earnings ratios are much more attractive.

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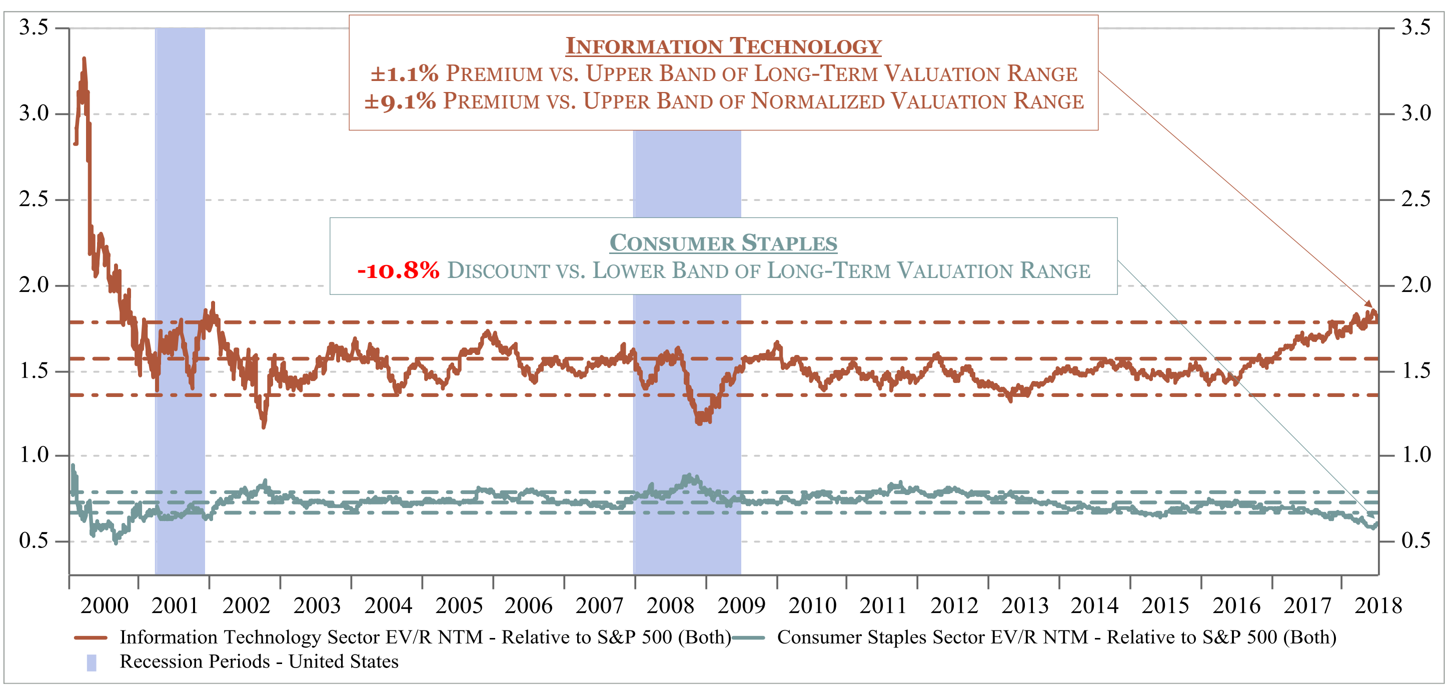
Chart II: Sector-Level Relative Valuation Analysis (EV/Revenue NTM)



Source: FactSet Research Systems, Inc.

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Although the sector trades at a substantial premium to its long-term average EV/R NTM multiple, Information Technology appears significantly cheaper *today* on a price-to-earnings next twelve months ("PE NTM") multiple basis than it did at any point throughout the dot-com market bubble because of the dramatic, broad-based improvement in the underlying fundamentals and profitability of the sector's constituent companies over the past ±17 years. As can be seen below in Chart III, the S&P 500® Information Technology Sector Index trades at a PE NTM multiple of **±18.2x** - a relative **±12.0%** premium vs. the S&P 500® - which is reasonable relative to sector-level earnings per share ("EPS") growth rates and represents a meaningful **-67.5%** discount to the sector's peak **±55.9x** PE NTM multiple from March 2000. The impressive improvement in profitability and subsequent multiple compression appears reasonable and rational, justifying continued meaningful exposure to the Information Technology sector across long-term investment portfolios, but, given the sector's premium valuations relative to the broader equity market index and other sectors, initiating new significant positions remains a challenging proposition at this stage in the market cycle.

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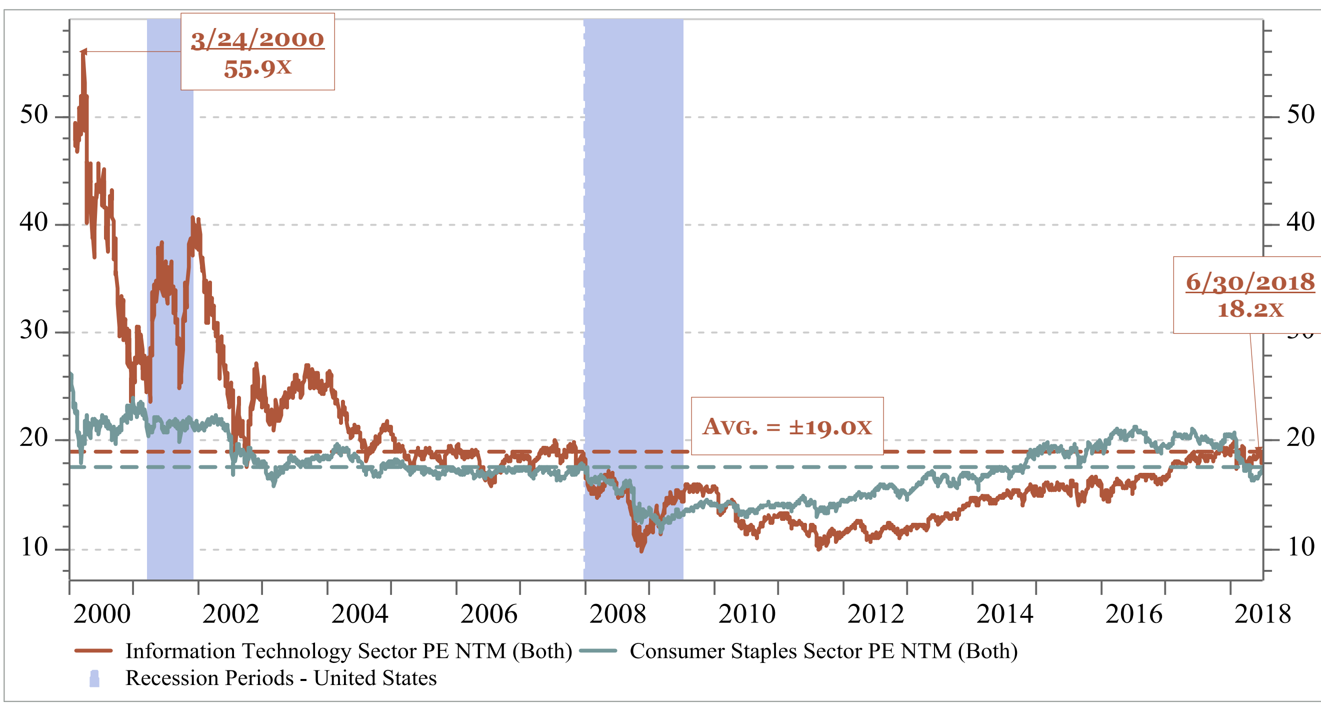
"Look at a stock as a business, instead of a piece of paper that moves up and down."

- William Ruane

Chart III: Sector-Level Valuation Analysis (PE NTM)



Source: FactSet Research Systems, Inc.

INVESTMENT OVERVIEW

DOT-COM DÉJÀ VU

CELEBRITY STOCKS

As previously indicated, several high-profile technology-related stocks have soared to "celebrity" status over the past several years and now represent a significant weighting of both the unadjusted and Adjusted Information Technology Sector Index, as well as the broader S&P 500®. As can be seen below in Table I, many of these celebrity stocks are companies that have become increasingly important and synonymous with everyday life for individual investors in the U.S. and around the world. These select celebrity stocks have provided outsized positive stock-specific contribution to the performance of the S&P 500® year-to-date ("YTD"), as evidenced by the significant market cap gains enjoyed by these stocks through the end of June. Valuations, however, are not unreasonable, except in the case of AMZN, which is one of the reasons we have avoided owning the stock directly, as we continue to view the stock's celebrity status and elevated valuation as stock-specific risks.

TABLE I: S&P 500® HIGH-PROFILE "CELEBRITY" STOCKS

COMPANY NAME	TICKER	MARKET CAP USD BIL.	S&P 500® WEIGHT	INFO. TECH. SECTOR WEIGHT	ADJ. INFO. TECH. SECTOR WEIGHT	PE NTM MULTIPLE
Apple Inc.	AAPL	$ 909.84	3.95%	15.21%	13.09%	14.57x
Amazon.com, Inc.	AMZN	$ 824.79	3.58%	-	11.86%	**106.17x**
Microsoft Corporation	MSFT	$ 757.64	3.29%	12.67%	10.90%	24.41x
Alphabet Inc. Class A	GOOGL	$ 337.24	1.46%	5.64%	4.85%	24.53x
Alphabet Inc. Class C	GOOG	$ 389.31	1.69%	6.51%	5.60%	24.23x
		$ 726.55	3.15%	12.15%	10.45%	
Facebook, Inc. Class A	FB	$ 466.10	2.02%	7.79%	6.70%	23.26x

Source: FactSet Research Systems, Inc.

RELAXED FINANCING ENVIRONMENT

Similar to the dot-com bubble, the financing environment has become hazardously relaxed, with corporate governance standards deteriorating, exotic deal structures, and compressed returns relative to risk. As investors become passive and comfortable, they begin to abandon corporate governance as a critical fundamental criterion, and this is evidenced in the accelerated usage and acceptance of the dual-class model to give executives and certain owners exorbitant voting rights relative to their ownership percentage. Several high-profile technology companies have implemented this strategy such as GOOGL/GOOG and FB while newer technology issues such as Spotify Technology S.A. ("SPOT") and Dropbox, Inc. Class A ("DBX") have given minority holders marginal input and last year's Snap, Inc. Class A ("SNAP") initial public offering ("IPO") of shares to investors with zero voting rights, which are critical to shareholders having a voice in the company and maintaining executive oversight, as unilateral control with minimal oversight is a considerable hazard for shareholders. This mismatch in ownership relative to control is evidenced at FB, where Mark Zuckerberg owns **±1.0%** of the shares but **±60.0%** of the voting power *(Source: Bloomberg)*. This misalignment might be the result of investor complacency and indicative of a frothy market susceptible to a correction.

Exotic offerings are also typical in an extended market as investors are more willing to tolerate unproven financing models that would be shunned in a more risk averse rational market. Recently, SPOT conducted a "direct listing" offering where no company shares were sold by traditional investment bankers and shares were

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sold by existing holders, with immediate price discovery made upon the initial trading of the shares. A prime example of investors insatiable risk appetite is the resurrection of zero-interest convertible bonds, which had been relatively absent since the dot-com market bubble. According to a recent article by *The Wall Street Journal*, in the ±17 years following the dot-com bubble, only **±13** U.S. technology companies had issued convertible bonds without coupons through the end of 2017: in 2018 alone, however, three companies - Nutanix, Inc. ("NTNX"), RingCentral, Inc. ("RNG"), and Etsy, Inc. ("ETSY") - have taken advantage of attractive financing conditions and investor demand by issuing zero-interest convertible bonds of their own. Moreover, **±24** U.S. technology companies have issued **±$11.0 billion** in convertible bonds YTD, a year-over-year ("YoY") increase of **±29.0%** from the same period in 2017 and the highest issuance volume in a comparable period since 2000, with an average coupon of just **±1.0%** *(Source: The Wall Street Journal).*

Monthly Index Review **USD Total Return**				
Data as of June 30th 2018	**June 2018**	**2018 YTD**	**2017**	**2016**
S&P 500®	+0.62%	+2.65%	+21.83%	+11.96%
Dow Jones Industrial Average	-0.49%	-0.73%	+28.11%	+16.50%
NASDAQ Composite	**+0.98%**	**+9.37%**	+29.64%	+8.87%
Russell 2000	+0.72%	+7.66%	+14.65%	**+21.31%**
MSCI Emerging Markets	**-4.09%**	**-6.51%**	**+37.75%**	+11.60%
MSCI EAFE	-1.19%	-2.37%	+25.62%	+1.51%
Bloomberg Barclays U.S. Aggregate Bond Index	-0.12%	-1.62%	+3.54%	+2.65%

Stock & Strategy Spotlight

Name	**Ticker**	**2018 YTD**
Starbucks Corp.	SBUX	**-13.80%**

Description & Investment Thesis

On June 19th, Starbucks Corp. ("SBUX") provided updated earnings estimates and comparable, same-store sales growth guidance for the company's fiscal third quarter 2018 ("3Q18") that fell short of consensus expectations. In particular, SBUX indicated that it expected global comparable store sales growth of **±1.0%** in 3Q18 (vs. consensus of **±2.9%**) and reduced the midpoint of their adjusted and unadjusted 3Q18 earnings per share ("EPS") targets by **-2.8%** and **-3.8%**, respectively. Additionally, SBUX announced that it plans on closing ±150 stores over the coming year in order to reduce overly-saturated markets and drive increased/improved customer traffic at higher-value locations. Following these announcements, shares of SBUX experienced their second-worst one-day sell-off in the past five years, falling **-9.1%** in response to souring investor sentiment surrounding the company's near-/intermediate-term growth outlook, as well as multiple downgrades and negative price target revisions by analysts. Shares of SBUX fell under renewed pressure after the company announced the departure of Chief Financial Officer ("CFO"), Scott Maw, with shares tumbling an additional **-2.6%** in response to the unexpected management team change. The Investment Team believes that, while these short-term headwinds may persist and weigh on share price performance over the coming months, the company is taking the appropriate steps to successfully navigate an increasingly mature marketplace by focusing on the value-additive performance of its underlying store base and not sacrificing fundamental quality for unsustainable growth. Moreover, the company's efforts to continue improving its balance sheet positioning by reducing its leverage profile and its target of returning **±$25.0 billion** to shareholder via increased dividends and share buybacks through fiscal year 2020 are indicative of the high-quality, attractively-valued investment opportunities that we believe are currently being overlooked across U.S. equity markets as a result of the prevailing high-growth, high-momentum regime.

UNDERSTANDING DIGITAL ASSETS & PLANNING FOR FIDUCIARY ACCESS IN ESTATE PLANS

liability is itself a record that is electronic. All digital assets, however defined, are accessed by a tangible device, such as a computer, smartphone, tablet, or a server.

UFADAA provides details regarding how a fiduciary, such as an Executor or Executrix, may obtain information from a custodian as to the existence of the deceased account holder's digital assets and potential management rights over such assets. Important points to note:

- The account holder has the ultimate decision as to whether a custodian should disclose to a fiduciary the existence of digit assets and whether or not access to such assets should be provided.
- The account holder has the right to grant a fiduciary access and management to only certain digital assets and not to all digital assets in which the user has a property right.
- If a fiduciary is granted access to an account or digital asset, the fiduciary does not acquire greater access rights in the digital asset than what the user had.

For an increasing number of individuals, digital assets are rapidly becoming a very important part of estates for both financial and sentimental reasons. This trend is projected to continue to accelerate in the years ahead as more and more traditional brick and mortar establishments close their physical locations and rely on their internet presence. Therefore, individuals should implement systems that allow them to track their digital assets. A virtual asset instruction letter, or "VAIL," lists all of the deceased account holder's on-line accounts and assets and provides web addresses, user names, and passwords to give the designated representative the ability to identify and access these accounts.

STEPS TO DEVELOPING A VAIL

- Identify each Internet account that you have and determine how each company handles an account when the account holder dies.
- Determine which accounts you want your representative to maintain and have access to, and prepare a written and electronic list of those accounts with their passwords.
- Determine which accounts you wish to have deleted and provide the necessary written instructions to do so.
- Consider saving the account and access information on a memory stick and store it in a safe place. Give your representative instructions about how to access this information, remembering to update it as passwords change.
- If you have a collection of pictures or other memorabilia that are being stored on the Internet, consider making a backup of that information. Store this information in a safe place, and provide your personal representative with instructions on how to access.
- Upgrade your power of attorney, trust, and/or will to include provisions authorizing your agent to access your e-mails and other electronic data.
- If someone other than your personal representative is being designated to handle your electronic data, then name those individuals in your estate planning documents.

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Wealth Advisory Overview

Understanding Digital Assets & Planning for Fiduciary Access in Estate Plans

Helpful Hints to Maintain a Digital Asset Inventory

- Master Password List: Maintain a centralized list of all digital asset providers, as well as the User ID and Password for each provider.
- Password Manager: Commercial password manager programs can serve to safe keep passwords and minimize hacking by keeping passwords locked in one central location.

As with most estate planning, the challenges and complexities are dependent on each individual's needs and circumstances. Preparing the best estate plan with the added layers of numerous on-line accounts and information stored by nearly everyone, requires considerate planning for digital assets. Although UFADAA provides a predictable manner in which a fiduciary, consistent with well-established fiduciary law, can deal with on-line accounts and assets, the best plan for managing digital assets should be outlined in the estate plan.

2018 Market Holiday Calendar

In anticipation of the Fourth of July market holiday this year, we wanted to provide an updated market holiday calendar for the remainder of 2018 to clients and colleagues, which we have included in the table, below.

2018 U.S. Stock Market Holiday Calendar

2018 Market Holidays	Date
New Year's Day	Monday, January 1st 2018
Martin Luther King Jr. Day	Monday, January 15th 2018
President's Day	Monday, February 19th 2018
Good Friday	Friday, March 30th 2018
Memorial Day	Monday, May 28th 2018
Independence Day	Wednesday, July 4th 2018 (1)
Labor Day	Monday, September 3rd 2018
Thanksgiving Day	Thursday, November 22nd 2018 (2)
Christmas Day	Tuesday, December 25th 2018 (3)

Notes:

(1) The market will be closed early at 1:00 PM EST on Tuesday, July 3rd 2018.

(2) The market will be closed early at 1:00 PM EST on Friday, November 23rd 2018.

(3) The market will be closed early at 1:00 PM EST on Monday, December 24th 2018.

Around McShane Partners

McShane Partners Welcomes Thomas Mack

Thomas Mack initially joined our firm as a summer intern in 2017 and is now a full-time employee as of June 2018 as our Research Analyst. In this role, he works directly with and provides ongoing support to the entire Investment Team.

Thomas is a graduate of Wake Forest University where he earned a Bachelor of Arts degree in Economics with minors in History and Spanish. While at Wake Forest, Thomas served on Sigma Alpha Epsilon's philanthropic committee, volunteered frequently with Samaritan Ministries, and studied abroad in Madrid, Spain. He is currently pursuing the CFA charter and is a Level I candidate.

Thank You, Cole!

The Investment Team would like to thank Cole Rector, a rising junior at St. Stephens High School in Hickory, NC, for his invaluable contribution to this month's edition of INSIGHTS.

Summer Intern Isabel Stedman

Isabel Stedman will be joining McShane Partners as a Summer Intern. She is a Charlotte native who will be a Sophomore at University of North Carolina at Chapel Hill. Isabel plans to major in Business Administration with a focus in Finance and minor in Entrepreneurship.

She spends a lot of time competing on the AA circuit for horseback riding. Her other endeavors include her personal business, Personable Shopping, an online look consultation website. She aspires to have a career in the financial industry, working in Private Capital.

Branding for McShane Partners is Underway

We are very excited about all our new marketing materials!

McShane Partners
Wealth & Investment Advisory

Wealth management is our only business; therefore, our attention is undivided and our intentions are transparent.

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