The unemployment rate has improved drastically over the last few years, currently sitting well below its 2 year average of 5.4%, and in line with its 1y average of 4.9%. Median weekly earnings increased 2.9% over the last year, and salaries are up 2.5% over the year. At face value, this data supports the idea that the American economy is slowly improving, and that QE may have paid off. The major hindrance to a current rate hike stems from stagnant inflation which has yet to reach the Fed’s 2% annual target rate.
The US 10y is down significantly from its 2y average of 2.1 and 1y average of 1.8, which may be evident of a longer term inflow to government bonds resulting from the Fed’s lack of action regarding monetary normalization. However, the run up from May to September could signal investor’s unwillingness to invest in the long end of the curve. This unwillingness is most likely driven by concern regarding short term uncertainty.

**Corporate Debt Markets**

![Graph showing Corporate Debt Markets](image)

The chart above is evident of a yield-starved investment climate. The Investment Grade index appreciated only .7% over the period, while the High Yield index saw a healthy 5.6% increase in the same amount of time. Right now, these kinds of bonds are extremely attractive to investors, given their relatively high yields (IG – 3.4%; HY – 6.4%).

**Oil Market**

![Graph showing Oil Market](image)
Oil prices have stabilized. The recovery has largely been driven by political price control, stagnant growth in the dollar, and supply reduction. It is important to note oil’s relationship to inflation. Moving forward, whatever happens to the price of oil, inflation could be at risk of helping or hurting the current macroeconomic condition. With stagnant oil prices, inflation will not approach an inflection point. If oil moves higher through 2016 into 2017, inflation may increase, supporting the rate hike argument.

**US Dollar Index**

While Q3 marked a relatively stable period for the USD, the September 2017 USD Futures Index implies monetary normalization to ramp up in the coming years. The tail end of the quarter saw the USD spot grow over 3% in the September. Analysts continue to note that a rising dollar may depress corporate earnings, especially if global monetary policies stays dovish. This divergent monetary policy may force the Fed to stay accommodative.

**Equity Markets**
Q3 marked a flat period for U.S equity indices. The S&P 500 currently trades at about 20x earning, about an average valuation compared to a 19.8x trailing 5-year multiple. This slight overvaluation may just be a manifestation of the new long-term low rate environment.

**Third Quarter Corporate Earnings**

On a weighted-average EPS basis, earnings in the past three quarters have been positively affected by a massive expansion in Healthcare’s bottom line, growing at 7.5% YTD. Conversely, these earnings have been hurt by waning Telecom earnings, marginally declining Consumer Discretionary earnings, and the massive drop in Energy sector earnings of more than 9% YTD.

**Portfolio Performance and Commentary**

**BHIC vs. S&P 500 Sector Return**

**Third Quarter –**
The BHIC portfolio closely traced the S&P 500 over Q3. Moving forward, our newly-adopted benchmark approach should change this lack of deviation. More emphasis on security analysis and subsector allocations combined with a commitment to reduce the number of holdings should further increase our tracking error. These two factors combined should reallocate portfolio risk, and lead to better returns.

**Year to Date –**

![Comparison to SPX YTD 2016](image)

The BHIC portfolio underperformed the benchmark YTD 2016, due primarily to underperformance among sectors including Energy, Materials, and Industrials. The benchmark has returned ~8%, while the portfolio returned ~4%.

**Sector Contribution to Total Return**

**Third Quarter –**

![BHIC vs. SPX Sector Contributions](image)

Compared to the S&P 500, the BHIC portfolio’s Financials, Real Estate, Telecomm, and Utilities sectors outperformed. Most of the outperformance in these sectors was attributable to loss avoidance. By staying out of Telecomm, our IT/Telecomm sector was able to add .2% to the portfolio. The portfolio did not
drastically outpace the index because of lack of investment in Materials and poor selection effect from within Consumer Staples, Discretionary, Healthcare, and Energy. The portfolio saw large single-stock appreciation from names including Healthcare Trust of America, Bank of America, Intel, Cisco, and Apple.

**BHIC vs. S&P 500 YTD Sector Performance**

**Year to Date –**

The selection effect also hurt us on a YTD basis. Positions in Energy, Consumer Discretionary, Healthcare, Industrials, Materials and Telecomm were the standout misallocations.

**Sector Recap & Investment Highlights**

**Consumer Discretionary**
Sector Performance Overview

Consumer Discretionary marginally trailed the S&P over Q3. The sector started Q3 with strong performance following beneficial macroeconomic data including surprisingly strong jobs. The sharp pullback around September 9th was due to a decrease in payrolls, global concerns around currency devaluation, and fear stemming from waning growth in Asia. The recent uptick in global systematic risk may be enough for investors to pull out of this historically more risky sector.

Sector Highlight

After a slow start to the quarter, Gentex went on to considerably outperform. The improvement was a direct result of a favorable Q3 earnings report released on July 22. Gentex announced a 12% quarter-over-quarter increase in sales and a 1% boost in gross profits. The rise in revenue stemmed from increased auto-dimming mirror shipments and an increase in light vehicle auto production. These gains were further sustained by rebounding car sales in Europe. The fund capitalized on Gentex’s recent outperformance, and liquidated the position for an overall return of 23%.

Energy & Utilities

Sector Performance Overview

The Energy Sector performed poorly in Q3. From a subsector perspective, drilling & exploration and integrated companies observed a brief rebound, given the positive OPEC decision in early October. The agreement was to preliminarily halt production and decrease the daily output by slightly over a million barrels per day from trending averages. WTI prices realized a modest gain as the news became public, but overall the price of a barrel of crude has remained under the $50 threshold.

Sector Highlight

HollyFrontier is a relatively small player compared to its Gulf Coast peers, however, its refineries are competitively positioned. HollyFrontier is the largest independent refiner that has all of its facilities located in the Rockies and Southwest region. As a result, it has benefited from the difference in price between West Texas Intermediate and other high-quality waterborne crude such as Brent over the third quarter. With access to abundant supplies of WTI, HollyFrontier refineries leveraged the margin that the
spread offered. However as the quarter concluded, elevated crude inventories and oversupply weighed in on the company’s valuation as investors sold shares.

**Financials & Real Estate**

![Chart of EVR US Equity, SPX Index, SSFINL Index from 7/1/2016 to 9/30/2016]

**Sector Performance Overview**
Following Brexit, the Financials sector regained most of its previously experienced losses. Valuations were supported by the Fed’s continued accommodative policy as well as positive stress test results which saw most banks pass the Fed’s test. While commercial banking is poised to benefit from a Fed rate hike, the newly divested REIT sector would be impacted negatively. Moving forward, the FOMC meeting in December and any major events involving the UK’s secession from the EU will help define a direction for financial companies in the near future.

**Sector Highlight**

Evercore Partners managed to outperform the S&P 500, as well as all the other financial subsectors this quarter. The stock saw a 17% increase in price, compared to 3% for the S&P 500 and 4% for the Financials Sector Index. The main reason for its outperformance was due to the company’s Q2 Earnings report, in which the company managed to surpass earnings by over 10% as well as revenue by close to 6% due to increased deal volume and normalization after Brexit.
Industrials & Materials

Sector Performance Overview

The Industrials sector index tracked the S&P for the period, ending in line with the benchmark. From mid-August onwards, the sector traded down on interest-rate-increase speculation. New York Fed President William Dudley stoked this fear by suggesting borrowing costs could be boosted as soon as October. The strong U.S. dollar continues to be a major headwind for many industrial companies. Overseas demand for US manufactured machinery continues to feel pressure with lagging world economic growth forecasts. Asian economic health comes as a primary concern for machinery, as they represent a large part of the market.

Sector Highlight

Acuity outperformed the sector, as management continued to invest in areas with significant future growth potential. By expanding their digital lighting and building management solutions portfolio, they are building a backbone for additional Internet of Things (IoT) applications. Digital lighting is expected to show strong growth as connected lighting is becoming a common industry theme. During the period Acuity acquired the IoT application platform, Dglogik, further illustrating this growth strategy. Acuity missed earnings during the period, resulting from a one-time cost related to streamlining their supply chain, and closing manufacturing location ahead of schedule. This action resulted in short-term labor issues, causing a loss of net sales equal to $25M. Net sales for the quarter were a record $926M (+21.9% Y/Y), missing by $22.7M.
Healthcare

Sector Performance Overview

Both the presidential election and congressional elections will have significant implications on the fate of The Affordable Care Act, as well as taxes levied upon the pharmaceutical space. Should Secretary Clinton be elected, biotechnology companies such as Roche, Amgen, and AbbVie may suffer margin pressures from the FDA’s biosimilar pathway. Medical devices manufacturers continue to rebel against the 2.3% excise tax imposed via Obamacare. The House passed legislation in 2015 to repeal Obamacare; the bill currently sits in the Senate. Device providers such as Medtronic, Johnson & Johnson, and Thermo Fisher Scientific would see margin boosts across the board should the legislation pass. Obamacare’s taxation on name brand drugs will top $4.1 billion by 2018, affecting pharmaceutical companies with exposure such as Gilead, Amgen, and Pfizer. Congress passed budget reconciliation legislation to repeal many of the tax measures against the healthcare industry, but the bill was vetoed by President Obama. Should the November elections place Republicans in both the presidency and Congress, such legislation could be enacted by 2017.

Sector Highlight

Icon PLC significantly outperformed the S&P500 Index despite the bearish overall outlook on the healthcare sector. Icon continues to see robust top line growth due to renewed contracts with Pfizer. The firm’s competitive advantage continues to be a function of its full scope of service offerings and international reach. In addition, the company’s partnership with IBM Watson lends them unique access to high power data processing and analytics, a growing necessity in the clinical trial process. Capital deployment has centralized around bolt-on, M&A, and share repurchases. Q3 earnings estimates target revenue of $1.6 million with modest margin growth.
Information Technology & Telecommunications

Sector Performance Overview

The IT index significantly outperformed the S&P for the period. The initial drop in valuations was the culmination of global concerns combined with weak performance of Asian markets. However following the September correction, tech was able to rally, led mostly by Apple’s release of the iPhone 7.

Sector Highlight

Apple significantly outperformed the sector during Q3, mostly due to the release of the iPhone 7 and Samsung’s Galaxy issues. Samsung was forced to drop the product entirely after the first round of recalls, because the phones continued to explode. There are no official numbers for iPhone 7 sales, but suppliers have hinted that they could be in the range of 70M to 75M in the first month and 100M by year end.

Consumer Staples
Sector Performance Overview

After slightly outperforming the S&P in Q2, the Consumer Staples Index was beaten by the S&P 500 in Q3. The two indexes began to diverge in the second week of the quarter, and XLP never was able to close the gap between the two for the remainder of the quarter. Both indexes remained flat during August. This uneventful quarter could be due to the disappointing jobs report on September 2\textsuperscript{nd}, as well as the lack of strong direction regarding the US economy.

Sector Highlight

Although Walmart Inc. (WMT) underperformed the S&P in Q3, it slightly outperformed the sector. In early July, the stock dropped as employee’s protested at some of their stores in China and analysts became skeptical of Walmart’s new payment app. In late August, the stock experienced volatility amid news of the acquisition of Jet.com, as well as Warren Buffet’s decision to sell his position in WMT.

We expect Walmart to spend much of the next fiscal year working on the quality of their stores rather than increasing volume. This strategy may help boost their Same Store Sales figures in Q4. While their revenue outlook for the rest of Q4 and most of 2017 is relatively flat, they may have a lower profit margin due to last year’s employee wage increases.