# BESPOKE Investment Group

# Model Portfolio Update

**February 12, 2018**

Below is an updated snapshot of the *Bespoke Model Stock Portfolio*. On pages two through four, we provide updated commentary for each of the individual stock positions in the portfolio. This is the best way to understand our reasoning for holding each name. One-year price charts for each stock are included as well. Year to date, the *Bespoke Model Portfolio* is up 1.5% compared to a decline of 1.8% for the S&P 500. Since inception in May 2007, the portfolio is up 141.2% versus the S&P 500's gain of 73.0%. Our cash position remains at a high level of 43.1%, but as opportunities present themselves amidst the market volatility, we will be looking to lower that level.

**Bespoke Model Portfolio: 2/12/18**

| Stock | Company | Current Price | Portfolio Weight (%) | Entry Price | Stop Price | Date Added | % Change |
|---|---|---|---|---|---|---|---|
| **Consumer Discret.** | | | **10.0** | | | | |
| DKS | Dick's Sporting Goods | 31.43 | 5.0 | 30.28 | 23.30 | 12/5/17 | 3.8 |
| SBUX | Starbucks | 54.64 | 5.0 | 55.00 | 49.80 | 2/7/18 | -0.7 |
| **Consumer Staples** | | | **0.0** | | | | |
| **Energy** | | | **0.0** | | | | |
| **Financials** | | | **5.4** | | | | |
| BRK/B | Berkshire Hathaway | 196.59 | 5.4 | 135.70 | 176.90 | 3/1/16 | 44.9 |
| **Health Care** | | | **15.1** | | | | |
| IBB | Biotech ETF | 106.00 | 4.6 | 102.22 | 98.90 | 6/20/17 | 3.7 |
| JNJ | Johnson & Johnson | 127.90 | 4.9 | 132.34 | 118.90 | 2/7/18 | -3.4 |
| ZTS | Zoetis | 72.74 | 5.6 | 54.24 | 62.50 | 3/28/17 | 34.1 |
| **Industrials** | | | **7.8** | | | | |
| ESLT | Elbit Systems | 143.76 | 5.5 | 106.14 | 129.70 | 1/24/17 | 35.4 |
| HTZ | Hertz Global | 19.52 | 2.2 | 20.85 | 15.05 | 9/18/17 | -6.4 |
| **Materials** | | | **4.6** | | | | |
| MTRN | Materion | 45.75 | 4.6 | 48.80 | 39.50 | 12/29/17 | -6.2 |
| **Technology** | | | **14.0** | | | | |
| ADBE | Adobe | 188.88 | 7.5 | 95.69 | 163.90 | 4/18/16 | 97.4 |
| TWTR | Twitter | 31.11 | 6.5 | 18.70 | 19.50 | 9/8/16 | 66.4 |
| **Telecom Services** | | | **0.0** | | | | |
| **Utilities** | | | **0.0** | | | | |
| **ETFs** | | | **0.0** | | | | |
| **Cash** | | | **43.1** | | | | |

**Performance (%):**

| | Since Inception[1] | YTD |
|---|---|---|
| **S&P 500** | 73.0 | -1.8 |
| **Model Portfolio** | 141.2 | 1.5 |
| **vs. S&P 500** | 68.2 | 3.3 |

= Recently Added

= Changed Stop Price/ Lowered Weighting

[1] *Bespoke's Model Portfolio began with an initial value of $100,000 on 5/29/07.*



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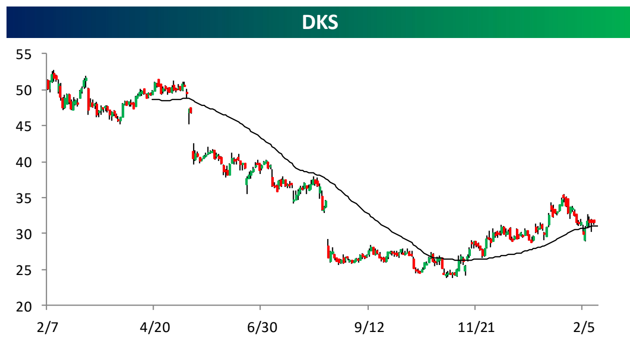
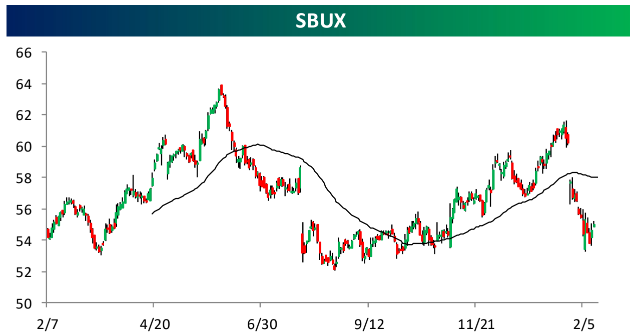
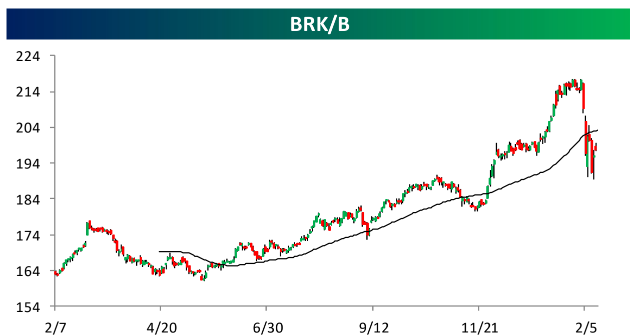


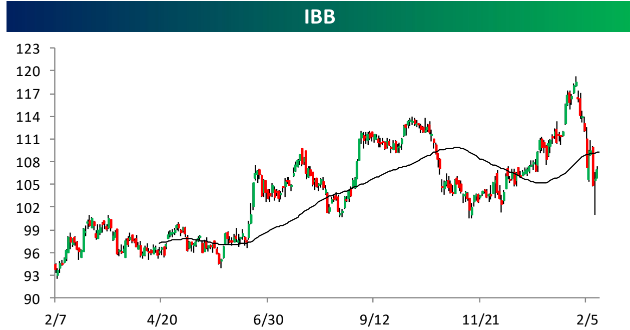

Dick's doesn't report for another month, but analysts are expecting an impressive result, with forecasts for revenue growth near 10% YoY, gross margins around 28.5%, and 13% YoY EPS gains. While those are relatively strong estimates, they're definitely doable. DKS valuation has taken off since Q4 2017 lows in the stock, but at current valuations we are comfortable staying long to continue capturing the nascent uptrend that's developed over the last few months. From a sentiment perspective, analysts are starting to get more bullish, and we note the stock has outperformed 12m target prices since late last year, a good sign that sentiment Dick's in the analyst community is in the process of rebounding.



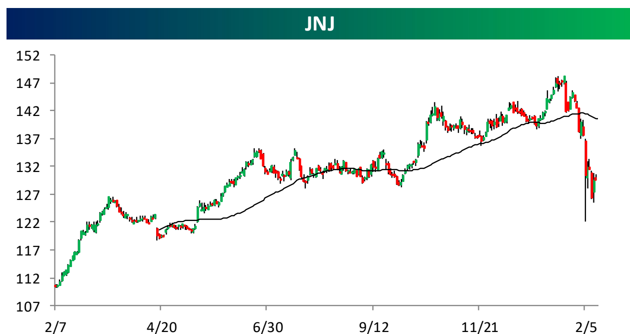

Starbucks (SBUX) is a name we've had in the model portfolio off and on over the years and for good reason. While revenue growth has slowed somewhat and margins have likely run into the top of their sustainable range, the stock's valuation has fallen from the near-30x NTM P/E and 17x EV/NTM EBITDA it hit in 2015. Those figures are 20.6x and 12.9x, respectively. Valuation isn't necessarily a compelling reason to own the name, but it's less of a headwind than a few years ago for the coffee company. Brand and product innovation are the keys now for a relatively mature company that's no longer growing quickly. January 25th earnings showed a 5th straight revenue miss but solid EPS and stronger guidance.




No material changes.




We don't have much to add on IBB, but we would note that the ETF made a new high and a higher low over the course of the current correction in equity prices. That's good enough for us, as it keeps the admittedly volatile uptrend dating to early 2016 intact for the time being. IBB provides exposure to a fast growing sector of the market, but also helps to spread out stock specific risk that tends to be prevalent among names in the space.




Johnson & Johnson is a new add to the portfolio. It's a high quality, predictable, and well diversified Health Care business. JNJ maintains high margins (35% EBITDA margins), steady revenue growth, and is rated AAA by Moody's, Fitch, and S&P. JNJ may be a more conservative oriented name than you typically find in our Model Portfolio, but recent market volatility created an attractive entry point for the business, and we think it's worth owning on the current pullback from all-time highs. Dislocations in stocks like JNJ that allow entry at large discounts are rare. We also note the company has a respectable yield (2.62% indicated) and has raised its payout for 55 straight years



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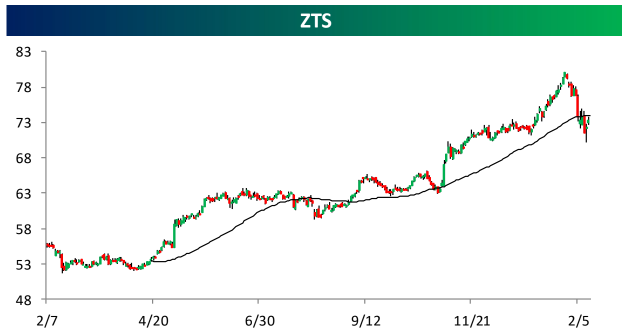
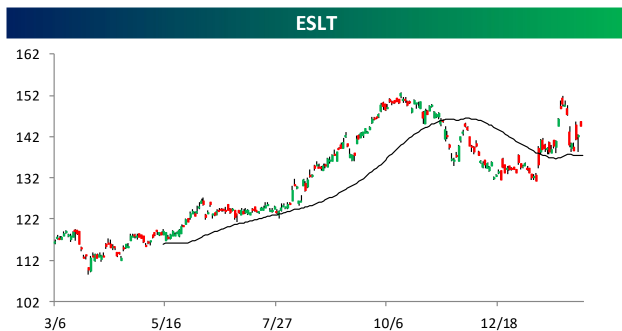
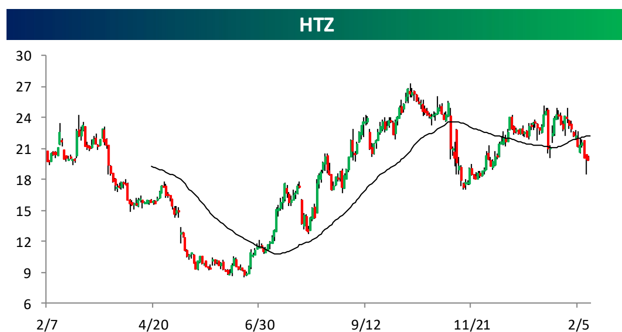


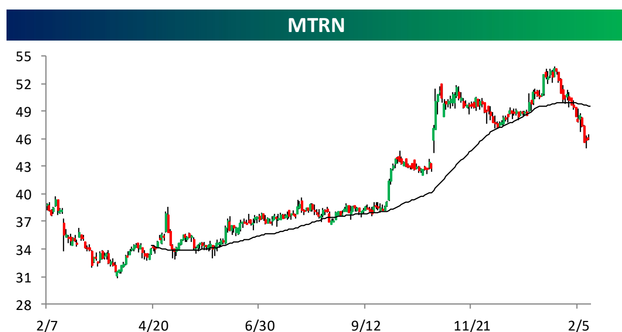

Zoetis reports next week and has pulled back to its 50-DMA on recent market volatility. We are still positive on the name and analysts are too with an estimate 65.7 cents per share EPS on an adjusted basis; the firm has not missed an adjusted EPS beat since its Q2 2014 report in August of 2014. Eli Lilly's proposed spin-out of Elanco, its animal health business, is looking to be in trouble with questions over viability in the space. In our view, that speaks to the strength of the ZTS business and its various products, and also lowers the likelihood of a more focused, nimble competitor in the space. Zoetis has also seen its premium valuation contract on the recent broad-based market downtick.



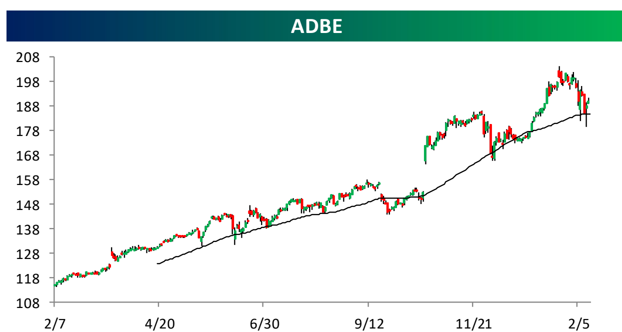

Elbit has weathered the recent market volatility relatively well, trading lower but holding above its 50-DMA and continuing to consolidate off Q4 2017 highs. That's fine by us given broader market conditions. A series of recent contract wins (cybersecurity with Bank of Jerusalem, a US Customs certification of radar and tower systems, services contracts with $150mm in Australia, and $85mm in defense systems in Europe) offset some bad news (a patent appeal on Thales Visonix patents for F-35 helmets was rejected, the second such loss in US Federal Circuit courts for Elbit). Generally speaking, we like holding the name as a play on defense spending, cybersecurity, and as a strong operator in a steady line of business.




The rip off mid-2017 lows for Hertz has given way to technical consolidation as the industry continues to evaluate used car pricing and the competitive pressures facing the space. Hertz reports earnings on February 26, with analysts expecting an adjusted EPS loss of 65 cents per share versus a 7 cent loss a year ago. Owning Hertz continues to require positive assumptions about management's ability to navigate changing consumer tastes and aforementioned used car price headwinds, but for now we are still comfortable in the name versus our $15.05 stop. We should also note that in January the company placed $1bn in rental ABS, an upsized deal that saw solid interest and priced through guidance, a decent sign of credit confidence.




After clinging to its 50-DMA for a few weeks just after we added, Materion ripped to new highs but has pulled back down again thanks to the current bout of volatility. We like this business a lot so we are hopeful our hard stop at $39.50 isn't threatened by a market-wide pullback unrelated to the core beryllium business. The company derives a respectable amount of sales from aerospace (about 15% of revenues across its largest customers in that industry) which makes it an interesting back-door play on strong global aviation activity. We also note that while Materion is exposed to the spot market, its higher value-add alloys provide more pricing power than many typical metals producers.




Adobe doesn't report until March 15th, but it's worth previewing that earnings where analysts are penciling 22% revenue growth, 35% net income margins, and 80% EPS growth. While the 8% pullback the stock has taken lately isn't fun, it's also less than the market as a whole and we should note the stock trades at 28.8x forward earnings multiples. That may sound like a lot to pay for the next 12 months of earnings but keep in mind how quickly those EPS are growing. Even relative to high growth tech peers, the 1.54x PEG ratio that adjusts P/E for growth is quite high, but the stock has a 107% incremental return on invested capital and a 21.3% overall return on capital; both high enough to justify elevated valuation.



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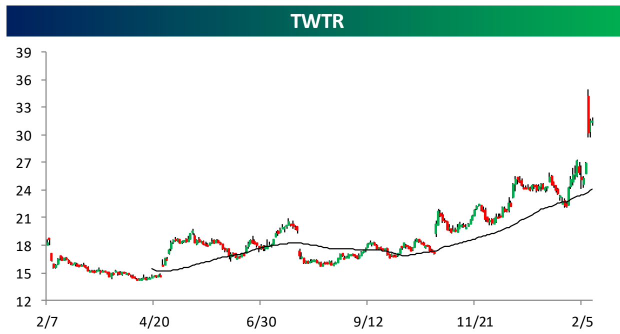


The little blue bird has learned to fly! Despite chaos in broader equity markets over the last few days we've been able to get a solid performance from Twitter, which announced strong earnings last week including much more robust revenue and earnings than the street expected. User growth was slower, but we hope Twitter is starting to settle into the more niche role it is best suited to rather than an attempt to become an alternative to true mass-market social platforms like Facebook. As always, stock based compensation is a concern, but spending in that area is declining and we think management may finally be getting a handle on some of the issues that have vexed investors.



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