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Investment Strategy
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Investment Strategy

Investment Strategy: "Better, Faster, Cheaper"

I first became aware of Frederick "Shad" Rowe, captain of Dallas-based Greenbrier Partners, by reading his brilliant comments in Forbes magazine decades ago. While Shade no longer writes for Forbes, his stock market insights are available via his monthly letter to the clients in his investment partnership. I always look forward to reading it, and last month's letter was no exception. Shad actually called me a number of years ago when I began using some of his prose from the old Forbes days, and we have been friends ever since. As a sidebar, he hosted the GIBI Conference (Great Investors Best Ideas) last week where a cast of Wall Street notables spoke. I attended that conference a year ago and had a fabulous time at his dinner the night before the conference for the speakers where we dined with folks like Michael Price, Mario Gabelli, Susan Byrne, David Einhorn, T. Boone Pickens, Gretchen Morgenson, etc. Regrettably, I could not attend this year due to previous commitments, yet I wish I had attended given the speaker lineup; but I digress.

It was Shad that first introduced me to the concept of "Better, Faster, Cheaper." As he wrote in his September letter:

> Our companies are still doing things better, faster, cheaper and for the customer. They have largely vanquished their competition. The biggest threat they face now, however, is political, and politicians are capable of inflicting great business damage. Importantly, unlike the trusts that were busted in the late 19th and early 20th centuries, our businesses are so much more popular with their stakeholders. Here is the question I keep asking myself: "Where are we? In the year 2000 when the dot.com bubble was about to burst and keeping lots of dry powder paid off; or, how about 1455 with the invention of movable type (enabling the printing of the Gutenberg Bible) and the explosion of mankind's ability to communicate; or, 1820 and the commercialization of the steam engine?" My answer is that this is not a bubble. The period we are currently in represents as significant a leap forward in technology and productivity as the world has ever seen.

Importantly, Shad begins his monthly letter by noting:

> Our joyless bull market continues. Many investors I hear from are worried that another bear market is around the corner because on the surface the world has not changed much and it has been nine years since the last bear market. They argue that now is the time to get out of stocks or lighten up. While it might feel good to take money off the table and assume a regression to the mean based upon recent history, seeking comfort has never been the basis of a winning strategy in the stock market. Neither has being a market timer. Meanwhile stocks, in general, have continued to rise.
>
> The stock market tends to be a predictor of future economic change, discounted back to the present. Our take is that there are great things taking place that are not readily apparent. Behind the political noise of the day, our companies are participating in one of the greatest growth and productivity surges the world has ever seen. Interestingly, this technological leap forward is taking place at the same time that increasing transparency (made possible by technology) is making it more fashionable to do the right thing. Even a small shift toward more ethical behavior opens up an even bigger opportunity for American companies operating throughout the world, further validating our "Americanization" theory. In short, we see plenty of reasons why the current bull market could be extended. All this does not imply that our current worldview is without risk. A number of our companies have transformed themselves from innovative upstarts into total global dominators. Consequently, they have huge targets on their backs courtesy of both sides of the political spectrum. This is a real threat. But is that a reason to get out? We do not think so.

As we have often said, "It's a bull market you know," which is the quip from Old Turkey in the must read book "Reminiscence of a Stock Operator" by Edwin Lefèvre. A bull market, indeed, which likely has years left to run, and very few people believe it. As Leon Tuey writes:

> What I find interesting and most encouraging is that despite the market's spectacular performance, there is not only no euphoria, but globally, investors remain skeptical and cautious. Clearly, ghosts of the last two bear markets

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continue to haunt investors from a sentiment standpoint, which is very bullish, as it tells me that this great bull market still has a long way to go in terms of time and distance. Many others factors continue to support this view. This bull market will die when the Fed sees fit to tighten meaningfully by draining liquidity from the system (which it has not); raising the discount rate many times in succession; and by inverting the Classic Yield Curve. As you know, these steps will only be taken when the economy overheats; inflation surges; and speculation is rampant.

Returning to Shad, the top 12 positions in his partnership represent approximately 95% of his equity exposure. Some of those names that are followed by Raymond James' fundamental research analysts and screen well on our proprietary models include: Facebook (FB/$173.74/Strong Buy), Apple (AAPL/$156.99/Outperform), Alphabet (GOOG/$989.68/Outperform), Costco (COST/$159.85/Outperform), and PayPal (PYPL/$68.66/Outperform).

The call for this week: I will be in NYC the first part of this week speaking at events for our financial advisors and then off to Montreal to speak at Raymond James Ltd.'s National Business Conference. As for the equity markets, our models remain conflicted. The long-term model, which turned positive in October 2008 and has never given a negative signal since, remains positively configured. The intermediate-term model registered a negative signal in early August and has stayed negatively configured. The short-term model went negative at the beginning of August, flipped positive around the beginning of September, and turned negative again last week; hence conflicted. Even the astute Lowry's indicators have mixed signals with a conventional short-term buy signal on August 31 and a trader's sell-signal on October 9 when the Stochastic Indicator crossed below its moving average. We would also note that the S&P 500 (SPX/2553.17) has gone into a fairly tight trading range before just about every decline in recent history (see chart below). The SPX has once again gone into another tight range since the first week of October. This morning, the preopening futures are flat as 3Q17 earnings results begin in earnest. With the large-cap banks earnings nearly over, tech stock should become the focus for investors.

Source: Stockcharts.com

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Strong Buy (SB1) Expected to appreciate, produce a total return of at least 15%, and outperform the S&P 500 over the next six to 12 months. For higher yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next 12 months.
Outperform (MO2) Expected to appreciate and outperform the S&P 500 over the next 12-18 months. For higher yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next 12-18 months.
Market Perform (MP3) Expected to perform generally in line with the S&P 500 over the next 12 months.
Underperform (MU4) Expected to underperform the S&P 500 or its sector over the next six to 12 months and should be sold.
Suspended (S) The rating and price target have been suspended temporarily. This action may be due to market events that made coverage impracticable, or to comply with applicable regulations or firm policies in certain circumstances, including when Raymond James may be providing investment banking services to the company. The previous rating and price target are no longer in effect for this security and should not be relied upon.

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Outperform (MO2) The stock is expected to appreciate and outperform the S&P/TSX Composite Index over the next twelve months.
Market Perform (MP3) The stock is expected to perform generally in line with the S&P/TSX Composite Index over the next twelve months and is potentially a source of funds for more highly rated securities.
Underperform (MU4) The stock is expected to underperform the S&P/TSX Composite Index or its sector over the next six to twelve months and should be sold.

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Strong Buy (1) Expected to appreciate, produce a total return of at least 15%, and outperform the Stoxx 600 over the next 6 to 12 months.
Outperform (2) Expected to appreciate and outperform the Stoxx 600 over the next 12 months.
Market Perform (3) Expected to perform generally in line with the Stoxx 600 over the next 12 months.
Underperform (4) Expected to underperform the Stoxx 600 or its sector over the next 6 to 12 months.
Suspended (S) The rating and target price have been suspended temporarily. This action may be due to market events that made coverage impracticable, or to comply with applicable regulations or firm policies in certain circumstances, including when Raymond James may be providing investment banking services to the company. The previous rating and target price are no longer in effect for this security and should not be relied upon.

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	Coverage Universe Rating Distribution*			Investment Banking Distribution		
	RJA	RJL	RJEE/RJFI	RJA	RJL	RJEE/RJFI
Strong Buy and Outperform (Buy)	53%	70%	55%	23%	46%	0%
Market Perform (Hold)	42%	28%	34%	12%	26%	0%
Underperform (Sell)	5%	2%	12%	10%	25%	0%

* Columns may not add to 100% due to rounding.

Suitability Ratings (SR)

Medium Risk/Income (M/INC) Lower to average risk equities of companies with sound financials, consistent earnings, and dividend yields above that of the S&P 500. Many securities in this category are structured with a focus on providing a consistent dividend or return of capital.

Medium Risk/Growth (M/GRW) Lower to average risk equities of companies with sound financials, consistent earnings growth, the potential for long-term price appreciation, a potential dividend yield, and/or share repurchase program.

High Risk/Income (H/INC) Medium to higher risk equities of companies that are structured with a focus on providing a meaningful dividend but may face less predictable earnings (or losses), more leveraged balance sheets, rapidly changing market dynamics, financial and competitive issues, higher price volatility (beta), and potential risk of principal. Securities of companies in this category may have a less predictable income stream from dividends or distributions of capital.

High Risk/Growth (H/GRW) Medium to higher risk equities of companies in fast growing and competitive industries, with less predictable earnings (or losses), more leveraged balance sheets, rapidly changing market dynamics, financial or legal issues, higher price volatility (beta), and potential risk of principal.

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Alphabet Inc.	Raymond James & Associates makes a market in shares of GOOG.
Apple Inc.	Raymond James & Associates makes a market in shares of AAPL.
Costco Wholesale Corporation	Raymond James & Associates makes a market in shares of COST.
	Raymond James & Associates received non-investment banking securities-related compensation from COST within the past 12 months.
Facebook, Inc.	Raymond James & Associates makes a market in shares of FB.
PayPal Holdings, Inc.	Raymond James & Associates makes a market in shares of PYPL.
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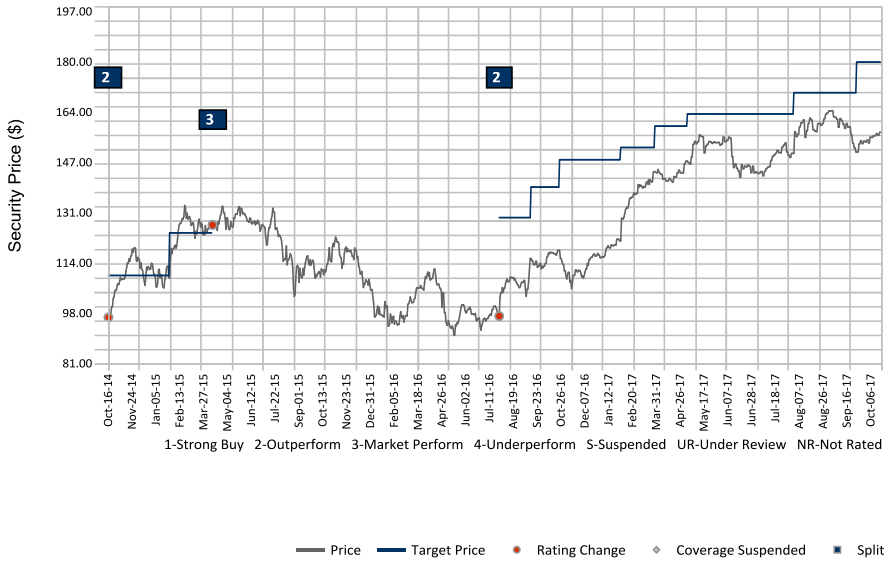
Stock Charts, Target Prices, and Valuation Methodologies

Valuation Methodology: The Raymond James methodology for assigning ratings and target prices includes a number of qualitative and quantitative factors including an assessment of industry size, structure, business trends and overall attractiveness; management effectiveness; competition; visibility; financial condition, and expected total return, among other factors. These factors are subject to change depending on overall economic conditions or industry- or company-specific occurrences. Only stocks rated Strong Buy (SB1) or Outperform (MO2) have target prices and thus valuation methodologies.

Target Prices: The information below indicates target price and rating changes for the subject companies included in this research.

Apple Inc. (AAPL:NASDAQ) Date: October 14 2017



Rating & Target changes

Date	Curr.	Price	Target	Rating
Sep-26-17	$	150.55	180.00	2
Aug-02-17	$	150.05	170.00	2
May-03-17	$	147.51	163.00	2
Mar-30-17	$	144.12	159.00	2
Feb-01-17	$	121.35	152.00	2
Oct-26-16	$	118.25	148.00	2
Sep-16-16	$	115.57	139.00	2
Jul-27-16	$	96.67	129.00	2
Apr-10-15	$	126.56	NM	3
Jan-28-15	$	109.14	124.00	2
Oct-16-14	$	96.26	110.00	2

Valuation Methodology: We value AAPL shares using three distinct methodologies including a discounted cash flow valuation, a comparison to a broad range of peer groups, and a a P/E and earnings growth comparison to the S&P 500.

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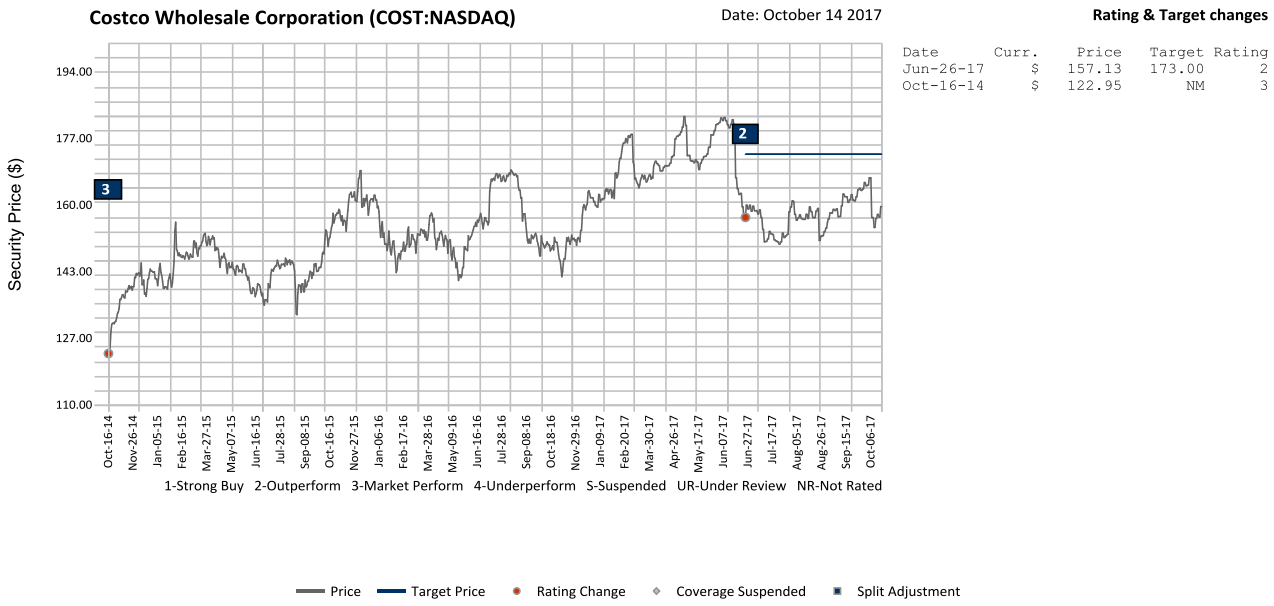
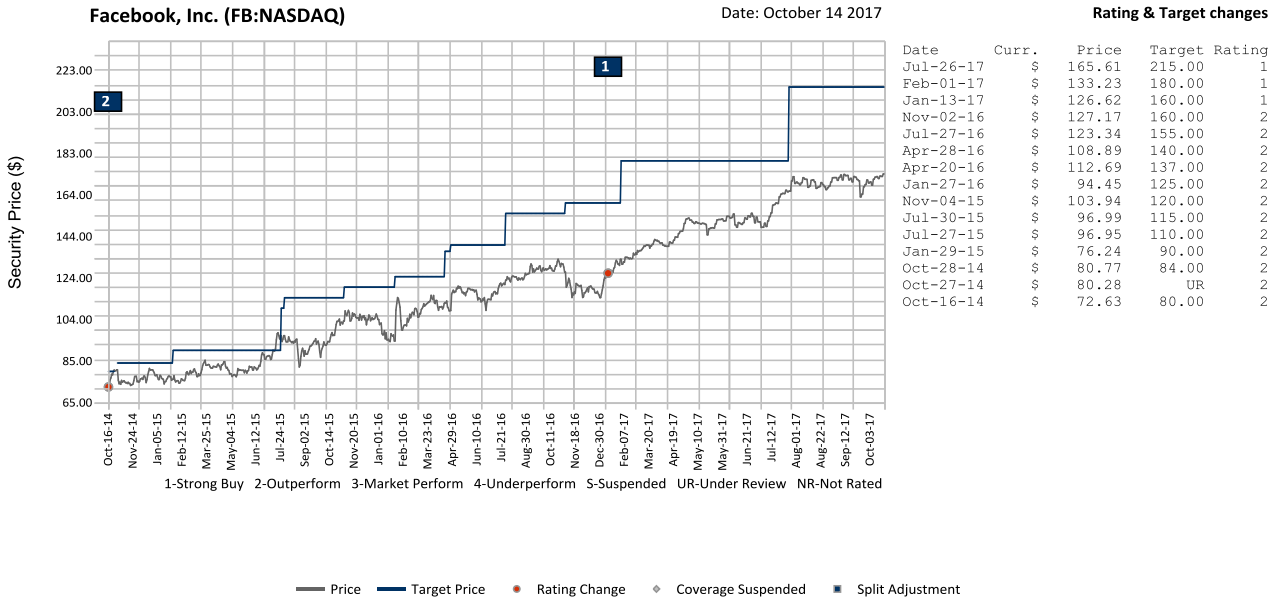


Rating & Target changes

Date	Curr.	Price	Target	Rating
Jun-26-17	$	157.13	173.00	2
Oct-16-14	$	122.95	NM	3

Valuation Methodology: We use a discounted economic free cash flow and present value of residual income to derive intrinsic equity values. We also, from time to time, reference traditional valuation metrics such as forward price earnings ratios and trailing market enterprise values versus trailing earnings before interest taxes depreciation and amortization (EBITDA).



Rating & Target changes

Date	Curr.	Price	Target	Rating
Jul-26-17	$	165.61	215.00	1
Feb-01-17	$	133.23	180.00	1
Jan-13-17	$	126.62	160.00	1
Nov-02-16	$	127.17	160.00	2
Jul-27-16	$	123.34	155.00	2
Apr-28-16	$	108.89	140.00	2
Apr-20-16	$	112.69	137.00	2
Jan-27-16	$	94.45	125.00	2
Nov-04-15	$	103.94	120.00	2
Jul-30-15	$	96.99	115.00	2
Jul-27-15	$	96.95	110.00	2
Jan-29-15	$	76.24	90.00	2
Oct-28-14	$	80.77	84.00	2
Oct-27-14	$	80.28	UR	2
Oct-16-14	$	72.63	80.00	2

Valuation Methodology: Our valuation methodology for shares of Facebook is based on a combination of EV/EBITDA, EV/EBITDA/growth, P/E, and EV/revenue ratios relative to the most relevant peer group.

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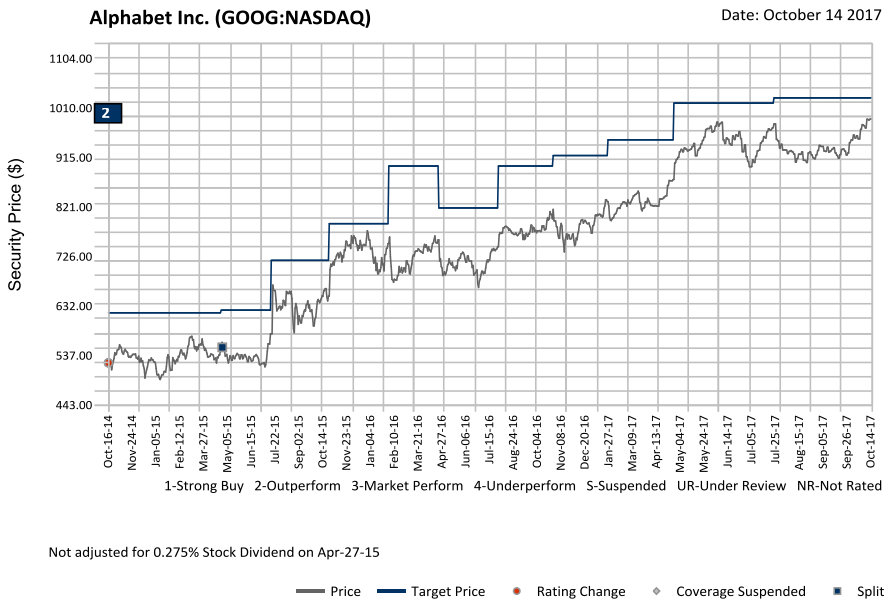
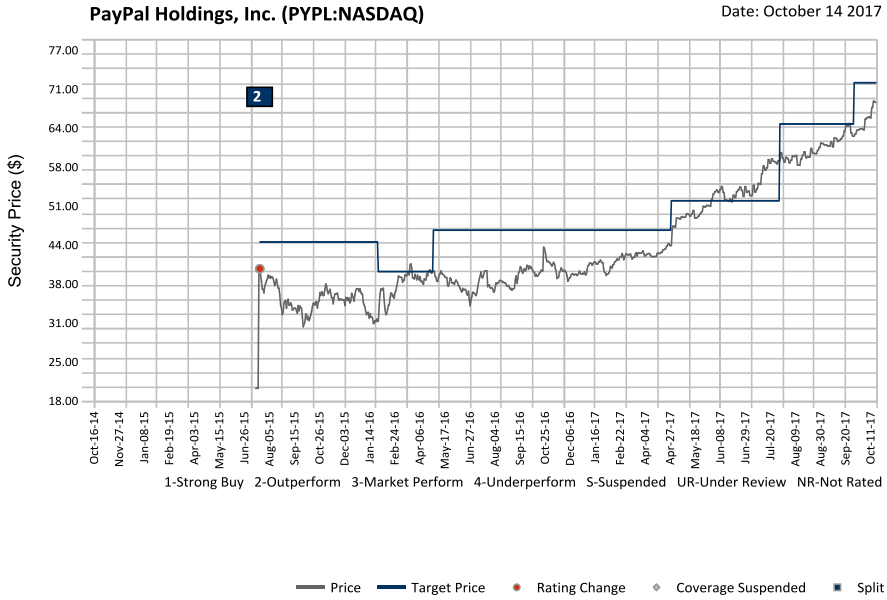


Rating & Target changes

Date	Curr.	Price	Target	Rating
Jul-24-17	$	980.34	1030.00	2
Apr-27-17	$	874.25	1020.00	2
Jan-27-17	$	832.15	950.00	2
Oct-27-16	$	817.35	920.00	2
Jul-28-16	$	745.91	900.00	2
Apr-22-16	$	759.14	820.00	2
Feb-01-16	$	752.00	900.00	2
Oct-23-15	$	651.79	790.00	2
Jul-17-15	$	579.85	720.00	2
Apr-24-15	$	547.00	625.00	2
Oct-16-14	$	524.51	620.00	2

Valuation Methodology: For valuation purposes, we consider GOOG's PEG ratio relative to peer group.



Rating & Target changes

Date	Curr.	Price	Target	Rating
Sep-27-17	$	62.94	72.00	2
Jul-27-17	$	58.79	65.00	2
Apr-27-17	$	44.41	52.00	2
Apr-27-16	$	40.01	47.00	2
Jan-28-16	$	31.59	40.00	2
Jul-21-15	$	40.47	45.00	2

Valuation Methodology: We value shares of PayPal Holdings, Inc. on a P/E basis relative to the transaction processing sector.

Risk Factors

General Risk Factors: Following are some general risk factors that pertain to the businesses of the subject companies and the projected target prices and recommendations included on Raymond James research: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation; or (4) External factors that affect the U.S. economy, interest rates, the U.S. dollar or major segments of the economy could alter investor confidence and investment prospects. International investments involve additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability.

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Specific Investment Risks Related to the Industry or Issuer

Company-Specific Risks for Costco Wholesale Corporation
Financial and operational performance is highly dependent on U.S. and Canadian Operations. Costco has a substantial international presence exposing it to exchange rate fluctuations.

Economic
By virtue of its size and scope, Costco is subject to economic factors in virtually every market in which it operates.

Unit Growth
Growth is dependent on the ability to acquire property and build or lease new warehouses in the U.S and Internationally. Regulation and local laws may make it difficult to acquire property suitable for a warehouse or distribution facility.

Product Quality
Costco has a substantial food offering including fresh food and prepared food products. If products do not meet applicable safety standards, or members' expectations of safety, the company could experience lost sales, increased costs, legal, and reputational issues.

Company-Specific Risks for Alphabet Inc.

Intense Competition
Alphabet faces competition from general purpose search engines, vertical search engines and e-commerce sites, social networking sites, traditional media companies, wireless mobile device companies, and providers of online products and services.

Investments in New Unproven Businesses
Alphabet expects to continue to invest in new businesses, products, services, and technologies. These investments carry risks and uncertainties, including distraction of management from current operations, insufficient revenues to offset liabilities assumed and expenses associated with these new investments, and inadequate return of capital on our investments.

Heightened Regulatory Scrutiny
Heightened regulatory scrutiny around Alphabet's dominant position in search advertising in the U.S. and Europe could limit Alphabet's ability to expand into new areas, forge new distribution deals, and form partnerships.

Concentration in Advertising
While Alphabet offers a broad range of online products and services, over 90% of revenue comes from online advertising spend. Given the cyclical nature of advertising budgets, a slowdown in spending could adversely affect the company's growth and profitability.

Company-Specific Risks for Facebook, Inc.

User Engagement
Facebook's success depends on adding, retaining, and engaging active users. We note that a number of other social networking companies that achieved early popularity have since seen their active user bases decline significantly.

Competition
Facebook faces competition from a variety of companies offering Internet products, services, content, and online advertising offerings, including Google, Microsoft, Pinterest, and Twitter, as well as from mobile companies and smaller Internet companies that offer products and services that may compete with specific Facebook features. Additionally, Facebook faces competition from other social network offerings as well as other regional social networks that have strong positions in particular countries.

Government Restrictions
It is possible that governments may seek to censor content available on Facebook in their country, restrict access to Facebook from their country entirely, or impose other restrictions that may affect the accessibility of Facebook in their country for an extended period of time or indefinitely. For example, access to Facebook has been, or is currently, restricted in whole or in part in China, Iran, North Korea, and Syria.

Concentration of Voting Power
Mr. Zuckerberg controls a majority of the company's voting power, and as such, shareholders have essentially no input in the direction of the company.

Company-Specific Risks for Apple Inc.

Rapid Technology Evolution
Historically, the global consumer electronics and computer hardware business has been characterized by aggressive price cutting, with resulting downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, and price sensitivity on the part of consumers.

New Product Adoption
Apple's current dominance in the world of consumer electronics has been largely the result of a five-year run of developing hit products beginning with the first iteration of the iPhone in 2007, which was followed by the iPad in 2010. Relying on its strong margins from hardware

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sales, Apple is at risk should new products not create excitement in the market and fail to support premium prices. Apple relies on its carrier partners to subsidize the purchasing price of iPhones in order to maintain competitiveness vs. alternative hardware providers. In markets that lack subsidies, Apple's iPhone penetration is drastically reduced.

Defense of Intellectual Property
Apple maintains significant investments in research and development to ensure its premium market position across product categories. As a result, it holds a significant number of patents and copyrights and has registered and/or has applied to register numerous patents, trademarks and service marks. By contrast, many of the Apple's competitors seek to compete primarily through aggressive pricing and very low cost structures. If Apple is unable to protect its intellectual property from cooption by competitors, Apple's ability to maintain a competitive advantage could be negatively affected. Conversely, many of Apple's products include third-party intellectual property, which requires licenses from those third parties. Based on past experience and industry practice, those licenses have been obtained on reasonable terms. There is however no assurance that the necessary licenses could be obtained on acceptable terms or at all.

Pricing Structure
Apple is unique in that it designs and develops nearly the entire solution for its products, including the hardware, operating system, numerous software applications, and related services. Conversely, many of its competitors rely on Google's Android as a "free" (subject to various IP royalties) operating system allowing them to focus on hardware specifications and offer aggressive pricing.

Global Supply Chain
Apple is subject to a global supply chain and relies on contract manufacturers for most of its production. Working conditions at contract manufacturers in places like China have brought negative attention and may be a source of negative customer perception to its products in the future. Other risks to its supply chain may be the result of too much demand and limited component availability leading to delayed product shipments, risks associated with currency volatility, and risks associated with stability of sovereign governments.

Company-Specific Risks for PayPal Holdings, Inc.

Competition in Global Payments Industry
The global payments industry is highly competitive, and as new companies and technologies continue to enter the space, it could put further downward pressure on pricing, potentially resulting in lower revenues for the company.

Funding Mix
The company's transaction expenses are directly tied to how consumers fund their PayPal transactions. An increase in the proportion of payment volume funded using credit and debit cards would have a negative impact on the company's financial results.

Changes to Payment Card Networks or Bank Fees
An increase in fees charged by the company's payment processors could have a negative impact on the company's business.

Reliance on Third Parties
PayPal relies on third parties for services that are critical to its business and any termination/disruption in services or increase in fees charged by these third-party partners could harm PayPal's business.

Cyber Security Risks
The company stores and transmits customers' personal financial information, including payment card information; if the company's website or system were to be hacked or breached in any way, it could reduce customers' confidence in the security of the company's payments platform.

Fraudulent, Bad, and Unfunded Transactions
The company incurs significant losses due to claims from consumers that merchants have not performed or that the goods and services they received were different from what was advertised as well as losses from consumer fraud.

Regulation of Cross-Border Trade
Any developments that have the effect of inhibiting cross-border trade (e.g., foreign exchange rate movements, regulatory/legal issues, etc.) could potentially have a negative impact on the company's business.

Credit Exposure
PayPal ultimately purchases and retains most of the receivables related to the consumer loans made through its PayPal Credit products; as a result, PayPal bears most of the credit exposure in the event of default.

Economic Risk
The vast majority of PayPal's revenue is transaction based and a slowdown in economic activity leading to lower retail sales could adversely impact the company's merchant customers.

Operating Agreement With eBay
If eBay does not fulfill its obligations under the agreement or decides not to renew the agreement in the future, this could have a negative impact on PayPal's business, as eBay currently represents a significant portion of PayPal's revenue (22% in 2016).

Modeling Challenges
The company does not provide specific line item breakouts for specific metrics, including revenue drivers, transaction funding mix, and geographic revenue breakdown.

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Simple Moving Average (SMA) - A simple, or arithmetic, moving average is calculated by adding the closing price of the security for a number of time periods and then dividing this total by the number of time periods.
Exponential Moving Average (EMA) - A type of moving average that is similar to a simple moving average, except that more weight is given to the latest data.
Relative Strength Index (RSI) - The Relative Strength Index is a technical momentum indicator that compares the magnitude of recent gains to recent losses in an attempt to determine overbought and oversold conditions of an asset.

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