RAYMOND JAMES

Investment Strategy
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Investment Strategy

"Just One Thing"

We have always liked the movie "City Slickers" and particularly one scene. It's the scene where Curly (Jack Palance) turns to Mitch Robbins (Billy Crystal) and says, "Do you know the secret of life?" The punchline is, "It's just one thing" (one thing). For investors we agree, all you need to know is just one thing. That thing was pointed out vividly in a book written in the 1920s about a stock operator named Mr. Partridge, often referred to as "Old Turkey" because he was such a shrewd investor. Consequently, many Wall Street wags would ask him, "What do you think I should do in the stock market?" Old Turkey would cock his head to one side, contemplate the question, and with a fatherly smile would say, "You know it's a bull market." It was as if he were giving you a priceless talisman wrapped up in a million-dollar insurance policy. And currently, the one thing you need to know is that – it is a secular bull market!

Our friends at the invaluable Lowry Research organization recently wrote about this by noting:

> From time to time, our commentaries have used a magician as a metaphor for the stock market. That is, one part of the market will serve to distract the audience of investors while the other part does the "magic." In today's market, the major price indexes, principally the DJIA and S&P 500, are serving as the distraction while the more significant action is taking place in the broader market.
>
> For example, while most market narratives have been focused on the volatile trading and limited gains in the major price indexes, small cap stocks have been quietly going their own way. In fact, over the past week, both the small cap Russell 2000 Index and S&P 600 Small Cap Index have recorded not only new bull market highs, but also new all-time highs. And, these highs have occurred in broad-based rallies, as both our Operating Companies Only (OCO) and S&P Small Cap Advance-Decline Lines have also reached new bull market and new all-time highs. Since small caps have, historically, been among the first stocks to show developing weakness as a bull market enters its final stages, these new highs in both the small cap price indexes and Advance-Decline Lines suggest an ongoing and healthy primary uptrend showing few signs of age.

While the Russell 2000 (RUT/1626.63) is a good proxy for the overall market (Chart 1), and broke out to the upside in 2013, the Value Line Geometric (VALUG/566.71) is a much broader based index. Studying the attendant chart (Chart 2) one sees that the VALUG just broke-out in September 2017. As our friend Leon Tuey writes:

> Many are deeply worried and one of their concerns is the longevity of this bull market. I find the technical structure of the Value Line Geometric Index most intriguing as only in September, 2017, it broke out of a 19-year base. It's the longest base in the world, except for the NIKKEI (which broke out of a 26-year base). The VALUG is saying that this bull market is still in its infancy.

Plainly, we agree and have said so repeatedly in these reports. As often stated, secular bull markets have three "legs." We think the first leg began in October 2008 and ended in May 2015. The second leg started in February 2016 when the Royal Bank of Scotland's strategist said, "Sell everything except high quality bonds." The second leg is always the longest and strongest. When it ends is unknowable, but if past is prelude the equity markets will go into another upside consolidation, like the one between May 2015 and February 2016, and then breakout to the upside and commence the third leg. To size that, in the 1982 – 2000 secular bull market the third leg began in late 1994 and ended in March of 2000.

As for the here and now, last week was pretty much the end of earnings season. The results show that nearly 68% of reporting companies beat expectation. Meanwhile, roughly 72% bettered revenue estimates (the sector beats can be seen in Chart 3). Despite that, most of the large capitalization indices closed down for the week, while the smaller cap indexes closed up for the week. Impressively, the spread between the percentage of companies raising, versus lowering, forward earnings estimates continues to rise (+4.9%). That's a level that has only been reached a few times over the past 17 years. As readers of these missives know we stated a few years ago the equity markets have transitioned from an interest rate, to an earnings driven secular bull market.

Please read domestic and foreign disclosure/risk information beginning on page 5 and Analyst Certification on page 6.

Speaking of earnings, every earnings season we screen for companies that are favorably rated by our fundamental analysts in the Raymond James research universe, which have beaten both earnings and revenue estimates and raised forward earnings guidance. We also use our proprietary algorithm to see if they are technically favorable. Three such names are: Flir Systems (FLIR/$54.38/Strong Buy), Netflix (NFLX/$324.18/Outperform), and Paylocity Holdings (PCTY/$58.65/Outperform). More recently, over the past six months, we have warmed to the energy sector. That strategy has paid off this earnings season with the energy sector posting a 72.4% leap in earnings for 1Q18 (Chart 4). Moreover, as SentimenTrader's captain, Jason Goepfert, writes, "Energy stocks enjoying new highs. More than 40% of stocks in the S&P 500 Energy sector have reached a 52-week high." We continue to like the energy space.

From a trading perspective, we wrote this on Friday, "On a short-term trading basis it looks like a 'stock market stall' to us into next week. But, the downside should be limited to the 2670 – 2685 level on the S&P 500 (SPX/2712.97) because the intermediate 'energy mix' is still near a full charge." One of the recent headwinds has been the backup in the 10-year T-note yields, which have risen from their yield-yelp lows of 1.34% in July 2016 to last week's intraday day high of 3.115% (we have been bearish on fixed income). The other headwind is that the inflation genie may be out of the box (we have been bullish on inflation). As written, the "inflation genie" is being reflected in trucking rates that have risen some 27% year-to-date. We believe inflation is coming and have written about that many times. We do not, however, think it will be anywhere near the 1970/1980s ramp rate. Accordingly, we have tilted toward "stuff stocks" (midstream MLPs, metals, agriculture, etc.). We have also recommended avoiding the defensive sectors (consumer staples, utilities, etc.), for the past 18 months, because they were as expensively valued as they have been in decades, and they are casualties of higher interest rates and inflationary pressures.

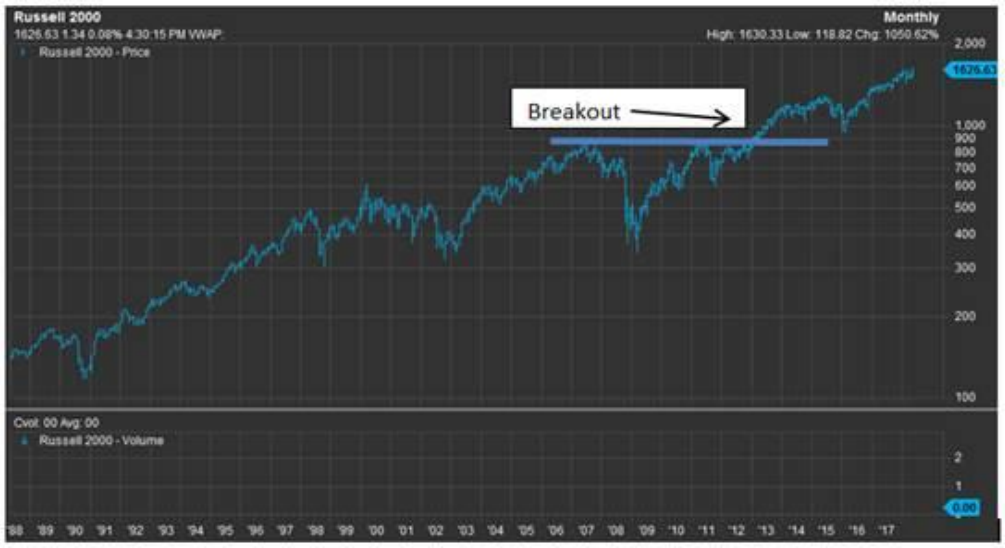
BINGO, the defensive sectors have lost ground over that timeframe. We continue to think the economy, despite the mixed signals in the near term, is going to strengthen in the back-half of this year. That seems to be the message of the stock market and we agree. While NOBODY can consistently "time" the stock market, if one listens to the message of the market, one can decide if they should be playing "hard," or "not so hard." Since January 2018 I have not been playing very "hard," but did re-commit some of the cash, raised in January, near the early February lows. I continue to invest, and trade, accordingly.

The call for this week: We think downside attempts for the equity markets will be contained given the economic, and earnings, backdrop. The downside should be well supported for the SPX in the 2670 – 2685 level. As Lowry Research writes:

> In summary, investors should avoid being distracted by the sluggish performances in the DJIA and S&P 500, but instead should focus on the abundant signs of a healthy bull market and the opportunities for new buying being afforded by this underlying strength.

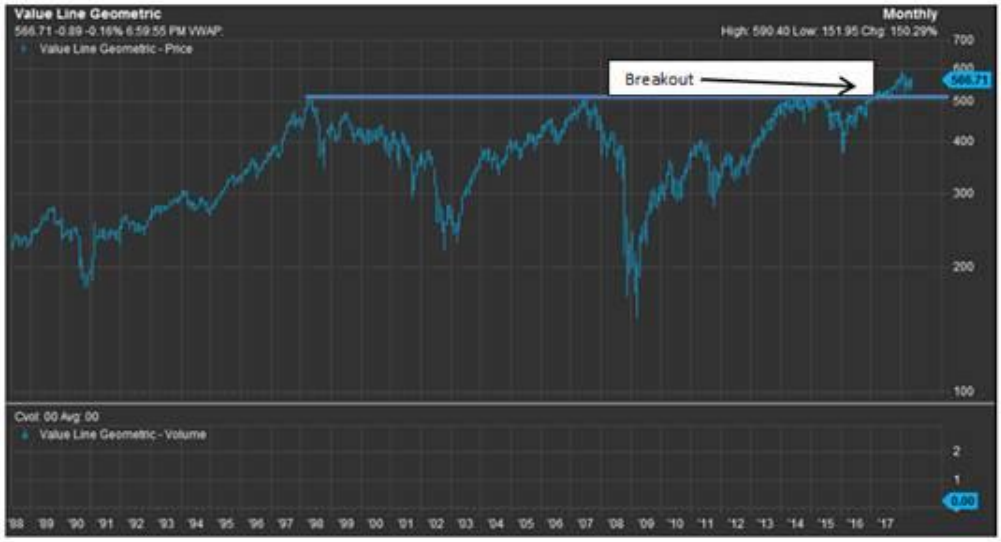
This morning the preopening S&P 500 futures are up by some 15 points as China says the trade war is on "hold." As we have said since the "under cut" low of February 9, "the lows are in!"

Chart 1



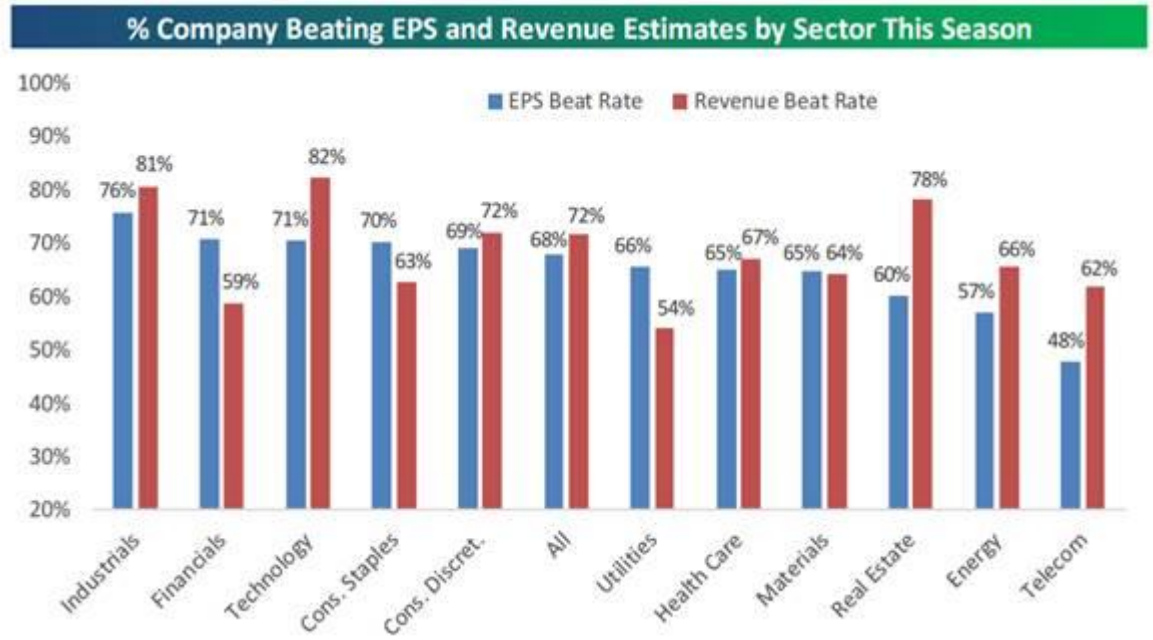
Source: FactSet

Chart 2



Source: FactSet

Chart 3



Source: Bespoke Investment Group

Chart 4

Source: Bespoke Investment Group

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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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Strong Buy (SB1) The stock is expected to appreciate and produce a total return of at least 15% and outperform the S&P/TSX Composite Index over the next six months.
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)	56%	70%	52%	23%	36%	0%
Market Perform (Hold)	39%	26%	34%	11%	13%	0%
Underperform (Sell)	5%	4%	14%	7%	11%	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.

High Risk/Speculation (H/SPEC) High risk equities of companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, significant financial or legal issues, or a substantial risk/loss of principal.

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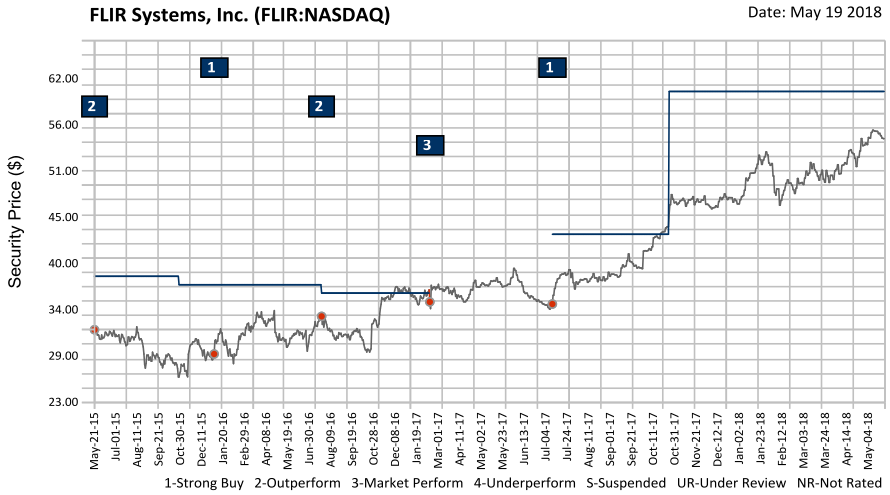
FLIR Systems, Inc.	Raymond James & Associates makes a market in shares of FLIR.
	Raymond James & Associates received non-investment banking securities-related compensation from FLIR within the past 12 months.
	Raymond James & Associates, Inc. acted as financial advisor to FLIR in the partial sale of its commercial security business, primarily Lorex, and its small and medium-sized (SMB) security products (Digimerge) business.
Netflix, Inc.	Raymond James & Associates makes a market in shares of NFLX.
Paylocity Holding Corporation	Raymond James & Associates makes a market in shares of PCTY.
	Raymond James & Associates received securities-related compensation from PCTY within the past 12 months.

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.

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

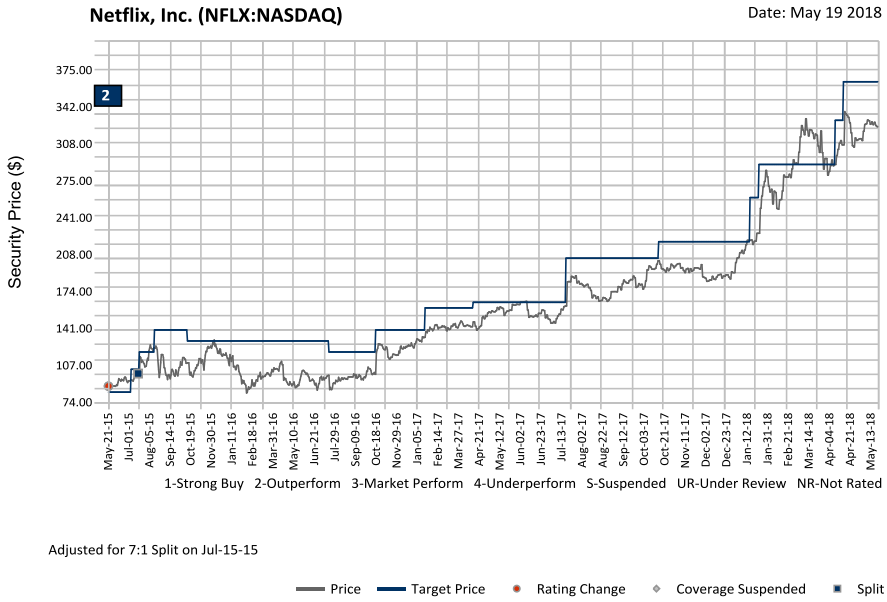


Rating & Target changes

Date	Curr.	Price	Target	Rating
Oct-25-17	$	45.48	60.00	1
Jul-10-17	$	34.70	43.00	1
Feb-14-17	$	34.95	NM	3
Jul-25-16	$	33.23	36.00	2
Jan-05-16	$	28.75	37.00	1
Oct-29-15	$	26.01	37.00	2
May-21-15	$	31.64	38.00	2

Valuation Methodology: Our methodology of calculating fair value for FLIR includes a multi-tiered framework. This process starts with

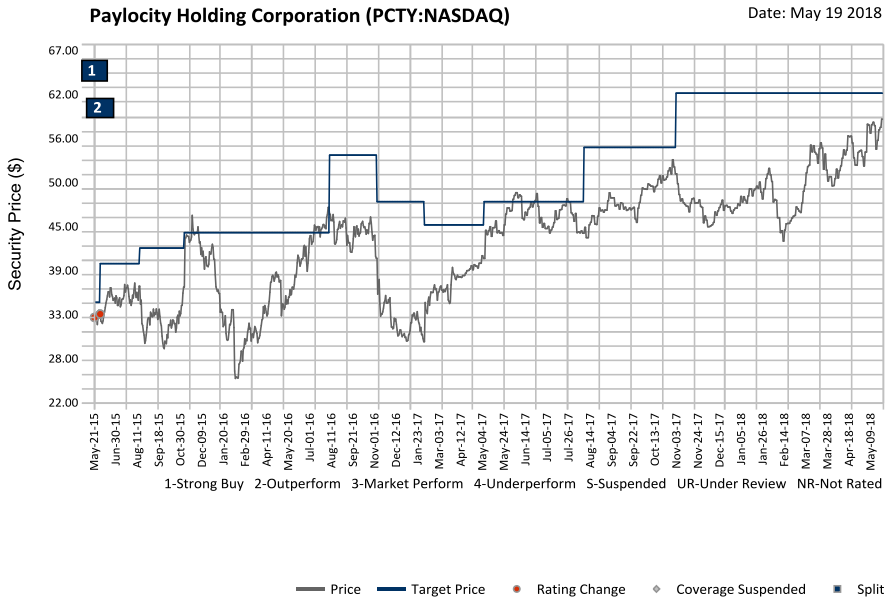
building discounted cash flow and market expectations models. Moreover, our methodology also utilizes comparables analysis against historical trading and peers based on P/E and EV/EBITDA metrics.



Rating & Target changes

Date	Curr.	Price	Target	Rating
Apr-16-18	$	307.78	365.00	2
Apr-10-18	$	289.93	330.00	2
Jan-22-18	$	227.58	290.00	2
Jan-16-18	$	221.23	260.00	2
Oct-16-17	$	202.68	220.00	2
Jul-17-17	$	161.70	205.00	2
Apr-17-17	$	147.25	165.00	2
Jan-19-17	$	133.26	160.00	2
Oct-17-16	$	99.80	140.00	2
Jul-19-16	$	98.81	120.00	2
Oct-14-15	$	110.23	130.00	2
Aug-14-15	$	123.73	140.00	2
Jul-16-15	$	98.13	120.00	2
Jul-15-15	$	100.37	104.00	2
Jul-06-15	$	94.57	104.29	2
May-21-15	$	89.00	83.57	2

Valuation Methodology: We value Netflix based on a DCF analysis. We also consider forward P/E, EV/EBITDA, and P/E/G ratios.



Rating & Target changes

Date	Curr.	Price	Target	Rating
Nov-02-17	$	51.59	62.00	2
Aug-09-17	$	43.92	55.00	2
May-04-17	$	40.67	48.00	2
Feb-02-17	$	29.92	45.00	2
Nov-03-16	$	40.68	48.00	2
Aug-09-16	$	46.36	54.00	2
Nov-06-15	$	36.97	44.00	2
Aug-14-15	$	37.08	42.00	2
Jun-01-15	$	33.48	40.00	2
May-21-15	$	33.05	35.00	1

Valuation Methodology: We believe enterprise value-to-sales (EV/sales) represents a reasonable valuation metric given the immature nature of the company's financial model with significant growth investments being made today to drive future high-margin recurring revenue over a long-term basis. With the emphasis in small-cap tech investing focused on maximizing growth and addressable market opportunities, other valuation metrics such as EV/EBITDA, EV/free cash flow (FCF), and price-to-earnings (P/E) will likely remain less relevant, in our opinion. EV/sales is a common valuation methodology in enterprise software, and when utilized in combination with relative top-line growth rate assumptions, provides a foundation for valuing SaaS stocks, in our opinion. Longer term, we believe significant operating leverage could materialize given the high-margin nature of recurring revenue and additional valuation metrics that take into account EBITDA, FCF, or earnings would become more relevant.

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.

Specific Investment Risks Related to the Industry or Issuer

Company-Specific Risks for FLIR Systems
Risks to our investment thesis for FLIR include sensitivity to economic conditions, changes in federal customer spending patterns, and the risk of market acceptance of new product introductions.

Company-Specific Risks for Netflix Inc.

Competition
The video rental market is highly competitive and rapidly changing. The primary domestic competitors for Netflix today include: 1) multichannel video programming distributors (MVPDs) which include cable providers, telecom companies, and direct broadcast satellite 2) Internet movie and TV content providers (i.e., Apple's iTunes, Amazon.com, Hulu, YouTube); 3) DVD rental kiosks (i.e., Redbox). In Europe, the largest competitor is LoveFilm with over 1 million subscribers. Netflix's strategy vs. other providers leverage its "virtuous cycle" whereby investments in content drive subscriber growth which enables Netflix to acquire more content and more subscribers.

Streaming Content Availability and Rising Costs
As the business transitions from DVDs to streaming, the company will need to invest more to acquire streaming content in order to fuel subscriber growth. With the emergence of well-funded competitors like Google, Amazon, and Apple, as well as entrenched players such as HBO and Starz, we expect content costs to increase significantly in the future, which could negatively impact Netflix's operating margins.

Macroeconomic Uncertainty
Like most consumer-discretionary businesses, the company's operating performance is impacted by the global economic environment and the impact on consumer spending patterns. Typically, purchases of discretionary items, including movie rentals, decline during recessionary conditions.

Postal Rates
Netflix ships its DVDs through the U.S. Postal Service. To the extent that the USPS increases first class mail rates, this would likely have a negative impact on Netflix's gross margins.

International Execution
Netflix is investing in international expansion in order to deliver strong long-term subscriber growth. However, Netflix lacks a significant brand image in many international countries and we believe is likely to face stiff competition from other global and local competitors.

Company-Specific Risk Factors for Paylocity Holding Corporation

Mid-Market Exposure Could Create Greater Business Volatility
The company's target market is in the 20-999 employee range. This market is considered the mid market, where certain dynamics are common among prospects and customers including slower new customer acquisition cycles relative to enterprise customers, higher churn, and negative same-store sales from customers reducing employee counts due to macro uncertainty. With this higher volatility in the target market, it may reduce the visibility in the company's future growth as well as create near-term volatility in business trends.

Attractive Mid Market Open to More Competition
The company is focused on the mid-market opportunity, which we calculate to be a potential $8 billion market and growing. We believe the attractiveness of the market due to size and relative underpenetration could cause competition to heat up in this market born from other small growth competitors, established payroll/HCM players like Ultimate Software, and defensive moves by the legacy incumbent payroll/HCM providers.

Contracts Are Cancellable Within 60 Days or Less
The company does not have long-term contracts with customers, and the contracts are structured so a customer can terminate the contract with 60 days' or less notice. With this clause in contracts, customers can cancel within a short period of time, having ramifications on the company's retention rate, customer count, and ultimately revenues.

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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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