CAPITAL19
GLOBAL STOCKS AND OPTIONS

CAPITAL 19 GLOBAL GROWTH PORTFOLIO

March Q1 2019 Investment Report

US Markets March: Tech stocks shine, Fed interest rate trajectory swings to a cut

Portfolio NAV jumps 12.3% in Q1 as markets look set to topple old records

Just like that, we've already seen out the first quarter of 2019, and what a start to the year it has been. Cast back to the opening days of January, few could have predicted such a turnaround following an abysmal revenue downgrade from Apple (APPL) and underwhelming US factory data.

But the stock market is flying high, notching up achievement after achievement. As investors piled back into riskier assets the **S&P 500** recorded its best quarter in the last decade, and the best opening quarter since 1998.

Index	*March Performance*	*YTD Performance*
Dow Jones	0%	11.2%
NASDAQ	2.6%	16.5%
S&P 500	1.8%	13.1%

As it turns out, the key to massaging the nerves of the market has, in many respects, been soothing reassurances - none more so than that first communicated by the **Federal Reserve** in January around a more cautious path to lifting rates, and reaffirmed at its March meeting. Given mixed economic data, plus the angst markets feel every time slowing global growth gets a mention, we don't see a catalyst for a rate hike, rather a rate cut.

The US government - *when not shut down* - has also been keen to see to it that markets held their rebound. At the hint of any anxiety, the Oval Office has been quick to casually remind an impatient market that **US-China trade negotiations** are progressing well - notwithstanding the lack of detail. Here we are, with discussions longer than expected, it *almost* seemed an April Fools' Day prank was in store for the market.

The **treasury yield** curve for 3 month and 10 year bonds inverted in March for the first time since 2007, often deemed a recession warning sign. Our outlook remains upbeat. **Company earnings** have largely outperformed, **energy prices** are rising, and **US economy** fundamentals appear fairly stable, even if subdued. As far as the latter, jobs growth has been excellent, despite recent hiring data slipping. There has been modest increases in wages and consumer confidence, albeit inflation, housing and manufacturing remain quiet.

The highs and lows of corporate earnings

With the quarter concluding, only a small selection of companies reported earnings in March. Among higher profile businesses, there were mixed results.

Target (TGT) and **Costco** (COST) highlight the retail sector isn't prepared to roll over just yet. TGT announced its best result in years, with higher sales, earnings and store traffic, while COST produced a resounding earnings beat. Both climbed 10.5% during March. We attribute their impressive results to price positioning as big-box staple retailers, and favour Costco.

Strong growth in China helped **Nike** (NKE) top earnings forecasts and meet revenue targets, but it lost 6.1% due to subdued North American growth. Expectations were likely built into its all-time high share price before reporting, but we're excited by China growth prospects.

Despite surpassing consensus targets leading software companies **Salesforce** (CRM) and **Adobe** (ADBE) came under scrutiny as they tamed outlooks. Both businesses, with expectations reset and a strong history of beats, recovered from their sell-offs.

Fedex (FDX) missed revenue and EPS forecasts, also lowering its 2019 earnings guidance for the second time in 3 months. While a 5% slide in shares reversed by month's end, we would be concerned by passive global economic growth, competition levels and squeezed margins.

March Quarter

In a crowded market there were no shortage of winners and losers, but tech stocks led the way. **IBM** (IBM) jumped 24.1%, **Facebook** (FB) moved 27.2% higher and **Apple** (APPL) leapt 20.4%. **Cisco** (CSCO) was another standout, gaining 24.6% as input prices fell and it smashed revenue and earnings forecasts. Elsewhere, **Exxon Mobil** (XOM) enjoyed a stellar run, up 18.5% after a huge earnings beat and higher oil prices, while **Citibank** (C) climbed 19.5%.

At the other end of the scale, **Kraft-Heinz** (KHC) dived 24.1% following its huge write-down. **Biogen** (BIIB) slumped 21.4% as one of its clinical trial drugs for Alzheimer's failed. Watch out for competition in its other area of focus, multiple sclerosis. **Macy's** (M) downgraded guidance in January, plummeting 19.2%. Lastly, **CVS Health** (CVS) declined 17.7%, reigning in its full-year earnings forecast and posting an impairment. We're bearish due to lower medication prices and reimbursements, plus increased competition from Amazon.

Portfolio Performance

March

Our portfolio saw another month of positive growth in March, with **Net Asset Value** (NAV) growing 2.4%. Although lower than the gains of 5.7% in February and 3.8% in January, it was in line with the Nasdaq Composite, and well ahead of both the Dow Jones and S&P 500.

Gains on **equities** were 1.6% of March's opening NAV, led by Apple, McDonald's (MCD) and Alphabet (GOOGL). McDonald's, up 3.3% across March, made the news after announcing its largest acquisition in over 20 years. Improving trade negotiation sentiment carried Google and Apple higher 4.5% and 9.7% in turn. The former launched its game streaming service, which we like for revenue diversity in a growing area, whereas the latter was upgraded by Bank of America and we think stands to gain from a US-China trade treaty. **Equity and index options** yielded returns of 0.2%, while AUD **futures** facilitated 0.8% asset growth.

Total **realised income** was 1.4%, including the above futures, plus closure of our position in Facebook. We sold FB at $169.18 after the company's third in command, and head of WhatsApp, both left the company disagreeing with Mark Zuckerberg. Our concerns relate to the proposed strategic direction towards a privacy-based platform of services. Also concerning were repeat failures at resistance and the large bias of put options over calls for June, with a $160 strike price. **Unrealised income** totalled 3% of the portfolio's starting NAV.

There were no notable movements in **forex** during March, with the USD/AUD settling at 1.4091, down from 1.4097. At March 31 the **cash** balance accounted for 36% of all assets.

March Quarter

By the end of the first quarter, portfolio **Net Asset Value** (NAV) lifted 12.3%, outperforming the Dow Jones (up 11.2%) over the same period. **Equities** delivered returns of approximately 10.7%, with contributions particularly weighted towards the following stocks:

- Apple (APPL) - up 20.4% in Q1; we increased our holdings
- Alibaba (BABA) - up 33.1% in Q1; we maintained all our holdings
- Facebook (FB) - up 27.2% in Q1; we closed our position in March

Out of 20 positions held across the first three months of 2019, 17 delivered positive returns to the portfolio, and only one (CME Group: CME) stretched our preferred tolerances.

Equity and index options, comprising puts and calls over the range of stocks held in the portfolio, provided modest gains of 1.1%. With as many as 44 positions opened, the overwhelming majority (84.1%) of trades resulted in small (positive) returns.

Total **realised income** was 2.8% of portfolio NAV at the start of the year, with the majority via gains in equities such as Facebook and Nike, as well as Australian Dollar futures contracts. **Unrealised income** accounted for 3.3% of the portfolio's starting NAV.

In terms of currency action, **futures** for the **Australian Dollar June '19** contract delivered a small portfolio gain of 0.8%. Although there were large **forex** movements during specific periods in the quarter, by the end of March these fluctuations balanced out to have a negligible impact on portfolio NAV. **Cash** levels meanwhile, grew by 33.6% on account of portfolio gains being liquidated, although these may be redeployed in coming months.

Economic data and events to watch

With hiring slumping during February, the numbers for March's nonfarm payrolls could provide context as to a possible trend, or as we think, a temporary blip. We do not expect any surprises in the Fed meeting minutes for March, with members already seemingly vocalising their outlook, nor inflation to be anything other than tame.

Subdued retail sales are something we don't see improving yet, one reason we're avoiding brick and mortar retailers. Having expected US-China trade negotiations to conclude last month, there may actually be more substance to the affair than we first thought, but any sugar hit could be short-lived given markets are near all-time highs.

Data/Event	*US Date*
Retail Sales	April 1
Manufacturing PMI	April 1
Durable Goods Orders	April 2
Non-manufacturing PMI	April 3
Nonfarm Payrolls	April 5
Inflation Rate	April 10
Federal Reserve March Minutes	April 10
Consumer Sentiment	April 12
Balance of Trade	April 17
Retail Sales	April 18
Durable Goods Orders	April 25
Personal Income and Spending	April 29
US/China Trade Negotiations	TBA

Upcoming earnings results

The reporting floodgates are set to open in the second half of April, as the major banks kick off the latest round of quarterly reports. Thereafter, several software and tech giants will be in the spotlight, including Netflix, IBM, Facebook, Microsoft, Amazon and Google. In between, an assortment of industrial bellwether stocks will also set an early tone.

Company	*Code*	*US Date*	*Company*	*Code*	*US Date*
Walgreens Boots	WBA	April 2	***Procter & Gamble***	PG	April 23
Blackrock	BLK	April 11	***Verizon***	VZ	April 23
JPMorgan Chase	JPM	April 12	***Coca Cola***	KO	April 23
Wells Fargo	WFC	April 12	***3M Company***	MMM	April 23
Infosys	INFY	April 12	***Facebook***	FB	April 24
Citigroup	C	April 15	***Visa***	V	April 24
Goldman Sachs	GS	April 15	***Boeing Company***	BA	April 24
Johnson & Johnson	JNJ	April 16	***AT&T***	T	April 24
Bank of America	BAC	April 16	***PayPal Holdings***	PYPL	April 24
UnitedHealth Group	UNH	April 16	***Glaxosmithkline***	GSK	April 24
Netflix	NFLX	April 16	***Caterpillar***	CAT	April 24
IBM	IBM	April 16	***Microsoft***	MSFT	April 25
PepsiCo	PEP	April 17	***Amazon***	AMZN	April 25
Abbott Laboratories	ABT	April 17	***Royal Dutch Shell***	RDS.A	April 25
Morgan Stanley	MS	April 17	***Intel Corporation***	INTC	April 25
Novartis	NVS	April 18	***Comcast***	CMCSA	April 25
Philip Morris	PM	April 18	***Exxon Mobil***	XOM	April 26
Honeywell	HON	April 18	***Chevron***	CVX	April 26
American Express	AXP	April 18	***Alphabet***	GOOGL	April 29
General Electric	GE	April 19	***Pfizer***	PFE	April 30
Barrick Gold	GOLD	April 22	***MasterCard***	MA	April 30
			McDonald's	MCD	April 30