CAPITAL19
GLOBAL STOCKS AND OPTIONS

CAPITAL 19 GLOBAL GROWTH PORTFOLIO

February 2019 Investment Report

US Markets February: Trade anxieties subside, Alibaba leads the way

*Equity markets continued their record run, while options and forex gains supported our portfolio growth of **5.7%***

How time flies when the market is on a tear! Concerns that January's bounce in equities would be short-lived have all but faded. And not just in any old manner. US stocks smashed it out of the park in February, setting several records. If there's one lesson, momentum can make all the difference, you don't want to bet against the market and fall foul of it.

All three major indices advanced 3-4% during February. The **Dow Jones** notched up nine straight weekly gains to start a year, something not seen since 1964. **NASDAQ** has gone one better, a first in its 48-year history. The **S&P 500** posted its best start to a year since 1991.

Index	*February Performance*	*YTD Performance*
Dow Jones	3.7%	11.1%
NASDAQ	3.4%	13.5%
S&P 500	3%	11.1%

A major factor driving the market was added caution expressed by the **Federal Reserve** during key speeches and in its Board minutes. We see the prospect of no rate hikes in 2019 as increasingly likely, barring an improbable leap in inflation or growth. Mind you, we certainly don't envy Jerome Powell right now with the added Presidential scrutiny.

Investors were relieved to hear trade discussions between the US and China were progressing well. Donald Trump signalled an extension to negotiations beyond March 1st, which suggests to us the posturing may soon end . Both sides want to reach a deal. Both want to move on. But neither wants to ask the other to dance.

Speaking of compromises, the US government surprised many by avoiding a second shutdown. Of course, the matter of border funding didn't end there. No, it took some old fashioned interventional *'democracy'*. Nevertheless, markets are proving immune to political shenanigans…and meetings with North Korean dictators too.

Earnings season proved the economy remains resilient if not laboured, with strong readings in manufacturing and nonfarm payrolls overshadowing mixed inflation, weak retail sales and declining housing starts. There's little to suggest this will suddenly change either.

Confession time rounds to a close

Exxon Mobil (XOM) led results with a comprehensive earnings beat that sent its stock 7.8% higher across February. Other notable companies which outperformed on revenue and earnings include **Cisco** (CSCO), **Philip Morris** (PM) and **Nvidia** (NVDA), all leaping higher.

Walt Disney (DIS) also topped analyst expectations, thanks largely to subscriber growth in its ESPN+ streaming service. Disney will roll out a similar service for movies and programs, with its acquisition of Fox pending.

With Netflix in our portfolio we're watching the threat this could pose in the direct-to-consumer segment, but see NFLX's strategy as sound.

The most high-profile report of the month came from **Alphabet** (GOOGL), with shares flat following a revenue and earnings beat. Revenue soared 21.5% to US$32.2bn, while quarterly earnings were US$12.77 per share. Some expressed disappointment over expenditure, whereas we saw this as a seasonal facet. It appears to us sales and profits for the main advertising segment are as strong as ever . Investment in speculative initiatives represents acceptable risk-return when fundamental operations print cash.

Coca-Cola (KO) fell afoul of investors, with its stock tumbling 8.4% last month. The major catalyst was a weak earnings outlook based on slowing global economic growth. Our view is that the gradual shift away from sugar consumption to more healthy alternatives presents a major long-term barrier for the company.

One pair to disappoint included a rare name in **Berkshire Hathaway** (BRK.A). We've never been one to go against Warren Buffet but we sure do wonder what on earth he saw in **Kraft-Heinz** (KHC), which itself announced poor margins, a dividend cut, $15bn in impairments and an SEC investigation. Even the best get them wrong from time to time! So wrong, BRK posted a loss, led by its own $3bn write-down. Although Berkshire Hathaway slumped 3%, Kraft lost one third of its value.

Home Depot (HD) and **Macy's** (M) were another duo to deliver an underwhelming report, and we view both with a bearish outlook. The former fell short of earnings, revenue and same-store sales forecasts, despite broad growth. The latter produced a beat, having already downgraded guidance in January. Our stance is largely based on lacklustre housing sales and price growth, which is likely to deter renovations. There is also a concerning level of debt on Macy's balance sheet in a gloomy retail environment.

Portfolio Performance

At month's close, the portfolio **Net Asset Value** (NAV) climbed 5.7%. This figure accounts for the effects of advisory fees, plus dividend and interest accruals. Equities accounted for 1.5% of total portfolio growth, with several positions closed out on call. In unison, **equity and index options** performed robustly, delivering 1.6% as the aforementioned calls coincided with February expiration.

Among the equity positions called away during February were partial reductions in **Facebook** (FB), **ServiceNow** (NOW), **Skyworks Solutions** (SWKS) and **Visa** (V). Positions were liquidated in entirety for **Microsoft** (MSFT), **Zillow Group** (ZG) and **Nike** (NKE), albeit we repurchased a small quantity in the latter.

Realised income on equity and index options, plus equities, was 1.1% of starting portfolio NAV. Unrealised income reached 2% of the portfolio's starting NAV.

As flagged in our last performance report, we called for upside to the portfolio NAV as the AUD would come under pressure.

With a trade deal likely to have some impact on China's growth, and in turn Australia's currency, the portfolio is still well positioned to capture forex gains. In February the **USD/AUD** increased from 1.3745 to 1.4097, boosting NAV by 2.6%. **Cash** available increased as a percentage of portfolio NAV, from 1.5% to 33.4%.

Alibaba (BABA) delivered large gains for the equity portfolio, with its share price climbing 8.6%. The company announced strong box office receipts during Chinese New Year courtesy of a handful of its co-produced films, as well as good growth in its video hosting business. The strategy for digital media diversification is sound. We flagged trade negotiations as a risk, but with all on track, our conviction in holding is paying off as we see this undervalued.

Core holdings in Visa accounted for significant portfolio gains with the stock up 9.7% across February. Visa's Chief Enterprise Risk Officer sold US$11.34m worth of stock on February 7, which appears to have put a floor in the price.

Apple (APPL) and **PayPal** (PYPL) were the next-best performers among our equity holdings, with the stocks up 4.1% and 10.5% respectively. Optimism over trade discussions pushed Apple stock higher. We're pleased about potential high-margin services like streaming video and subscription news, which may be announced soon. PayPal hit an all-time high and we like the mid-term growth outlook from its mobile payments app, Venmo. We note earnings risk with PYPL's deal as preferred payment option on eBay set to expire next year.

While headline losses in FB and NOW were prominent, they were effectively offset by gains in the corresponding options. **Unitedhealth Group** (UNH) was the only holding to incur a direct, non-trading loss of note during the month. This followed a 10.4% drop during February on account of mooted regulatory plans to end drug rebates from which it benefits.

Top 10 Holdings

Company	*Code*	*Weight (%)*
McDonalds	MCD	6.93
Apple	AAPL	6.53
Alibaba	BABA	4.93
Google	GOOGL	4.46
CME Group	CME	4.11
PayPal	PYPL	2.09
Facebook	FB	1.95
Bank of America	BAC	1.89
United Health	UNH	1.87
Amazon	AMZN	1.85

Upcoming earnings results

With most of the big names having already reported, there's just a small selection of companies due to report throughout March.

Company	Code	Expected Date
Salesforce.com	CRM	March 4
Target Corporation	TGT	March 5
Costco	COST	March 7
Adobe Systems	ADBE	March 14
Broadcom Inc	AVGO	March 14
Oracle Corporation	ORCL	March 18
Fedex Corporation	FDX	March 19
Nike	NKE	March 21
Walgreens Boots	WBA	March 27
Accenture	ACN	March 28

Economic data and events to watch

Looking ahead there's three key events we'll pay particular attention to, although we don't see any surprises as likely. Nonfarm payrolls will be a good reading on the jobs market, but shouldn't sway stocks with any long-term conviction, even if they miss forecasts.

While we believe the Fed Reserve will hold rates steady, it's the minutes which will be more important. Our forecast is for dovish commentary, which, with inflation readings a week earlier probably tame, means some time before the next move in rates.

Finally, US/China trade negotiations should wrap up this month. That could provide some liquidity and volatility to take on opportunities in stocks that have been exposed to the trade war, albeit we note there has been a lot of optimism in recent weeks that may already be priced in.

Data/Event	Expected Date
Personal Income and Spending	March 1
Manufacturing PMI	March 1
Non-manufacturing PMI	March 5
Balance of Trade	March 6
Nonfarm Payrolls	March 8
Retail Sales	March 11
Inflation Rate	March 12
Durable Goods Orders	March 13
Consumer Sentiment	March 15
Fed Interest Rate Decision	March 20
Durable Goods Orders	March 26
Balance of Trade	March 27
Personal Income and Spending	March 29
US/China Trade Negotiations	TBA