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CAPITAL 19 GLOBAL GROWTH PORTFOLIO

January 2019 Investment Report

US Markets January: Interest rate outlook softens, FAANG stocks take flight

Portfolio gains headlined by a record rally in equity markets, while the USD/AUD retreated

With 2018 done and dusted, it's as if the stock market hysteria that rounded out the final quarter of last year never took place. US markets produced one of their strongest monthly performances in recent times, rallying throughout January to achieve the best start to a year in over 30 years. All of a sudden, investors are upbeat again. It's a timely reminder, the market can be a fickle place, with sentiment turning on a dime.

Across January, the **Dow Jones** rose 7.2% - its best January result since 1985 - while the **S&P 500** lifted 7.9%, something not seen at the beginning of any given year since 1987. Meanwhile, the **NASDAQ** outperformed both indices, surging 9.2%.

The strength of the rally surprised investors given a string of headwinds leading into 2019. Market performance during December was the worst since the Great Depression in the 1930s. If that wasn't enough, tit-for-tat squabbling between President Trump and Speaker Nancy Pelosi about funding for a wall – sorry, *'physical barrier'* - led to the longest US government shutdown in history. Rounding it out were ongoing **trade negotiations** with a slowing China.

Fortunately, investors have learnt to see through contrived political rhetoric and focus on earnings and economic signals. Markets witnessed a shift in sentiment as **Federal Reserve** Chair Jerome Powell signalled a more dovish stance and greater discretion in the near-term trajectory of interest rates. As expected, the Fed followed this up by leaving rates on hold. Now we'd be surprised if there are even two rate hikes this year.

Also boosting confidence were strong **employment numbers** that showed US employers continue to hire workers at a record pace, with wages also growing at their highest rate in a decade. While growth could slow, we see these factors supporting a modest economic position with sufficient momentum to dispel overblown concerns of a looming recession.

Earnings Season Kicks Off

If expectations weren't already soft heading into earnings season, **Apple's** (APPL) sales downgrade in early January set the cat among the pigeons. The company said lower iPhone sales and slowing growth in China would hit revenue, sending shares tumbling.

For all the doom and gloom however, Apple continues to deliver bumper profits. The tech giant's brand power is unquestionable. We saw the news already priced into the stock's decline in prior months, which until then was down 39% from its highs. This represented an opportunity to add to our portfolio as the downgrade appeared overstated.

Although Apple reported its first decline in revenue and earnings across the holiday period in a decade, it comfortably beat revised guidance. Perhaps unfortunate for us, we would have loved to pick up some more shares on the cheap. As it turns out, the stock even gained 5.5% for the month, rebounding from what looks a short-term bottom.

Among the other **FAANG** stocks which reported, **Facebook** (FB), **Amazon** (AMZN) and **Netflix** (NFLX) had few problems beating consensus targets, advancing 27.2%, 14.4% and 26.8% respectively. The December sell-off had all the signs of being overdone, so momentum returning to these market darlings was of little surprise. Long-term outlook on each is still bullish, though it's likely we'll see some consolidation and sideways activity first.

Banks performed strongly as concerns of interest rate hikes eased. **Bank of America** (BAC) gained 15.5%, **Citigroup** (C) rebounded 23.8% and **Goldman Sachs** (GS) put on 18.5%. We added Bank of America before results showing EPS of US$0.70 versus analyst expectations of US$0.63 and US$0.20 in Q4-18. Revenue also fared to the upside, with its trading arm outperforming peers.

In separate segments, there were also earnings beats from **Boeing** (BA), **General Electric** (GE), **IBM** (IBM), **UPS** (UPS) and **Whirlpool** (WHR). If the pattern wasn't already apparent, lean earnings forecasts ensured plenty of companies shared the spoils.

It wasn't all one-way traffic however, as **Tesla** (TSLA) delivered subdued earnings and news that its CFO would depart the company. Joining the sin-bin, **DowDuPont** (DWDP) delivered unconvincing results, while **Macy's** (M) long-term woes continued as it slashed revenue and earnings targets, leaving investors haemorrhaging by an 18% drop in one day - its largest ever. In our view, the bricks and mortar retail sector shows no sign of turnaround and it reinforced our thesis to take a position in Amazon.

Portfolio Performance

By the end of January, our portfolio closed with a **Net Asset Value** (NAV) 3.8% higher than the start of the month. Equities contributed strongly to growth, delivering gains of 7.3% - in line with index returns.

As a hedge, a low volume of call options were sold on the portfolio equities, which materialised a decline of 0.9%. Realised income on equity and future options amounted to a 0.1% gain of the portfolio's starting NAV, partially offset by minor losses on futures options.

On January 1 cash represented 30.2% of the NAV, however this money was largely deployed into the market in pursuit of opportunities arising from an overcorrection in stocks during December. By month's end, cash assets made up 1.5% of NAV.

The **USD/AUD** deteriorated over January from 1.4181 to 1.3745 as the outlook for US interest rates softened. The AUD rose in line with iron ore and oil. With the US portfolio unhedged, currency movements impacted AUD reporting, reducing assets by 2.5%.

Although open positions were impacted by the declining USD, we expect the AUD to remain under pressure in the coming months and provide potential upside to the portfolio NAV.

Across the portfolio, 15 of 20 stocks delivered positive returns. We took new positions in 10 companies, with the majority in anticipation of earnings reports. The largest gains came from Facebook (FB) - as mentioned earlier, whom beat market consensus - as well as **ServiceNow** (NOW), **Alibaba** (BABA) and **Nike** (NKE).

As one of our new positions, computer software company ServiceNow soared 23.6%. This included more than 10% when it reported $7m in net income compared with a loss the year prior. We were pleased by adjusted EPS of US$0.77 beating Wall Street's expectations of US$0.63, and a significant jump in revenue.

Meanwhile, Alibaba reported 41% year-on-year growth in revenue, with domestic and international markets showing promising signs despite not meeting consensus targets. However, with earnings surpassing forecasts, a rally in the tech sector and easing concerns around the global trade war, the stock leapt 22.9% higher in January. The watchpoint from here will be trade negotiations this month, as well as broader levels of economic slowdown in China. For now, the valuation is closer to compelling than demanding.

Nike's gains have largely followed its earnings results delivered just before Christmas, with momentum only building in recent weeks. We wouldn't be surprised to see the stock head back towards its all-time high from September 2018, on a tear lately regaining market share.

Microsoft (MSFT) delivered disappointing results, only just meeting earnings calls but missing on revenue. Worryingly, the company has set the bar lower for next earnings season but this could help reset market expectations, so we only see it as a temporary setback.

Finally, mixed earnings results from **McDonald's** (MCD), **Visa** (V) and **PayPal** (PYPL) didn't otherwise impact portfolio performance, however a soft outlook from PayPal may draw closer scrutiny.

Top Completed Holdings

Company	*Code*	*Weight (%)*
McDonalds	MCD	7.1
Visa	V	6.7
APPLE	AAPL	6.6
Face Book	FB	5.4
Service Now	NOW	5.3
Nike	NKE	4.9
Alibaba	BABA	4.8
Alphabet	GOOGL	4.7
CME Group	CME	4.4
Zillow	ZG	4.2

Economic data and events to watch

Reports aren't the only thing you'll need to be on watch for, with a slew of economic data likely to shape markets in coming weeks. We'd be surprised if the government doesn't shut down again mid-month, but markets were unfazed last time. It could however, delay the release of key economic data.

GDP and inflation data remain most likely to move the markets, especially if the effects of the recent shutdown emerge. It may well serve as a barometer for renewed

Data/Event	*Expected Date*
Non-farm payrolls	February 1
Manufacturing PMI	February 1
Non-manufacturing PMI	February 5
State of the Union	February 5
Jerome Powell Speech	February 6
Balance of Trade	February 6
GDP Growth Rate	February 11
Personal Income and Spending	February 11
Inflation Rate	February 13
Durable Goods Orders	February 14
US government shutdown deadline	February 15
Retail Sales	February 15
Consumer confidence	February 15 (*TBC*)
Balance of Trade	February 20
Durable Goods Orders	February 27
North Korea Summit	February 27/28

Upcoming earnings results

Earnings season continues to steam ahead in February. Keep an eye out for some of the following companies who are due to report.

Company	*Code*	*Expected Date*
Exxon Mobil	XOM	February 1
Alphabet	GOOGL	February 4
CME Group	CME	February 4
Skyworks Solutions	SWKS	February 5
Toyota Motor	TM	February 5
Walt Disney	DIS	February 5
Philip Morris	PM	February 7
Cisco Systems	CSCO	February 13
Coca-Cola Company	KO	February 14
Nvidia Corporation	NVDA	February 14
Walmart	WMT	February 19
Zillow Group	ZG	February 20
Berkshire Hathaway	BRK.B	February 22
The Home Depot	HD	February 26
Macy's	M	February 26

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