LOM OFFSHORE FINANCIAL SERVICES

Monthly Global Market Commentary
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Technology Sector Weighs Down the Broader Market Rally
By Peter Goodall

Global markets bounced back last week as news that the US and China were in trade talks lessened anxiety about an all-out trade war. Markets were closed on Friday for the Good Friday holiday. The S&P 500 ended the week up 2.06% while the MSCI World Index rose 1.42%.

FANGs Bared

Facebook, Amazon, Netflix and Google (now Alphabet) are sometimes called the FANGs. They represent a little under 1/8th of the S&P500, a market-weighted index. That gives these four holdings a massive impact on over the overall performance of the index. Well, they have had a really bad week.

Facebook shares ended the week up 0.25% (mainly attributable to a Friday rally) on news of the Cambridge Analytica scandal. The timing of the scandal is not great. A new regulatory framework is emerging for the industry. The EU General Data Protection Regulation (GDPR) completes its transition period in on May 25th. If similar breaches were to come to light after the transition period, Facebook could be liable for more than $1.6B in fines. In the US, the Federal Trade Commission has confirmed that it is investigating whether Facebook violated a 2011 consent decree. Mark Zuckerberg will be speaking in front of the Congress. Ironically, if the fallout were to result in increased regulation it would likely help Facebook by increasing the barriers to entry for new competitors. LOM holds active positions in Facebook and remains bullish about the long-term prospects of the company.

Amazon stock fell last Tuesday after the news agency Axios reported that President Trump was rumored to be targeting the company with antitrust laws in an attempt to protect brick-and-mortar retailers. This was confirmed on Thursday by the President on Twitter. It should be noted that Jeff Bezos, the CEO of Amazon, is also the owner of the Washington Post (a vocal opponent to the President). The feud between the two men has been public for a long time. The stock ended the week down -3.22%.

While Netflix is down but it is not on any real substantive news. Some conservatives are threatening to stop subscribing to Netflix because it recently added a Susan Rice, an Obama national security advisor, to their Board of Directors. Also, some Brazilians are upset because Netflix released a drama based on impeachment of Dima Rousseff, the former president of Brazil. Most boycotts like this have little effect on the long-term performance of companies. Netflix ended the week down 1.86%.

Google is fine. It ended the week up. Nothing notable here although the stock recently traded down more than ten percent from last month's high.

So… let's use this time to talk about Tesla. There was another fatal car crash this week. The price dropped after the National Transportation Safety Board announced it would be investigating the crash. It is worth noting that they are looking into the crash itself and not placing blame on Tesla. Street views prior to the crash appear to indicate the metal barrier that is designed to limit the impact of these types of crashes was broken or partially removed the day before to the accident. The company issued a press release a few days prior to the crash where the NTSB had released a report showing self-driving cars resulted in a 40% reduction in crashes. That said, we all tend to think erroneously that we are better drivers than the average person. It will take people time to get comfortable with this technology. There was a period of history where we would employ bellhops to assist us while riding the elevator.

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The bigger issue with Tesla surrounds its debt. The company has to repay approximately 39.6% of its debt over the next 2 years. That is $4,679.6M. Not counting inventories, it has liquid assets that can cover about half of its debt. This comes at a time where it has been burning through cash. To cover the difference, it will need to raise more debt, issue new shares or become a lot more profitable in the short run. Tesla ended the week down -11.74%.

Interest Rates Impact on Businesses

In an interview with the Walls Street journal, Patrick Harker (the Philadelphia Federal Reserve Chair) discussed expectations that the Fed will raise interest rates three time this year since he was seeing "some firming of inflation." Compared to other Federal Reserve Presidents, he has tended to lean towards lower interest rates. This is indicative of a consensus shift towards a more aggressive increase in rates throughout 2018. Barring new information, we are still anticipating interest rates to rise four times this year.

The increased interest rates are beginning to impact earnings for companies rolling short term debt. Many companies have used the historically low interest rates to take on larger amounts of cheap debt. As this debt matures, the companies now face the prospects of repaying it or replacing it with debt at a higher interest rate. This will be a broader challenge that companies will face over the coming years, causing a headwind to the economy.

Conclusion

There is a lot going on both in the markets and geopolitically right now. We see one risk to this market being that good economic news may not always be good for equity prices. For example, as we see signs of a healthier economy, such as last week's upwardly revised U.S. GDP report, the Fed may be encouraged to act more promptly and aggressively on interest rate increases this year. Therefore, what has been known as the "Fed put", may no longer be the big safety net promoting risk taking as it has during the past several years of easy money policy. Moreover, some of the political risks seem unnecessary and concerning. Trump has recently upset markets not only with his suggestions of a trade war, but with his Twitter attacks on individual companies such as Amazon as noted above.

While volatility can be unnerving for some investors, we maintain that these ongoing vicissitudes can also provide us with attractive opportunities to position strategically by picking up higher quality securities at substantial discounts to our estimation of their intrinsic values. Despite last week's volatility and an overall dour tone in the markets, we began to see several of these securities stabilize on the tail end of Friday. Perhaps equity markets are beginning to look forward to a lucrative Q1 earnings season as reports begin to come out later this week. This will be the first period in which companies begin to see the benefit from the U.S. tax cuts and we expect to see some good reports in the weeks ahead.

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Stock Market Performance

	4/2/18	W-o-W	M-o-M	Y-o-Y
DJIA	23,554	-2.7%	-4.0%	14.0%
S&P 500	2,579	-3.0%	-4.2%	9.2%
MSCI World	2,067	-0.1%	-1.1%	11.5%
S&P/TSX	15,239	-0.4%	-0.9%	-2.0%
BSX	2,491	-3.4%	-1.8%	28.4%
FTSE100	7,057	2.4%	-0.2%	-3.6%
DAX	12,097	2.6%	1.5%	-1.8%
CAC	5,167	2.0%	0.6%	0.9%
Nikkei	21,389	3.0%	1.0%	13.1%
Hang Seng	30,093	-1.5%	-1.6%	24.8%
Shanghai	3,163	0.9%	-2.8%	-1.8%

Key Rates and Prices

Currencies	4/2/18	Month ago	Year ago
EUR	$1.23	$1.23	$1.07
GBP	$1.40	$1.38	$1.26
JPY	¥105.97	¥105.75	¥111.39
CAD	$0.77	$0.78	$0.75
CHF	$1.05	$1.07	$1.00
AUD	$0.77	$0.78	$0.76
Fixed Income			
3M LIBOR	2.31	2.03	1.15
3M Treasury Bill	1.72	1.64	0.75
2Yr Treasury Note	2.26	2.24	1.26
10Yr Treasury Note	2.74	2.87	2.39
Fed Funds Rate	1.75	1.50	1.00
Commodities			
Gold/oz.	1,342.01	1,322.75	1,249.35
Silver/oz.	16.64	16.52	18.27
Copper/lb.	3.05	3.13	2.65
Oil	63.33	61.25	50.60

Global Economic Calendar (April 2nd — April 6th)

Mon: PMI Manufacturing Index (US)
Tues: Motor Vehicle Sales (US)
Wed: ADP Employment Report US), EIA Petroleum Status Report (US), Factory Orders (US)
Thurs: Jobless Claims (US), International Trade (US)
Fri: Baker-Hughes Rig Count (US), Employment Situation (US)

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