2nd Quarter 2018 Newsletter

April 2018

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Recent News:

During the chaos of the Financial Crisis, the S&P 500 bottomed out at 677, on March 9, 2009. On that day, there was no signal or "all clear sign" that indicated it was safe to re-enter the market. Quite the contrary, it was hectic and filled with uncertainty. Nine years later, with the S&P 500 above 2,500, the market was able to generate a return of over 250%.

Investor sentiment has quickly shifted from extreme optimism following the tax reform passage, to outright bearishness with a looming trade war. The last 18 months were categorized as tranquil for their lack of volatility. This year, starting in late January and early February, has been anything but calm. Prior to this market decline, the S&P 500 had just completed its longest stretch ever, 551 days, without a fall of at least 5%. The Velocity Shares Daily Inverse Short-Term exchange traded note (ticker XIV) was a complicated financial product that allowed its buyers to bet against market volatility. This became a simple trade to make gains in a somewhat boring and low volatility market. Then, when volatility appeared, investors lost $1.9 billion or 93% of their value in a single day. Some investors lost over 80% in a few hours. Credit Suisse has terminated this note investment, but not before this blowup occurred. The short volatility trade has ended abruptly, and this year the market has been experiencing large swings, both up and down.

Instead of viewing elevated volatility as a sign that the market is becoming more fragile, we see it as a sign that things are actually behaving more normally. We are not contrarians but do worry when the market gets either too bullish or too pessimistic. In late 2017 and for most of January 2018, investors were optimistic following tax reform and subsequently poured record amounts of money into equity funds. Following the abrupt volatility implosion, escalating trade tensions and higher interest rates, expectations have been tempered. How volatile has it been recently? On April 4th, the Dow swung nearly 1,300 points intraday, from bottom to top.

We were pleased with our performance last quarter and continue to expect heightened volatility in the future. If you would like a detailed snapshot of our monthly performance, top holdings, and large exposures, please let us know. Over the next month or so, companies will begin to report first quarter earnings results. We anticipate excellent growth and continued strong commentary from company management teams regarding their outlook and prospects. After an unusual period of extreme bullishness, it seems like the market mentality is now back to climbing a wall of worries. As we normally do, we will frame these issues below.

Our Newsletters:

We attempt to highlight current events and issues in our newsletters (click here to see our last 9), but we unfortunately do not have a Magic 8-Ball with all the answers. As bottoms up, fundamental research analysts, we are often asked why we even bother to opine on macro issues, like inflation or interest rates or geopolitical issues like Russia or North Korea. Well, financial sector stocks make up a significant portion of our portfolio, and interest rates are the most important input factor for traditional financials. Like most financials, our portfolio benefits from higher interest rates. However, we are not credit sensitive (i.e. no banks or insurance companies) and actually benefit from volatility.

During each quarter, we attempt to write and publish proprietary research on thematic topics, as well as specific stock recommendations. Over the last three months, we wrote a research note on one of our largest holdings, CME Group (ticker CME). It highlighted what we look for in an investment, discussed our unique investment philosophy and process, as well as our thoughts on its upside. If you would like to read that CME note, click here or visit our website at www.manolecapital.com and then click on the "Research" tab.

This spring, we have five interns from the University of Tampa, and they helped us survey their peers. We recently published a research note on millennials and Gen Z's thoughts and opinions on various financial services. To read that note and better understand how younger generations view bank accounts, bitcoin, technology, P2P payments, and other financial services, click here.

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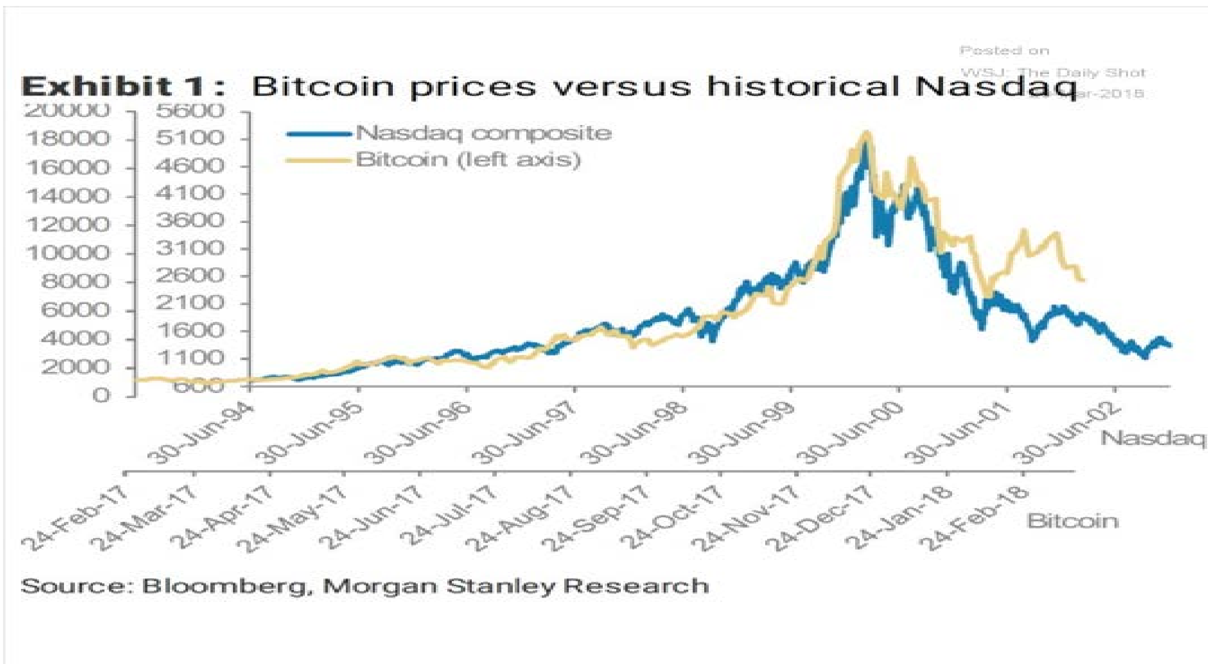
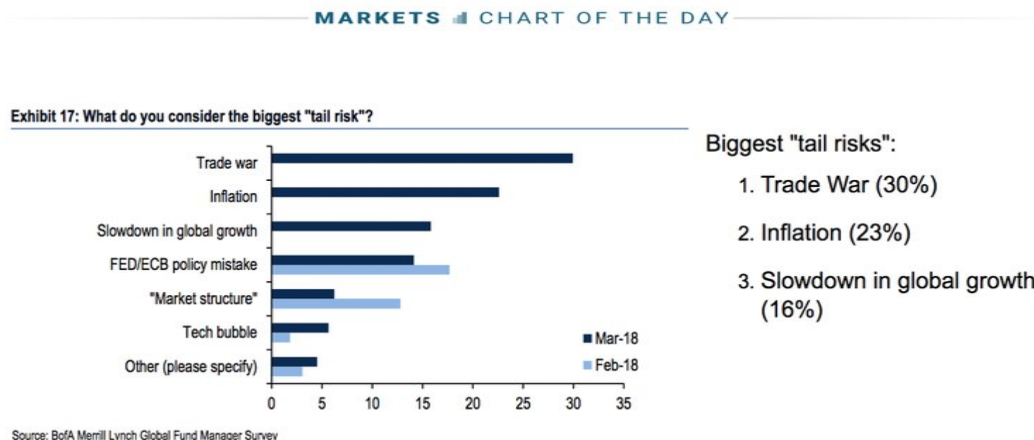
Lastly, we also took the opportunity to revisit our bitcoin note from December of 2017, which can be read here. As the Morgan Stanley / Bloomberg chart shows, there are many similarities between the massive move higher in bitcoin (in late 2017) with Nasdaq's climb in the dot-com era (1998 to 1999). If history repeats itself, bitcoin will continue to have huge volatility going forward. During the first quarter, bitcoin had its second worst quarter ever, falling by 50%. Even if bitcoin is a viable currency (which we do not believe it is), we still would not be an investor, as we do not transact or speculate on any currencies. Manole Capital is an asset manager, investing in FinTech companies, not a currency speculator.



At the end of our newsletters, as always, please take a look at our "Interesting Stats, Quotes & Info" page. We hope you find these specific data points (and random thoughts) as interesting as we do.

Macro Issues:

Each month, Bank of America Merrill Lynch surveys money managers to understand what are the biggest market "tail risks". In this note, we will discuss the three to four of the largest, potential risks they identified.



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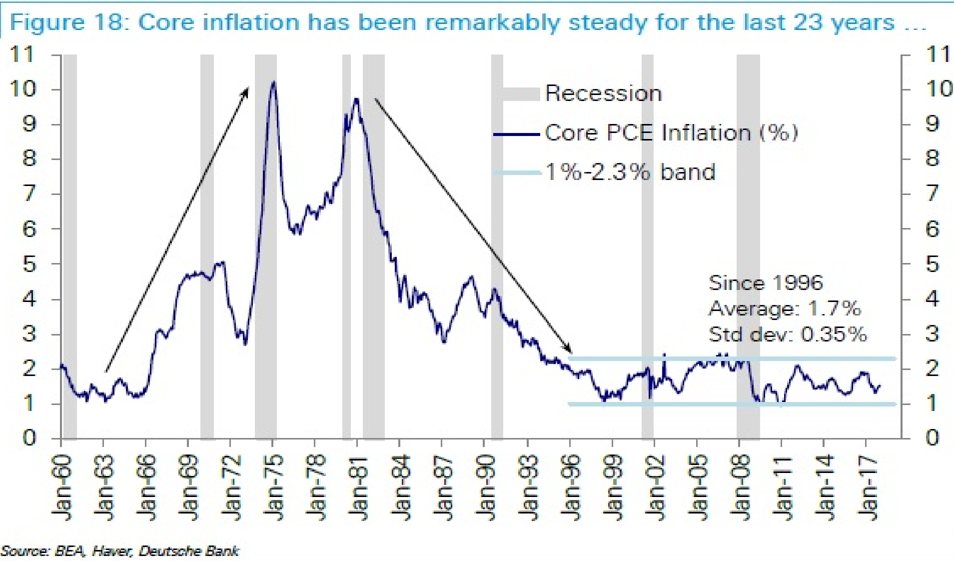
Interest Rates, Inflation & the Federal Reserve:

Now that we are a decade past the Bear Stearns collapse (March 6, 2008) and the Financial Crisis, the Fed is simply trying to normalize its activities. It has two, statutory key mandates for its monetary policies and actions. One is employment and the other is inflation. On the first, unemployment is at 4.1% and at a 17-year low. The job market remains quite strong and the Fed continues to see unemployment trends heading lower. In fact, the Fed believes unemployment will fall to 3.8% by the end of this year and 3.6% by 2019. With these very positive forecasts, we would expect a quick normalization of interest rates, if employment was its only concern.

The second and more perplexing issue the Fed has been wrestling with has been inflation. While some find it odd, the Fed targets a 2% inflation rate. It wants our economy to be growing at a pace that generates modest price increases. Unfortunately, inflation has been essentially non-existent. Former Fed President Yellen continuously commented that she did not understand why inflationary pressures could not get up to its target. The Personal Consumption Expenditures or PCE index has undershot the Fed's 2.0% target for annual inflation in 67 of the past 69 months. As the chart below indicates, inflation has been range bound since 1996 and averaged only 1.7%. Some feel inflation remains hindered by structural forces like improving technology and productivity gains. Some think an aging population and a decline in immigration are weighing on it. Quarter after quarter, inflation is low, although we believe there are certain pockets of the economy that are still experiencing significant pressures (i.e. college and university tuition, coastal and urban rents, food, gasoline prices, etc). We would argue modest 1.0% to 1.5% inflation is much better than the alternatives of 3% to 4% inflation or the high-teens we saw in the early 1970s (see Right). Modest inflation is also much better than the ugliest of all things - deflation.



Testimony in Plain English:

New Fed President Jerome Powell met market expectations on March 21st and raised short term interest rates by another 25 basis points. This is the 6th time the Fed has raised interest rates since late 2015 and he continues the accommodative steps former Fed President Janet Yellen began. Since this rate increase had been a foregone conclusion for several months, the more important aspect was to listen to Chairman Powell's initial commentary as Fed President, as well as to try to interpret the quarterly Statement of Economic Projections known as the "dot plots".

We appreciate that Chairman Powell is not a traditional economist and he is actually the first non-economist to be Chairman of the Federal Reserve in four decades. We understand that his opinions will be viewed somewhat differently (i.e. straightforward) from prior Presidents that strived to make their commentary as opaque as possible. It will take time for the market to gain confidence in Chairman Powell, but we clearly heard him state an optimistic outlook for 2018 and 2019. He attempted to calm markets and laid out a plan for gradual interest rate increases. His testimony made the case for an improving growth environment, a strengthening labor market and modest inflation pressures. However, since it was his first appearance as Fed President, many market observers continue to doubt his words.

The Fed upgraded its assessment on the US economy, noting that "the economic outlook has strengthened in recent months". The Fed's 2018 GDP forecast was revised upward to 2.7% from 2.5%, and 2019 GDP was also lifted to 2.4% from 2.1%. While these forecasts are just Fed estimates, it is a positive to see revisions moving higher. Lastly, Chairman Powell downplayed runaway inflation concerns by saying "there is no sense in the data that we are on the cusp of accelerating inflation."

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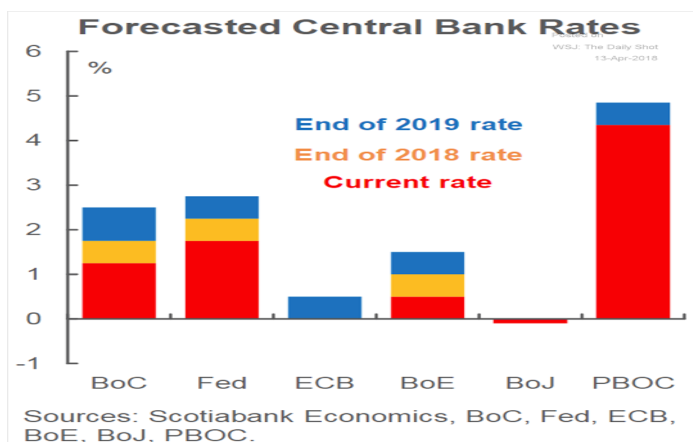
The best site to gauge market expectations for interest rates is the CME's website. Click here to see what the market believes the Fed will do going forward. The base case interpretation of Fed expectations for 2018 was looking for three increases. Strong recent growth and upward momentum had some thinking four rate increases were a possibility. Examining the Fed's most recent "dot plots", the market is now expecting another two 25 basis point increases in 2018. Looking out to 2019, the market seems to expect another two increases.

Our Interpretation & Expectations:

In Chairman Powell's testimony, we believe he was articulating a "stay the course" plan. He will carefully look at all of his inputs and we would expect him to listen to his fifteen other Fed Board members. Chairman Powell will likely be prudent, and data dependent in all of his actions. In fact, he specifically said that "The Fed's patient approach has paid dividends and contributed to the strong economy we have today." We would be quite surprised if he contradicted Chairwoman Yellen's work, but we do expect him to have a somewhat different opinion on the size of the Fed's balance sheet and the flattening yield curve. We expect the Fed will need to see obvious evidence of accelerating inflation pressures to increase its steady normalization of rate policies. The market should view this as dovish and a continuation of the status quo.

We continue to expect and model two more interest rate hikes in 2018. Some believe that accelerating growth, coupled with a massive tax cut and growing debt burden, that three more increases are coming. Whether 2018 has three or four interest rate hikes will obviously matter, but it misses the dominant point: interest rates are headed higher. Whether 2019 has two or three additional increases, is not terribly important to us. Once again, interest rates are headed higher. Following the Financial Crisis, the Fed took necessary steps to protect and bolster our economy. By taking interest rates to essentially zero and undertaking unprecedented bond purchases (i.e. Quantitative Easing or QE), the Fed was reacting to that awful environment. While Europe and Japan are keeping rates negative or near zero, our Fed is attempting to be anticipatory, not reactionary. We applaud them for analyzing the data and attempting to get our yield curve back to a more normalized state.



Unlike our Fed, Japan continues to act like it is 2008. Japan is the second largest government bond market, with $9 trillion in outstanding debt. The Bank of Japan continues to swallow up essentially all of its new issuance and it now owns 41% of the entire Japanese government-bond market. By continuing to pump more cash into its financial system, it is almost guaranteeing that interest rates stay low and near zero (i.e. 10-year paper in Japan is still at 0.02%). Mario Draghi, the President of the European Central Bank, is not expected to lift interest rates for the remainder of his tenure, through late 2019. We worry that Europe and Japan, which continue to act in a near comatose state, and will not have any options. While we do not envision an environment where our Fed cuts rates to offset an issue, it at least has the option to do so.

Interesting Coincidence:

Lastly, and in the camp of totally useless information, we found this chart and loved the correlation. It shows the heights of our last five Fed Presidents and what happened with interest rates during their tenure. As you can see, rates definitely have to rise, since Jay Powell is much taller than Janet Yellen.

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Glass Half Full:

We heard a new Fed President state confidence in the US economy, increase growth expectations and confirm that it intends to take a slow and measured pace when raising interest rates. In our opinion, we got exactly what we were looking for in Fed commentary. Fed President Powell will need to be nimble to extend the life of the nine-year expansion, but he must understand that central banks need to be prudent when raising interest rates. Over five of the last seven credit-tightening cycles, since 1970, the Fed has choked off growth, tightened too quickly and indirectly resulted in a recession.

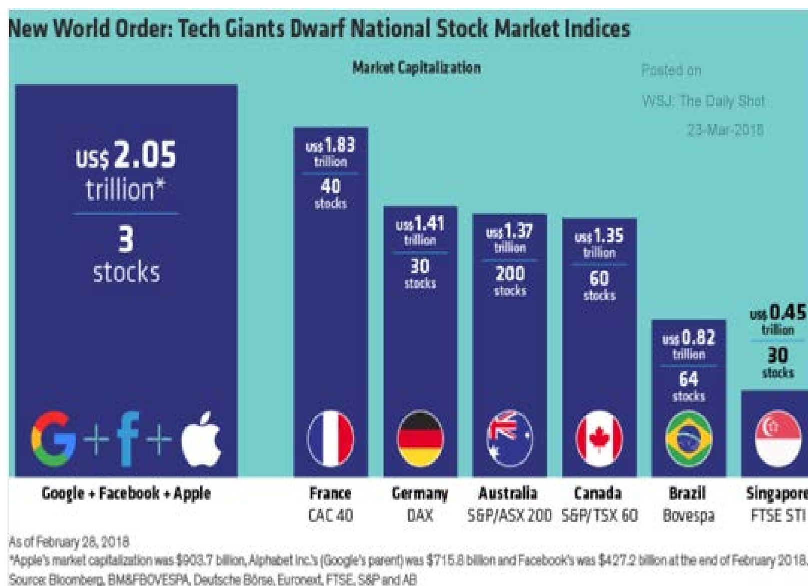
We remain bullish on the US economy. The positive impact of the largest tax reform bill in decades is just now influencing business activity and getting built into estimates. Earnings results have been solid, and growth is continuing to nicely expand. Our concentrated portfolio of Fintech companies continues to deliver top line growth at more than three times the pace of the overall market (18% vs 5%), with more than double the average pre-tax margin (33% vs 15%). When earnings shortly get released, we expect to hear positive commentary on the forward outlook from our portfolio's management teams.

A Wall of Worries:

That being said, there are always worries that could end this lengthy bull market. In late January to early February, the market underwent a quick 10% drop. The VIX skyrocketed and significant volatility emerged. For all of 2017, we were surprised at the lack of volatility, despite a vocal President and numerous fiscal issues (i.e. government shutdowns). The short volatility trade, that was profitable for so many investors, came to a screeching halt. During this time period, many of our holdings performed quite well. Our preference for predictable, sustainable transaction-based business models, generating recurring revenues and free cash flow performed like we expected. Our exposure to online broker dealers, derivative exchanges and certain market makers were especially beneficial last quarter.

Market Concentration:

It seems that the market continues to be fueled by a select few technology stocks. Apple is steadily approaching a $1 trillion valuation and FAANG or Facebook, Apple, Amazon, Netflix and Google now account for 1/4th of the entire Nasdaq market. If we look at Apple, Google and Facebook, we find that its market capitalization rivals or exceeds several individual countries' stock markets.



While we do not own any FAANG stocks, we do continue to worry about too much concentration and leadership by such a select few. During this recent three-week decline, the five FAANG companies have collectively lost nearly $400 billion of market value. Maybe Facebook's recent data privacy issues and subsequent 15% decline (over $85 billion off its market capitalization) will lead to FAANG weakness? We do not know how strong the #deletefacebook theme will be, but Congressional testimony by Mark Zuckerberg was a rocky period for Facebook stock.

Speaking of Facebook, why don't we address the elephant in the room: Russia.

Russia:

In March, Russia held elections, and nobody was surprised to see President Vladimir Putin win with more than 75% of the votes. The US relationship with Russia is undoubtedly strained and Special Counsel Robert Mueller's investigation into Russia's involvement in our elections continues. Will this investigation lead to damaging facts emerging on Trump's involvement? While President Trump can legally fire Mueller, we believe it could lead to a Republican revolt. Senator Chuck Grassley, Republican from Iowa and Chairman of the Judiciary Committee said firing Mueller would be "political suicide" for President Trump. That

being said, we were very disappointed to see National Economic Council director Gary Cohn resign in mid-March. Couple that with the firing, over Twitter no less, of Secretary of State Rex Tillerson and nothing from this White House seems surprising.

North Korea:

During this quarter, we really enjoyed watching the Winter Olympics from South Korea. Anyone up for a quick eight "ends" of curling? Leading into these games, the noise and posturing between the White House and North Korea's Kim Jong-un was quite loud. Following the games, it appears that talks will be scheduled with an attempt to dial back some of these tensions. North Korea getting nuclear weapons and threatening the US continues to be a worry. Previous negotiations have led nowhere, but only time will tell if these new rounds of talks lead to anything substantial.

We are also surprised that President Trump recently replaced National Security Adviser H.R. McMasters with John Bolton. When Bolton was the former US ambassador to the United Nations under President George W. Bush, he was a strong advocate of aggressive military action against Saddam Hussein in Iraq. On North Korea, he recently wrote an op-ed piece for The Wall Street Journal where he said, "The threat is imminent, and the case against pre-emption rests on the misinterpretation of a standard that derives from pre-nuclear, pre-ballistic-missile times. Given the gaps in US intelligence about North Korea, we should not wait until the very last minute. That would risk striking after the North has deliverable nuclear weapons, a much more dangerous situation." Unfortunately, we believe Bolton is quite polarizing and do not feel he will be a calming influence on President Trump.

A Protectionist Trade Agenda:

As the Bank of America Merrill Lynch chart on page one indicated, the biggest tail risk for the market is a trade war. 30% of money managers surveyed felt that a trade war was the most likely issue to impact the stock market. It is our opinion that Trump's "America First" approach is an attempt to help Republicans in the important mid-term elections by fulfilling a campaign pledge. In addition, he likely sees this as a great campaign theatre, if he can state that he simply was protecting American jobs and businesses from the Chinese.

Furthermore, we believe that President Trump understands the importance of a rising stock market for his election chances in 2020. President Trump tweeted 40x when the market was rising and how there was a strong correlation between his time in the White House and the recent success of the stock market. Since market volatility arose in late January - only one tweet. He absolutely understands that a rising stock market helps his chances of getting re-elected. On the day these trade tariffs were signed (March 22nd), the S&P 500 fell 2.5% and the Dow dropped over 700 points. If President Trump is wise, he will take the market's reaction as a useful warning sign. He must understand that all trade wars end with no winners, only losers.

China:

After decades of US foreign policies specifically designed to avoid a trade conflict, President Trump is breaking from the normal Washington strategy. President Nixon met with Mao Zedong in 1972 and was trying to coax China into a more open society with a market-orientated economy and free trade reforms. The idea was to cooperate with China's quest for economic development and slowing transform it from adversary to ally, possibly even from dictatorship to democracy. With much fanfare, Beijing subsequently joined the International Monetary Fund, the World Bank and then the World Trade Organization.

The World Trade Organization or WTO:

When China joined the WTO in 2001, some advocates believed it would begin to conform and play by fair, global rules. However, the WTO has done little to stop China's years of misdeeds. It has predatory trade practices, restricts access to its markets, does not enforce intellectual property violations and continues to force companies to transfer technology to Chinese firms. US companies are clearly frustrated over the slow pace of market-opening reform in China, but are simply too afraid to bring WTO action against China for fear of retaliation from Beijing. Despite numerous WTO complaints, the global trade body has done little to enforce its rules. WTO's director general, Roberto Azevedo, has called for "restraint and urgent dialogue as the best path forward to resolve these problems."

Instead of taking unilateral actions and making Twitter threats, we would have preferred that President Trump attempt to pressure the WTO to act. Another option would have been to get other countries involved in battling any unfair Chinese policies. If the intention was to fight bad Chinese practices, then President Trump should have gotten support from our allies in Europe and Asia to present a more unified front. Then, it could have used the global trade body to apply additional gravity. If China

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were not to comply with a WTO order, it runs the risk of getting expelled and a global, unified retaliation. This would do more to impact China's actions, than threats and protectionist actions.

In our opinion, this would have been a more logical approach to trading issues, but this is not the way President Trump handles negotiations. Instead, this tariff proposal seems like there is no real focus. First, President Trump imposes tariffs, but quickly exempts Canada, Mexico, Australia, Brazil and the European Union on national security grounds. Why were these allies and valuable trading partners on the list to begin with? China's culture is one of respect and they will be reluctant to cave into President Trump's threats. Rash ultimatums do not seem like the appropriate method for getting change.

Tit for Tat:

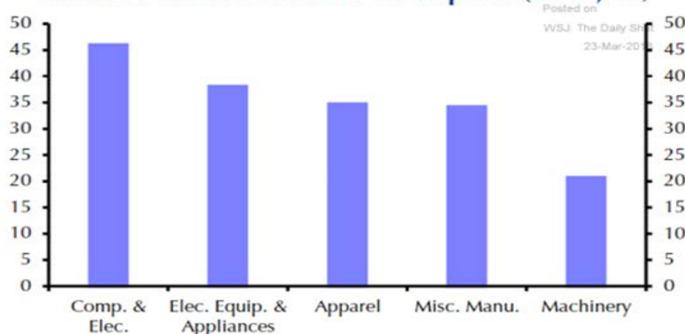
Will President Trump's recent Chinese tariffs lead to a global trade war? What first started out as a tariff of steel, aluminum, solar panels and other US imports, expanded to include technology, telecoms and other intellectual property. Then President Trump signed a memorandum, citing Section 301 of the trade Act of 1974, instructing the government to respond to unfair Chinese trade practices. Specific action will not take place for a month, which we hope provides enough time for the Administration and China to come to a resolution of these escalating trade tensions.

On March 22nd, Commerce Secretary Ross stated these tariffs were "not a sign of a trade war, but rather the administration standing up for Americans and US businesses." President Trump stated that the US and China are "in the midst of a very large negotiation." The Chinese Embassy immediately responded and said "China does not want a trade war with anyone, but China is not afraid of and will not recoil from a trade war. China is confident and capable of facing any challenge. If a trade war were initiated by the US, China would fight to the end to defend its own legitimate interests with all necessary measures."

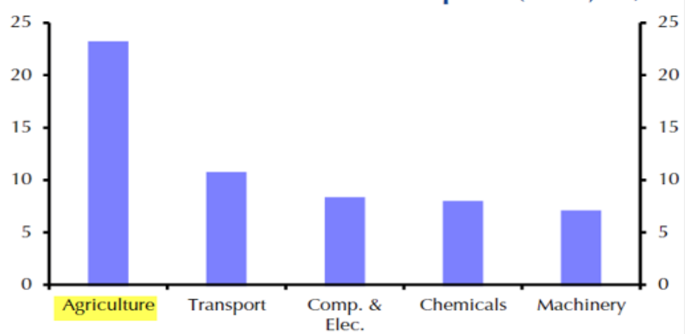
Are We Playing Chess or Checkers?

Immediately following Trump's tariff announcement, China responded with 128 product tariffs and countermeasures on items ranging from pork and wine to fruit and steel. What is noticeable in their product selections was a clear targeting of big-ticket US farm exports, which not coincidentally are all produced in Farm Belt states Trump won in the 2016 election. In fact, 8 of the 10 largest soybean producing states were won by President Trump in the election. Many US farmers are now bracing for a potential disruption from this potential trade fight. The financial hit would come at a rough time for farmers, as many have been struggling with low commodity prices for the last several years. Zippy Duvall, President of the American Farm Bureau Federation, recently said that "this could not be happening at a worse time for American agriculture." Farm incomes this year are expected to be at their lowest levels since 2006, according to the US Agricultural Department.

If this was Trump's idea of negotiations in a longer fight, he clearly lost round one. Chinese President Xi Jinping has been ready for this and has a well thought out game plan. We hope President Trump and his economic advisors have something better in mind for rounds two through ten. We applaud the Trump administration for trying to fix unfair trade agreements and practices but disagree with their tactics. None would logically argue with our government's attempt to address bad Chinese behavior, but we would favor a plan that does not punish our own citizens and infrastructure. President Trump stated, "I'm not saying there won't be a little pain, but the market has gone up 40%, 42%, so we might lose a little bit of it." These are big picture comments, regarding the stock market, but fail to capture the pain of the average American. We are selfishly glad our FinTech companies do not seem to be in the crosshairs and we have very little exposure to the Chinese market. While we will not totally escape this fight, we are pleased that we are not terribly exposed to those sectors potentially most at risk (see below).



Source: Census Bureau



Source: Census Bureau

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Our Thoughts:

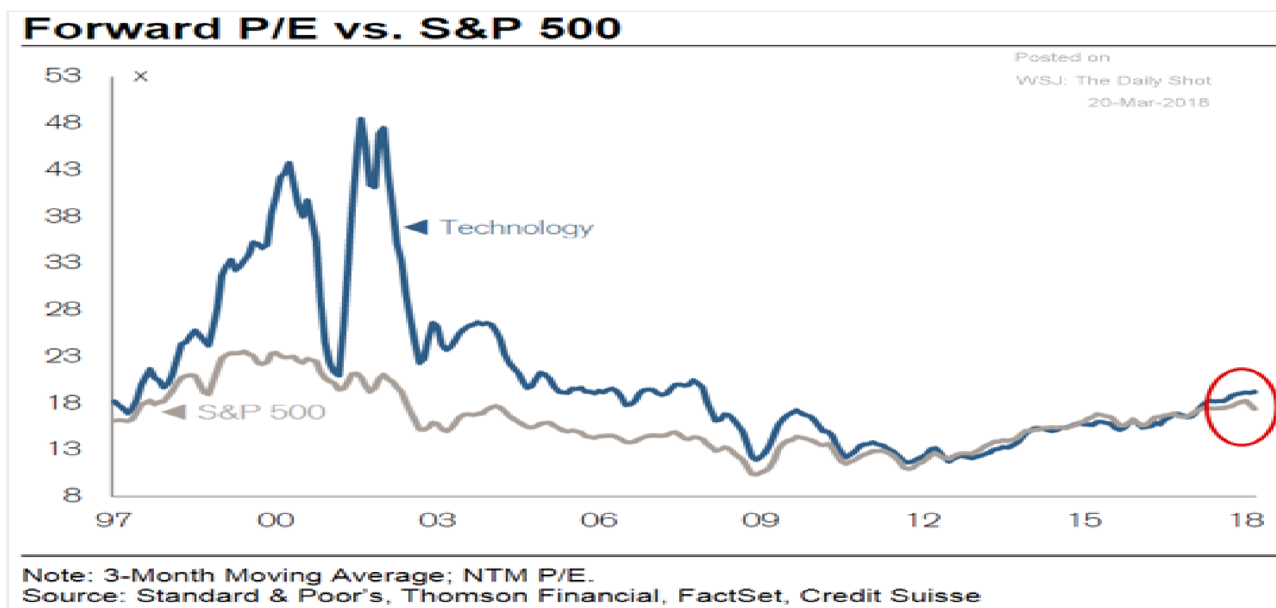
When we fast-forward 1 to 2 quarters, we do not envision a trade war with China will have ensued. We believe that certain nations will mobilize and begin to negotiate with the US over various trade policies. Ultimately, we believe calmer heads will prevail and negotiations will lead to better relations. Maybe this is the first salvo for the US re-entering TPP? We do not believe protectionist policies are wise in such a global and intertwined market.

Just a few days after harsh words and loud rhetoric that sent global stock markets reeling, quiet talks have begun between the US and China on trade issues. Behind-the-scenes discussions between the two most important economies in the world will shortly ensue and ultimately should soothe concerns. Over the next few weeks and months, this uncertainty will continue to spook the market. However, we believe that President Trump will begin to fully appreciate that protectionist tariffs undermine his tax reform win, deregulation success and a rising stock market. Even Chinese President Xi knows he needs continued rapid growth to prevent political unrest. China will gradually open up its markets, but it will do so at its own pace. The government of China will make gradual market reforms and will not react well to threats by President Trump.

The reality is that the $375 billion annual US trade deficit with China is a multi-faceted problem. The US has an overall trade deficit of 3% of GDP because Americans like and want to consume more than we produce. There is no doubt that these kinds of dips can be trying, but we have proven over time to be able to weather these market gyrations quite well. Only time will tell if we are right and this is another market overreaction. While this does nothing to make the recent downward swing any less painful, we are always looking for individual stock pullbacks that make certain companies more and more attractively priced. A few months ago, many market pundits were stating how expensive the market was in comparison to historical norms. After this sharp move lower, valuations are becoming more attractive.

Valuation:

Using the dot-com bubble as an example, most analysts do not see a similar level of significantly elevated valuations. Using a forward Price to Earnings or P/E valuation as a simple guide, one can see that valuations are nowhere near the levels the market was placing on technology stocks back in 1999 and 2000. In fact, the overall S&P 500 continues to trade at forward multiple very close to the technology sector. In late March, the forward P/E of the S&P 500 dipped below 17x. This is the lowest valuation it has traded at since early 2016. On the earnings front (the "E" in P/E), the S&P 500 is expected to grow at 16% year-over-year in the first quarter. This is the highest earnings growth since the first quarter of 2011.



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Conclusion:

The stock market likes stability, predictability and certainty. Despite numerous, mostly political issues, the market in 2017 was fairly calm. Volatility was non-existent, and the S&P 500 rose an impressive 21%. Volatility is back in 2018 and the market has gone from tranquil to nervous. Trade conflicts are clearly today's biggest worry. Corrections are natural and healthy, but it does not alter our investment strategy, philosophy and process. If anything, these short-term issues can be wonderful opportunities to increase our weights in great growth companies.

The underlying economic prowess of the US is unparalleled. We are entrepreneurial, globally competitive, natural resource rich, with a growing population of educated youth. Despite numerous threats from DC, Congress just passed a $1.3 trillion spending bill, that will boost federal spending by $300 billion over the next two years. Not only will this act as additional stimulus to our economy, but the positives of tax reform are just now beginning to flow through to businesses. The overall tech sector, which now represents roughly 27% of the S&P 500, had nearly 90% of its companies beat consensus revenue estimates last quarter. On earnings calls, managements teams are confident in underlying fundamentals and are guiding to excellent future growth. We strongly believe that the stock market and individual company share prices correlate and reflect their underlying fundamental strengths or weaknesses.

Nobody has perfect clarity into macro and geopolitical issues, nor can one safely predict these outcomes. The challenge for the Fed will be to see continued labor market improvements and inflation begin to approach its 2% target while slowly raising interest rates and not to unnecessarily burden the economy and its consumers. Economists will continue to debate the merits of these tariffs, government spending and the already passed tax-cut stimulus. The market will continue to price in the constant tug-of-war between positives and negatives. Our value add is to analyze the environment and attempt to frame how different scenarios will impact our portfolio of concentrated Fin Tech companies. As bottoms up, fundamental research analysts, focusing 100% of our attention on a great, secular growth sector, our advantage is knowing our companies well and keeping a close eye on their growth prospects. With valuations now more reasonable, unemployment at historic lows, business growing briskly, and an economic outlook that remains long-term positive, we think the US economy is in good shape. We believe that the way to win a trade war is to avoid a trade war. Are there problems or issues to concern ourselves with? Absolutely! However, we believe that with higher interest rates and elevated volatility, our portfolio is especially positioned to succeed.

We remain grateful for your trust and we are always available should you wish to chat.

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Credit Card Debit:

- US household credit card debt is approaching $1 trillion
- Per US household, average credit card debt is $8,109
- We worry about credit sensitivity, delinquencies and the rising levels of household debt
- Instead, we focus on transaction processors, that are agnostic to credit
- Examples are payment networks, merchant acquirers & processors

Student Debt:

- 44.2 million Americans with student loans and $1.48 trillion of debt
- 4.6 million Americans are behind on their payments, 22% have defaulted, up 17% year-over-year
- Average monthly student loan payment (for borrower aged 20 to 30 years): $351

Cash Balances at Online Broker Dealers:

- Are retail investors fully invested or are they missing out on this historic bull run?
- We like to use net new assets and cash balances at large retail online brokers as a good gauge
- TD Ameritrade brought in $88 billion last year and its clients have cash balances in the low-teens of total assets
- Charles Schwab raised $199 billion of net new assets last year, with 10.9% of its $3.4 trillion of assets in cash

Cash Balances at Banks:

- Back in 2007, no bank had more than 10% of US deposits held
- A decade ago the top 8 were BAC, JPM, Wachovia, WFC, Citi, WaMu, US Bank and Suntrust
- Our 3 largest US banks have added more than $2.4 trillion to domestic deposits and now all exceed 10% share
- This is 180% increase and is directly tied to the trio of lenders doing big, bailout deals during the Financial Crisis
- Now, the top 8 are BAC, JPM, WFC, Citi, US Bank, PNC, TD Bank and Capital One

CryptoCurrencies

- 72% or 123 of the 171 crypto currencies were started in 2017 and are less than 1 year old
- In terms of energy consumption, bitcoin mining uses the equivalent of what would be the 45th largest country
- Bitcoin volumes are down approximately 70% from late in 2017
- Coinbase has gone from the #1 downloaded app on Apple's iTune site, to not even being in the Top 200

Mortgages

- The average rate on a 30-year fixed-rate mortgage was 4.45%, up from 3.95% earlier this year
- The overall mortgage market fell 12% to $1.8 trillion last year
- In 2012, re-financings were 72% of originations, but that fell to 37% last year (lowest level since 1995)

Payments:

- There are still over 19 billion paper checks written each year
- Only 2% of US credit and debit transactions are authenticated with a PIN number
- The avg time a chip card takes to occur at the point-of-sale is 3.6 seconds
- According to Visa, counterfeit card fraud is down by 70% over the last 2 years (due to EMV or chip in card technology)
- The percentage of consumer transactions still done in cash are (per EuroMonitor): Japan 62%, US 32%, Britain 22%

Trade Deficits / Capital Surpluses:

- Trade balances are <u>not</u> the key ingredient to US prosperity
- Since 1976, America has run trade deficits for 42 consecutive years
- During the "Reagan Revitalization", strong economic growth occurred despite the trade deficit to GDP increasing 4x
- During the "Clinton Boom", the trade deficit to GDP also quintupled
- During the weakest post-war recovery, from 2009 to 2016, the trade deficit barely changed
- During 4 of the last 5 recessions (1980 through 2008), the trade deficit shrank

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Must Read's:

- A personal favorite and "must read" for us is Warren Buffett's annual review of Beskshire's results

"We have a deep appreciation for the competitive position of a business. In business school, they teach finance and strategy as different disciplines. But if you are an investor, you have to consider them together. You can't do a proper valuation without understanding the competitive position of a company within its industry, and the litmus test of a strategy is whether it creates value. It is shocking how few investors—as opposed to speculators—are truly rigorous in their assessments of competitive advantage. The final area is decision making. We are all subject to using heuristics and the associated biases that come along with them. How can we weave into our process ways to manage or mitigate those biases? As Charlie Munger has said, the goal is less to be brilliant than to not be dumb."

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