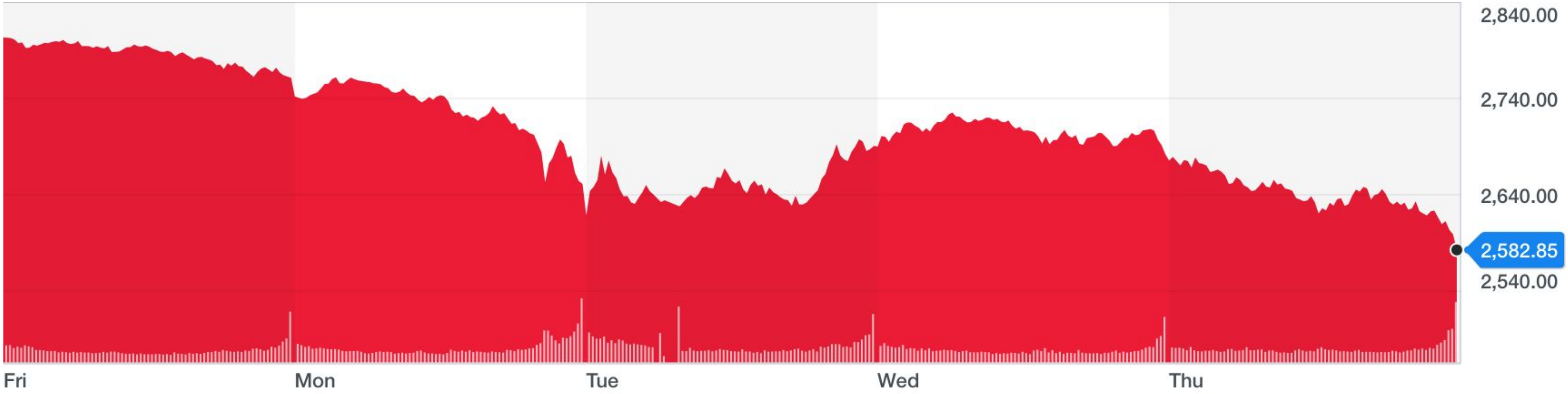
IC Meeting

2/9/18

Market Update

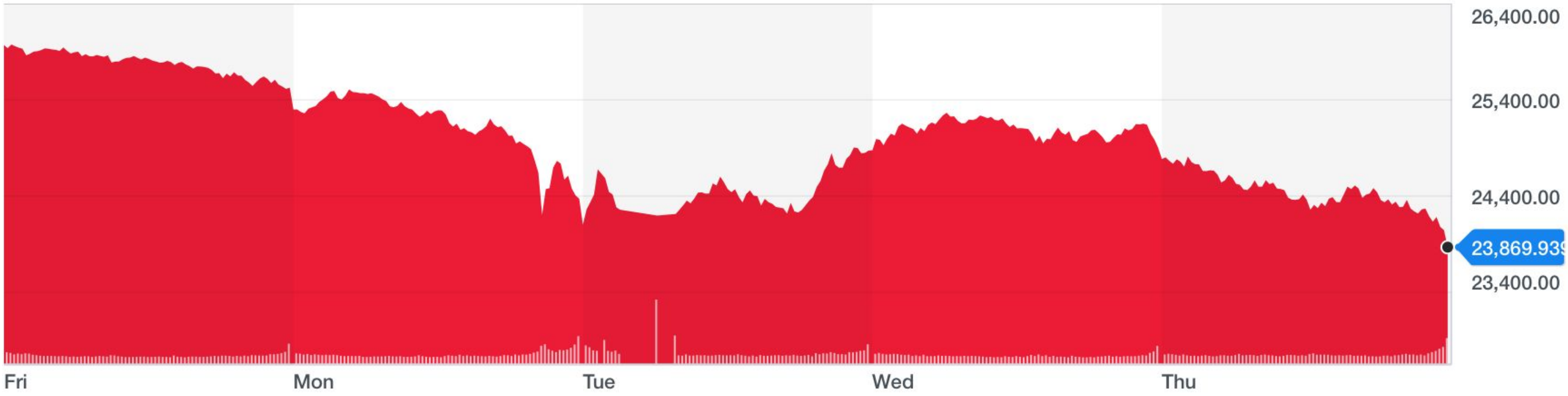
Colin Evanko

S&P 500



- Began at 2,803.09 on Friday, ended 2,582.25 on Thursday
- 7.9% drop

Dow Jones



- Dow began at 25,969.119 and ended at 23,869.939
- Over 9% decrease in value since friday

Dow Reaches Correction

- Last time a correction occured was February 2016
- A correction is a drop in 10% of the industrial averages value
- Many investors believed a correction was due
- Dow is down 10% from its high on January 26th
- Rising Interest rates and newfound volatility are contributing factors

Congress Passes Budget Deal to Prevent Shutdown

- House and senate came together (for once) to pass a spending bill to prevent a government shutdown
- Trump signed the 2 year spending bill this morning
- Compromise a sign of future cooperation between republicans and democrats?

Amazon Launching Delivery Service

- Amazon is launching a delivery service to compete with Fed-Ex, and UPS
- Beginning in Los Angeles and plan to expand
- Possibility of a large decrease in jobs for Fed-Ex and UPS employees, but also could contribute to a sharp rise in “Shipping with Amazon” employees
- Likely going to be less expensive than shipping with Amazon or Fed-Ex

Retail Jobs Unaccounted for

- Labor Bureau reported loss of 67,000 jobs in the retail industry
- Largest of any industry
- The Labor industry does not account for increase of jobs in brick in mortar
- Companies like amazon opening up large facilities where thousands are being employed
- Technology often diminishes a market, but most fail to see how the new market makes up for it

Market Outlook

By: David Perron and Sidney Michelini

Our Philosophy

- We are a club designed for the VERY long run
  - Our only goal is to preserve and grow equity for the next generation
- Due to our unique situation, we don’t really need to worry about market corrections
- Instead, we focus on making sure we buy and own companies that will be competitive over the next 10-20 years
- Rule of Thumb: Never buy a stock you think you will sell at any point in your time here

Why this matters?

- Investing isn’t about just making money. It's about taking on the correct amount of risk and potential rewards to meet your financial goals.
- Because our goals are long-term growth, we can engage in a buy and hold strategy that allows us to wait out bear markets.
- It also means that we should always pick stocks that we see as growing and maintaining their market share over decades.

What has happened in the last 10 years?

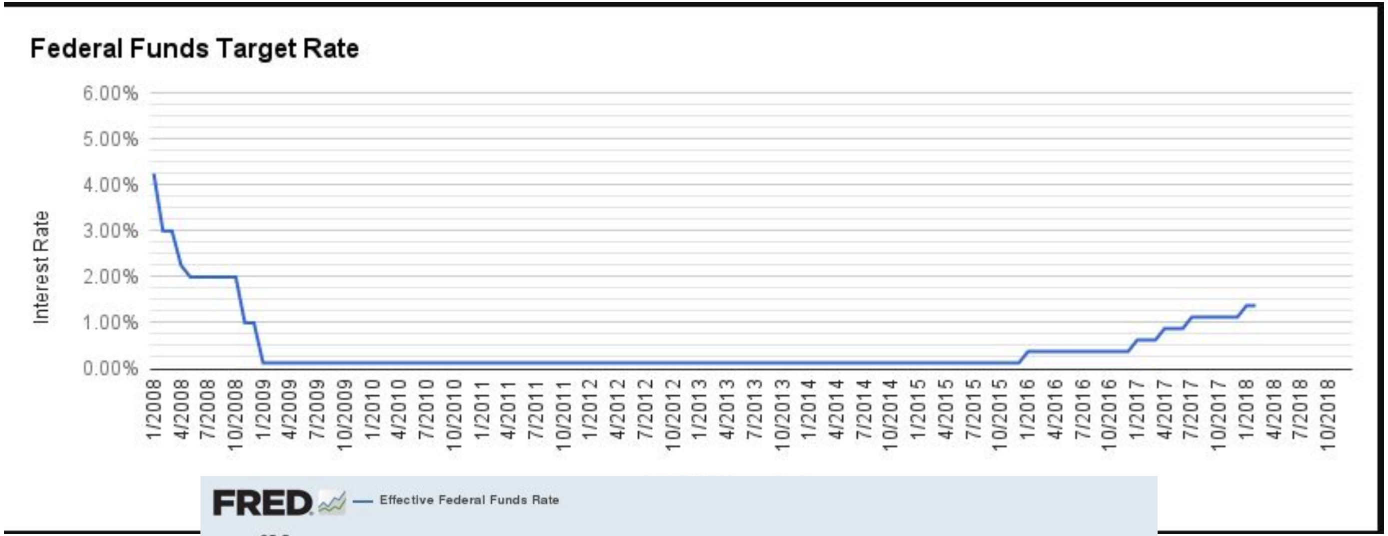
-The Federal Reserve slashed its FFR and kept interest rates at ultra-low levels

-When the Federal Reserve Board (the Fed) changes the rate at which banks borrow money, this has a ripple effect across the entire economy

-When consumers pay less in interest, this gives them more money to spend, which can cause increased spending throughout the economy

-Also keep in mind that interest rates are used to manage inflation: higher interest rates mean higher borrowing costs, people will eventually start spending less. The demand for goods and services will then drop, which will cause inflation to fall

-The stock market (and our portfolio) have benefited greatly from these low interest rates and the now over 9 year bull market. S&P 500 Total Return of ~ 151% last 10 years if you reinvested dividends.


Federal Funds Target Rate
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
Interest Rate
1/2008
4/2008
7/2008
10/2008
1/2009
4/2009
7/2009
10/2009
1/2010
4/2010
7/2010
10/2010
1/2011
4/2011
7/2011
10/2011
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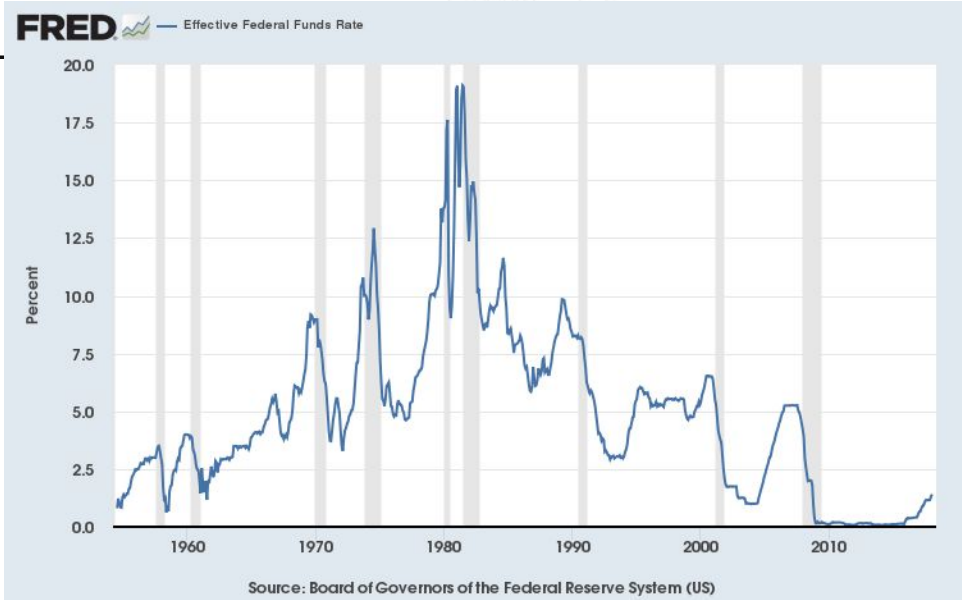

FRED
Effective Federal Funds Rate
20.0
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
Percent
1960
1970
1980
1990
2000
2010
Source: Board of Governors of the Federal Reserve System (US)

What has happened- Continued

-The Fed quadrupled the size of its balance sheet from less than $900 billion to roughly $4.5 trillion from 2008-2014

-3 stages of QE. Program resulted in $2 trillion in Treasuries purchases and $1.8 trillion in MBS

-After QE ended in October 2014, Fed maintained size of its balance sheet through reinvestment of principal proceeds from maturing securities

-The Fed's purchase programs suppressed bond yields below their natural market levels

Table 1 Quantitative easing phases timeline

QE I Balance sheet composition change from solely Treasuries to Treasuries and Agency MBS focus	
Nov. '08 - Mar. '10 (17 months)	Initially purchased $500B in MBS and $100B in agency debt from Fannie Mae, Freddie Mac, and Federal Home Loan Banks; later expanded mortgage purchasing program to purchase an additional $750B in MBS, $100B in agency debt, and $300B in longer-term Treasuries
	Total Purchases: $175 billion in agency debt (less than previously announced $200B), $300B in Treasuries, and $1.25 trillion in MBS
QE II Treasury Large-Scale Asset Purchase Program	
Nov. '10 - Jun. '11 (8 months)	Purchased $600B in longer-term Treasuries and reinvested QE1 principal payments of $167B
	Total Purchases: $767B in longer-term Treasuries
Operation Twist: Extend from short-term into longer-term Treasuries	
Sep. '11 - Dec '12 (16 months)	Purchased longer-term Treasuries with maturities of 6 to 30 years and sold short-term Treasuries with maturities of 3 years or less to extend the average maturity of holdings
QE III Reducing pace of Treasury and Agency MBS purchases	
Sep. '12 - Oct. '14 (26 months)	Purchased mortgage-backed securities and long-maturity Treasury securities, initially set at $40 billion in MBS per month and $45 billion for long-maturity Treasuries per month
	Taper Tantrum (Dec. '13): Announcement that the Fed would reduce the pace of purchases by $85B per month causing violent market reactions
Reinvestment Policy for maintaining size of the balance sheet	
Aug. '10 - Present	Replaced maturing securities to maintain a constant balance sheet size when no QE program is underway

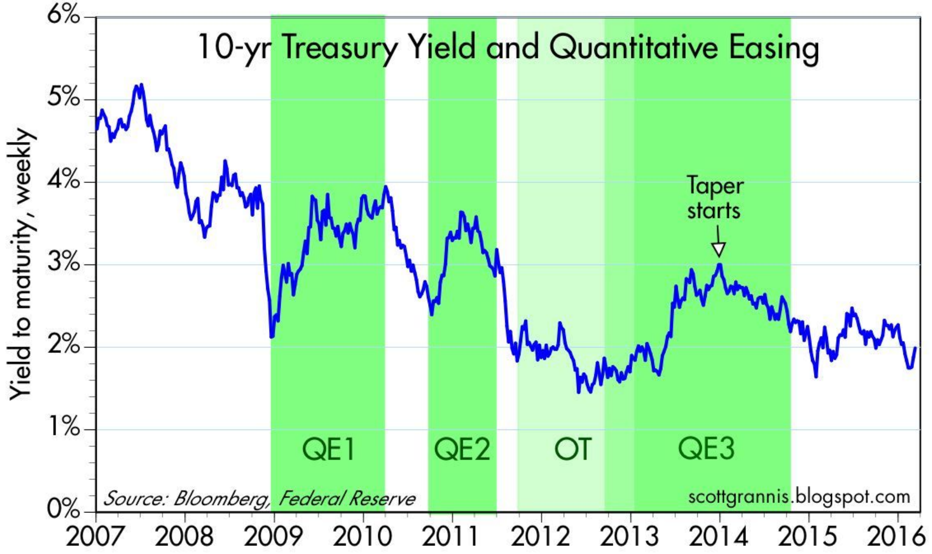
Note: MBS refers to agency MBS from Fannie Mae and Freddie Mac. Sources: Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York.

What is happening today?

-In October 2017, the Fed started to ‘normalize’ and shrink the size of its balance sheet

-Fed has raised interest rates 5 times since 2015, and is expected to hike rates in 2018 (current FFR is 1.25%-1.5%)

-We are in a time where stock and bond prices are historically high, the future outlook for each looks worrisome



Recommendations

- Rebalance- Markets have shifted wildly in the past year and we need to make sure that we have the correct weighting of all our positions. Rebalancing would make us much better prepared to manage downside risk and consolidate gains.
- Prepare for lower performance over the next few years- Assets are expensive right now and after the great performance last year, there may be limited room for future expansion. Not a reason to panic, but we should be prepared for lower returns.
- Potentially move into safer equities to protect against downward price movements. We should stay in the stock market, but we can always invest our cash or rebalancing money into safer stocks.

Leverage

Jeff Sikorsky

What is leverage?

Thanks for asking.

Leverage is just borrowing money to purchase assets

Common example is margin trading

Margin Trading

Trading on Margin means you are borrowing money for the purpose of investing it

Ideally, investments go up, you pay back the money you borrowed and keep the gain

When used correctly margin can be a powerful tool

The access to more capital allows you to do more than you could

Leverage is also used in acquisitions and buyouts (LBO= Leveraged Buy Out)

Margin Trading Dangers

Can be devastating if used by someone who doesn’t know what they are doing or if something goes wrong

In the case of margin, investors can get a Margin Call if their investments they purchased on margin dip below a certain threshold

Example: I borrow money from Adam to buy Tesla stock. Right after I buy it, Tesla stock drops after Elon Musk tragically perishes in a rocket crash. I now have a debt that I owe to Adam that I better figure out how to pay back.

I was going to pay him back with what I thought were gains, hopefully I can afford the loss

ETFs

ETFs are Exchange Traded Funds

When companies build an ETF, they raise money and buy stock in a lot of different companies

People can then purchase shares of the ETF just like a stock, and they are now able to diversify to a lot of different companies without having to own them all

Very popular investment strategy, typically looked at as safe

Leveraged ETFs

ETFs that utilize leverage and other financial derivatives to applify gains

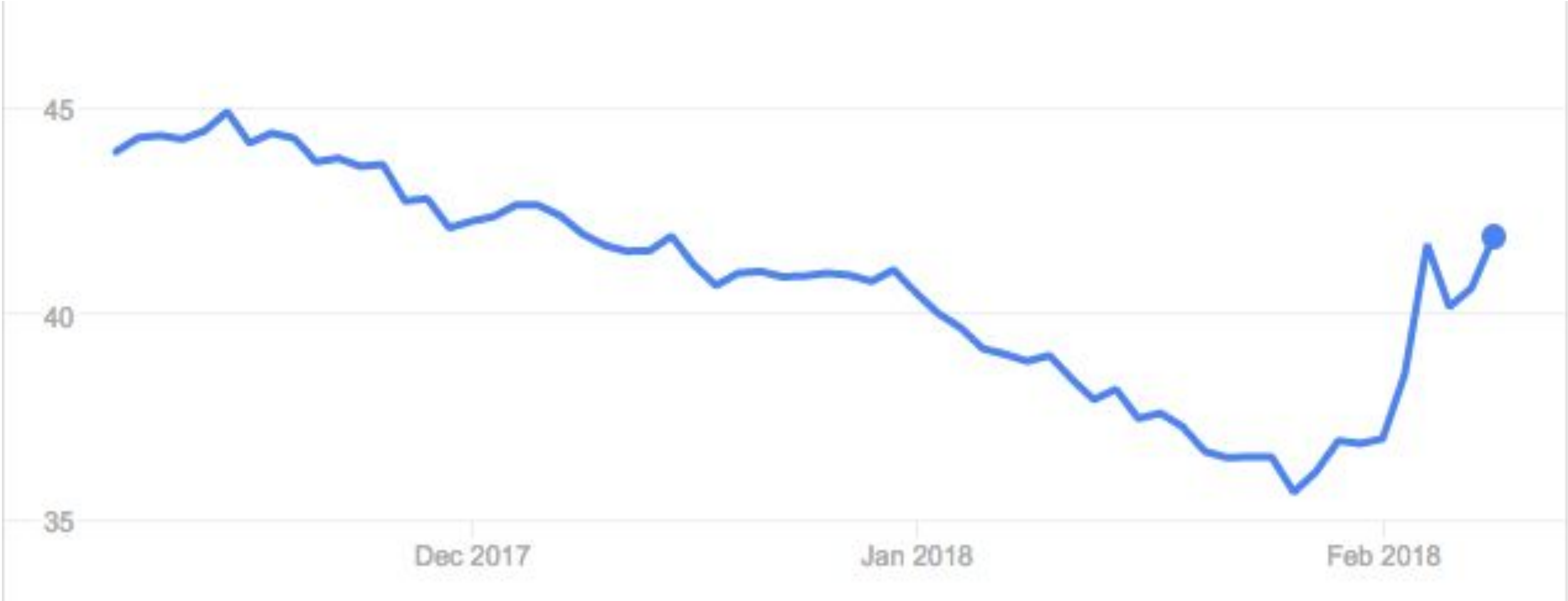
High risk, typically short term investments

Example $SDS **ProShares UltraShort S&P500 ETF**

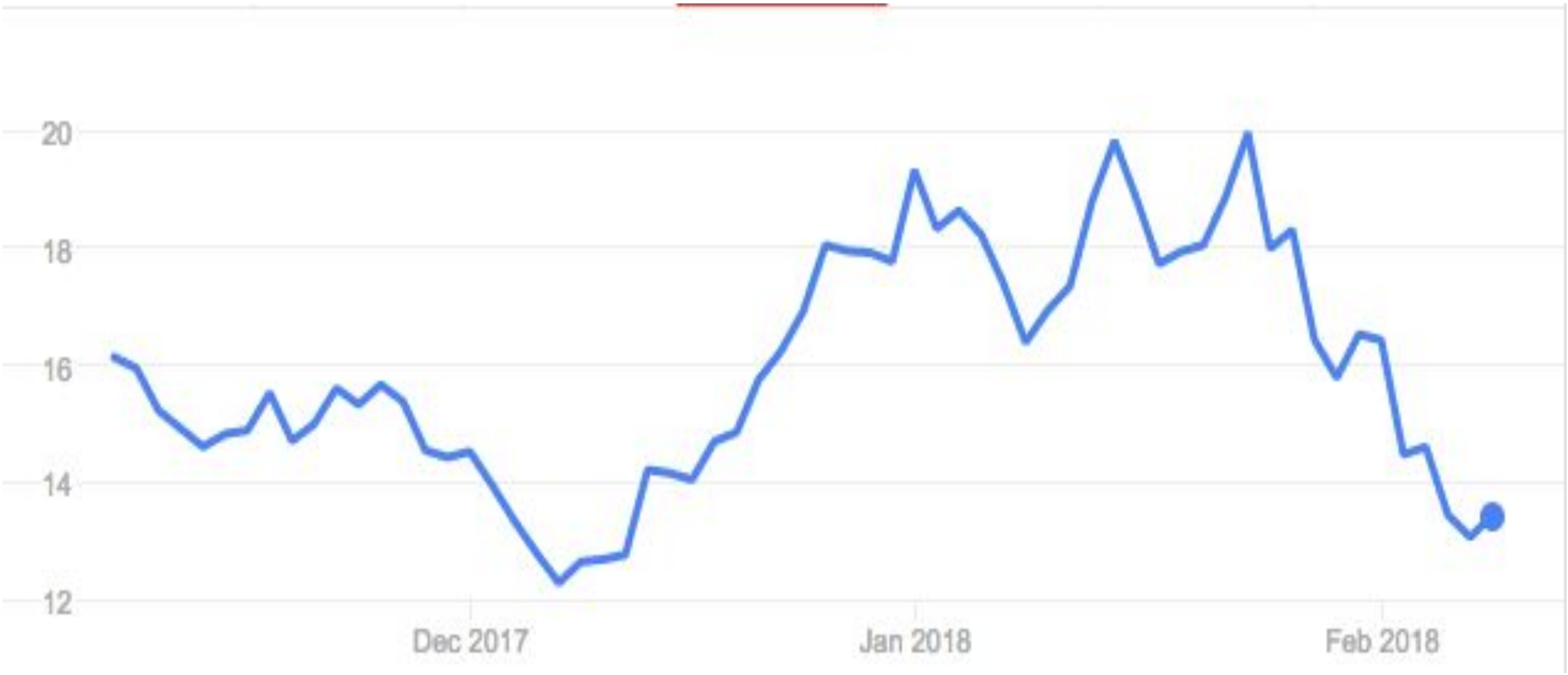
Uses leverage to match 2X the inverse of the daily movement on S&P 500

JNUG- 3x leveraged Gold Miners ETF

$SDS 3 month



$JNUG 3 Month



Market Signal?

More and more of these highly levered ETFs are being created and traded by investors.

They are extremely risky, and can blow up in people’s faces. (XIV)

People are also trading at the highest amount of margin ever recorded

Market is propped up on 600 Billion in Margin Debt

Graph shows margin (inflation adjusted) as compared to the S&P 500. Notice 2007


ADVISOR PERSPECTIVES
NYSE Margin Debt and the S&P 500
Real Values (Adjusted to Present-Day Dollars)
dshort.com
December 2017
Recessions
NYSE Margin Debt
S&P 500
Billions
Margin Data Through November 2017
600
500
400
300
200
100
3,000
2,500
2,000
1,500
1,000
500
0
1995
1997
1999
2001
2003
2005
2007
2009
2011
2013
2015
2017
2019

Carl Icahn

Said the amount of margin in the market is like a “Casino on steroids”

Described leveraged ETFs as, “The fault lines that will eventually lead to an earthquake on Wall Street…Maybe eventually worse than 1929”

Cause for concern?

Externship Chat

Mac, Jon, David