Industry Review – Betwixt mild fatigue and low-intensity stress

May 2019

Global GDP growth tracking for Q1 remains at a 2.8% - this stability masks a few important changes, at least on the national level. For one, Q1 US GDP growth came in 0.3%-pt stronger than expected at 3.2% but the global nowcaster points to much slower global GDP growth last quarter at 2.4% than the official forecast at 2.8%. Although global aggregates show activity bottoming this spring at a higher pace than EJR expected, momentum is not seen being uniform across regions. Central bank reactions, too, have been simultaneous – Fed dovishness led in January and other Developing and Emerging Markets' central banks are following – which partly explains recent FX swings.

During Q1, Consumer spending (0.82%), private inventory investment (0.92%), net exports (1.03%), state and local government spending (0.41%) and nonresidential fixed investment (0.38%) were all positive contributors for U.S. GDP growth, though consumption did slow (down from 1.66% to 0.82%). Net trade and inventories alone equated for half the growth - the most since Q4 2011.

Most markets are now signaling something between mild fatigue and low-intensity stress - reflective of last year's macro themes – imbalanced growth, monetary policy divergences and EM missteps. These if persist, will challenge the otherwise bullish prospects for U.S. markets.

Till Now…

S&P500 made a new all-time high in April, with the U.S. marginally outperforming other key global indices while weaker macro data continued to weigh in Europe. Within sectors, Tech and Healthcare were the key outperformers.

EJR notices that the investor positioning is still light, and that the equity rebound is likely to get a fundamental support into H2 2019 with the recent stabilization in Global PMIs. Market consensus expects S&P 500 companies could deliver 4-5% earnings surprise on better than feared margins. The above-trend revenue growth of 5% is indicative of healthy demand while lower margins are largely due to temporary factors.

On an interesting note, the proportion of bonds paying less than zero percent interest increases to one-fifth of the market, a 16-month high, according to Bloomberg. After the Federal Reserve turned more dovish than expected, investors have turned to safe havens, which led to lower Treasury yields and a yield curve inversion. A Bloomberg index tracking outstanding negative-yielding debt pushed past $10T and was seen hovering at the

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highest level since September 2017. Negative-yielding debt accounts for more than 19% of the market value of the Bloomberg Barclays Global Aggregate Bond Index, which tracks a range of global investment-grade debt from Treasuries to corporate and emerging-market issues.

World

ETF or ETN	Today	3 Mths	1 Yr	YTD▾
Global 100 (IOO)	0.3%	11.9%	8.9%	16.2%
World Index (ACWI)	0.2%	9.5%	4.9%	15.9%
Global 50 (DGT)	0.4%	7.0%	3.1%	13.7%
World ex-U.S. (SPDW)	0.4%	6.5%	-4.0%	12.9%
International Small Caps (GWX)	0.3%	4.5%	-11.2%	10.4%

Emerging vs. Developed Markets

ETF or ETN	Today	3 Mths	1 Yr	YTD▾
Emerging Markets (ADRE)	0.4%	7.7%	-2.7%	15.6%
Developed Markets (ADRD)	0.4%	7.0%	-3.5%	12.2%
Developed Market Value (EFV)	0.3%	4.7%	-7.2%	10.3%
Emerging Markets Small Caps (EWX)	-0.3%	4.7%	-9.2%	10.2%
Frontier Markets (FM)	-0.5%	0.6%	-12.0%	8.2%

Regions

ETF or ETN	Today	3 Mths	1 Yr	YTD▾
Pacific ex-Japan (EPP)	0.1%	8.5%	4.3%	15.4%
Emerging Asia Pacific (GMF)	0.3%	9.1%	-1.7%	14.6%
Euro Zone - Large Caps (FEZ)	0.6%	9.1%	-6.1%	14.5%
European Monetary Zone (EZU)	0.6%	8.1%	-7.4%	14.3%
Europe - Large Caps (FEU)	0.4%	10.5%	-1.5%	13.8%
Europe (ADRU)	0.7%	7.8%	-3.2%	12.8%
Asia 50 (ADRA)	0.5%	6.5%	-3.3%	12.4%
Scandinavia (GXF)	1.1%	6.0%	-0.5%	9.7%
Latin America 40 (ILF)	-0.4%	-0.2%	-6.5%	9.2%
ASEAN (ASEA)	0.6%	1.9%	-6.0%	6.8%

Broad Markets

ETF or ETN	Today	3 Mths	1 Yr	YTD▾
Developed Markets Small Caps (SCZ)	0.3%	6.6%	-8.1%	14.1%
International Small Caps (GWX)	0.3%	4.5%	-11.2%	10.4%
Emerging Markets Small Caps (EWX)	-0.3%	4.7%	-9.2%	10.2%

Source: https://seekingalpha.com/etfs-and-funds/etf-tables/

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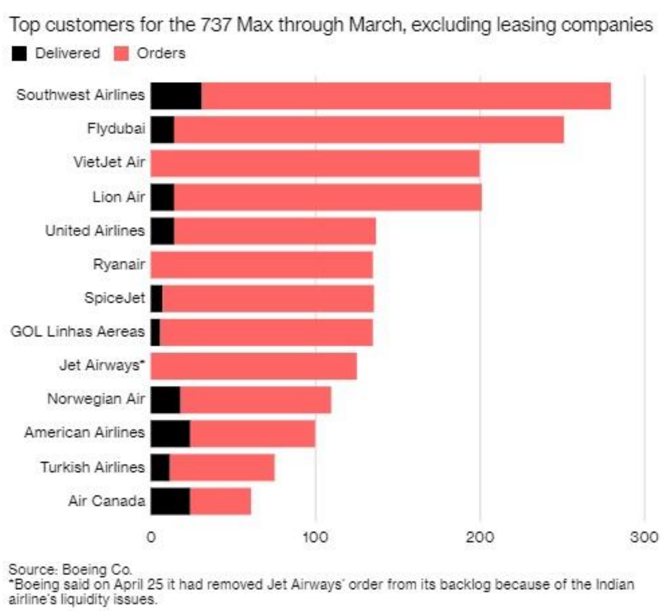
Below is our summary of the major industries:

Deteriorating:

Agriculture Prices/Ag Chemicals – Agri market participants have adjusted to the 'new normal' of a persistent US-China trade war talk. Volatile agricultural commodity prices are likely to be tied to: i) low farmer income; ii) commodity oversupply; iii) low fertilizer cost; and iv) industry consolidation. Any improvement in the US-China trade relationship is a materially bullish risk factor for agri markets.

Airlines – Airlines are struggling to deal with the financial fallout from the extended grounding of the Boeing 737 Max commercial jetliner. Southwest and American Airlines, the two U.S. airlines that owned 737 Max 8 aircraft when they were grounded on March 13, both warned investors of extended losses due to the crisis. American Airlines executives expect the grounding would cost the airline about $50 million in the first three months of 2019. The company expects to lose out on $350 million in 2019 assuming the grounding order is lifted by August 19. Further, Southwest Airlines has reported that Boeing did not disclose that certain safety features on the troubled 737 Max aircraft were not "operable", raising further questions about poor communication between the manufacturer and its customers. The main operators of Boeing 737 Max include Southwest (31 in the fleet through February), American Airlines (24) and Air Canada (24). Chinese airlines account for about 20% of 737 Max deliveries globally.



Beverage – This slow-growth industry is in a weak spot. Specifically, rise in tariffs is weighing on U.S. whiskey exports. American whiskey exports slumped in the second half of 2018, taking a blow from higher duties by the country's trading partners following Trump's tariffs on steel and aluminum imports. Canada, China, Mexico and the European Union have levied import duties ranging from 10 percent to 25 percent on U.S whiskey and bourbon last year, resulting in a 11 percent drop in U.S. whiskey exports in H2 2018. Earlier in March, Brown-Forman said its sales would take a hit in 2019 if the tariffs were to remain in place.

Health Insurance – The DOJ submitted a two-sentence letter to the Fifth Circuit Court announcing that it now thinks the entire ACA should be thrown out. Recall that back in December, Judge Reed O'Connor ruled that eliminating the Individual Mandate penalty renders the entire ACA framework unconstitutional.

Retail – Amazon (and other internet giants) will destroy margins for any industries involved in selling goods, and over time, services. U.S. retail sales surged in March at the fastest pace since late 2017. Spending on autos, gasoline, furniture, and clothing jumped. Sales increased 1.6% from February, the strongest increase since September 2017 - a pos. But what is of more worry, is that by the end of March 2019, retailers - including Dollar Tree, Abercrombie & Fitch, Kohl's, Gap, J.C. Penney, Victoria's Secret and Tesla - have already announced 4,810 store closures in 2019. According to Coresight Research, the closures far outweigh the openings, leaving real estate owners hunting for new businesses or unique concepts to fill empty storefronts. Last year, Coresight tracked 5,524 store closures, down more than 30% from a record 8,139 closures announced in 2017.

Media – Netflix, NBCUniversal, WarnerMedia amongst other internet distributors, and non-traditional media outlets continue to dis-intermediate traditional media providers and cable firms. Rising competition and increasing programing costs are key factors to watch out for. Note, print media continues to suffer. EJR expects M&A activity will continue in the media sector, though note potential deals will likely be smaller in size with limited debt financing. Over-the-top and non-linear programming trends will likely reduce cable net adds again in 2019. Rising programming costs and consumer backlash to price increases limit pay TV profitability and has led to public battles pitting content providers against pay TV operators.

Metals and Mining – Some have been given a reprieve as a result of increased demand, rising prices, and expectations of a more amenable regulatory environment. China's official manufacturing PMI (China PMI) reading for April, will be a key data point for global risk assets and metals markets. The top steel mill in China has issued a one-two warning about the outlook, saying it sees the twin risks of slowing demand and rising output in the country that accounts for half of global production. EJR doesn't rule out bigger M&A on the cards and this is further strengthened by Freeport CEO saying that base-metals mergers and acquisitions are "inevitable." during the company's first-quarter earnings call.

Power Generators – This industry faces a triple threat: 1) tighter margins (revenues are often tied to the price of natural gas), 2) more burdensome regulations (i.e. the new federal

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carbon limits), and 3) reduced demand as a result of solar and wind generation as well as LED lighting and efficient appliances. Pres. Trump's pledge to revive the U.S. coal industry and roll back Obama-era restrictions on emissions – is too late for many companies. Nationwide temperatures were normal on average, though unfavorable weather in the key January-February period as well as select regional shortfalls are notable. For Q1'19, US heating degree days were in line with normal weather, or a 5% improvement YOY. That said, several regions showed substantial deviations from normal, including the Southeast (South Atlantic, E S Central both -12%), Plains (W N Central +8%), and Pacific (+11%).

Restaurant Industry - We see an elevated discounting / promotional environment which coupled with rising food inflation will weigh on the margins. We do expect momentum to improve across the casual dining category in terms of foot fall. Same-store restaurant sales fell 0.61% in February to end eight straight months of positive growth, according to tracking conducted by TDn2K, but have returned to positive sales growth during March. Same-store sales growth was 1.2 percent for the month and 1.0 percent for the first quarter (average growth by month was 0.8 percent during the first three months of the year). The restaurant industry has posted four consecutive quarters of positive same-store sales growth for the first time since 2015. Of 196 markets tracked by Black Box Intelligence, 147 (or 75 percent) achieved positive same-store sales growth during the month. This represented a solid rebound for the industry after February, with bad weather hampering sales and only 44 percent of markets posting positive growth during that month.

Poland/Hungary - European Union's regulatory arm proposed a new method for distributing regional aid under its first post-Brexit budget, shifting part of the funds from eastern Europe to countries in the south of the continent that face unemployment and migration challenges. Funds for Poland would shrink to €64.4 billion compared with almost €84 billion in the 2014-2020 fiscal plan, while Hungary would see a decrease of around 24% to €17.9 billion.

Argentina/Turkey - As widely expected, the Turkey's central bank kept its key policy rate unchanged at 24.0%. The surprise was the change in the language in the interest-rate announcement. The CBRT sounded more cautious and referred to higher food and import prices as well as elevated inflation expectations as key risks to price stability. More importantly, the Bank removed its pledge to "deliver further hikes if needed" and adopted a neutral bias stating in the policy guidance - a positive. Turkish indices tracking confidence in services, retail and the construction sectors showed little change in April as an economic downturn persists. Confidence in the services sector, which is seasonally adjusted, rose to 83.1 this month from 81.6 in March.
Argentina's economy suffered its worst shrinkage during the tenure of President Mauricio Macri. Argentina's GDP fell 2.6% in 2018, underscoring the turmoil that dragged the South American country into recession last year. In 2018, Argentina experienced a currency

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crisis and stagflation. Annual inflation reached 47.6%, GDP fell by 2.5%, and unemployment and poverty increased.

Venezuela/Possibly Greece – The countries' debt is not sustainable and it is merely a matter of time before there is another restructuring. Greece's central bank said it expects the economy to grow 1.9 percent in 2019, less than the government's projection of 2.50 percent growth. high taxation coupled with high primary budget surpluses could hinder the recovery.

Telecom – Regardless of whether or not the Sprint + TMUS deal goes through, EJR expects wireless competition to remain. If approved, S+TMUS, the industry will focus on transition and building scale. And if the TMUS, S merger falls through, focus will shift towards profitability to fund network needs**.** The year is off to a solid start for large-cap telecom and wireless carriers with generally positive share price performance YTD. The combination of lower seasonal volumes, lengthening phone replacement periods, and slower add-on volume could be good for wireless margins.

Traditional Retailing – Continued strength in consumer spending supports the traditional retail growth story. As long as jobs, wages, and wealth remain on current favorable trend, healthcare, taxes, and debt service should not be a concern. Non-store retail continues to outpace with double-digit growth of 10%. Clothing and accessory stores were up slightly year to date at 1%, while Department stores lagged at down ~4%. For 2019, EJR expects to see a lower likelihood for accelerating growth across the P&L. Most of the companies are lapping elevated top-line gains from a strong consumer and increased marketing investments (thanks to tax cuts) as well as a less inflationary cost environment.

Improving:

Chemicals – The chemical industry is riding an upturn in the world economy and continued strength across major end-use markets such as construction, automotive and electronics. Another positive for the industry is a recovery in demand in the energy space – a key chemical end-market that had been out of favor for a spell. The recovery has been driven by the rebound in crude oil prices from their historic lows.

Defensive Industries – Alcohol, defense are traditional defensive credits and continue to be so.

Infrastructure – Watch for massive improvements for firms connected to building; an infrastructure act will enhance the gains.

Packaging – The paper and food packaging industry was and will continue to benefit from e-commerce. However, Amazon could squeeze their margin.

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Technology – While at a slower pace than normal, tech industry spending remains robust. However, Apple will have difficulty maintaining prior growth levels. FX swings too might dent earnings in the medium term.

Neutral

Autos and Auto Suppliers – The seasonally adjusted annualized rate (SAAR) of U.S. light vehicle sales in January, reported by OEMs, tracked to an estimated ~16.7mm rate. In January, which typically tends to be the slowest sales month of the year, saw industry sales volumes decreased 1.9% YOY. EJR expect domestic auto sales to remain resilient in 2019 given the relative age of the car parc and a still healthy economic backdrop.

Banking – Banks' net interest margins face pressure from a more-dovish Fed, leading to lending spread compression, deposit re-mixing, and potential for yield-curve inversion. EJR expects markets to cut 2019, 2020 NIM estimates as Fed rate hikes are subtracted from consensus. The smaller banks are aided by the improved margins and the M&A upside.

Insurance – M&A and Weak core P&C underwriting margins, lackluster overall trends in the life & retirement business are medium term negatives. Though from a long-term perspective, the industry continues to improve with reasonable returns and continued consolidation. For life insurance companies, despite maintaining strong balance sheets and reserve levels, the prospect of higher interest rates has not come to fruition. As a result, life insurers have continued investing in riskier asset classes such as private placements, mortgage loans and mezzanine debt.

Railroads – Though Rail's good growth seems to be running out - and the overall rate of growth in 2018 which had decelerated – continues into 2019. Year-to-date (till the week ending April 20), U.S. rail traffic totaled 8.24 million carloads and intermodal units, a 1.8 percent decline from the same period in 2018. Of that total, U.S. carloads, which represented 48 percent of traffic, were down 2.7 percent to 3.97 million carloads, while intermodal units fell 1 percent to 4.27 million units. Meanwhile, rail intermodal volumes could face some competition from a looser truck market, although the railroad officials said improving service that they expect to result from the implementation of precision scheduled railroading could sway customers to rail.

REIT – General consensus is bullish on residential and industrial REITs, a relatively improved outlook for health care and net lease, and more bearish views on malls and office REITs. Vacancy ratios and leverage ratios are at cyclical lows but several REIT subsectors have begun to show signs of peaking. Notably, the retail segment has faced same store net operating income declines and occupancy rates has fallen modestly. Offsetting the decline in retail has been improvement in industrial REIT, partially due to

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ecommerce. Apartment prices have risen substantially in many cities including San Francisco and New York. Multi-family is likely to improve due to slow family formation. Suburban offices will likely continue to slide as occupancy rates decline.

Utility Distribution – Distribution firms face long-term issues associated with local power generation from solar. Nonetheless, currently firms are in decent shape. Moreover, highly leveraged utilities will probably have troubles raising equity, as the dividend yield will not be as competitive in a rising rate environment. Although the current Asian LNG and European gas price have fallen below $5/MMBtu, these are not sustainable. Asian LNG and European gas prices have fallen by more than 50% this winter because of a mild winter and LNG oversupply. Coal-to-gas switching is quite flexible in the European power market, but frictions exist along the rest of the global gas value chain: e.g. US and Eastern Australian LNG, gas supply offtake mechanism, Gazprom's pipe gas delivery, and power systems in Asia. Such frictions could let prices slip further, perhaps until sometime closer to midyear, after the market has adjusted and overcome frictions.

Need to watch:

Big Technology – Media sources say Samsung plans to lower its memory chip output next year to tighten supplies for an expected slowdown. The supply restriction would help maintain or push semi prices up. The company expects bit growth of less than 20% DRAM and a 30% rise for NAND flash. Overall semiconductor industry revenue growth is on pace to achieve 14% Y/Y growth in 2018 or ~8% ex. memory on positive demand trends during the year such as data center, automotive and industrial. The US-China trade-related slowdown combined with poor iPhone sales and auto production volatility kicked off a demand-driven correction reflected in the recent weaker than expected December earnings season. Hopefully, things recover in 2019, though signs are dimming by the month.

Credit Card Network/Processors – Acceptance of Bitcoin and other cryptocurrency would be a significant negative to the credit card network like Visa and MasterCard and credit card processor like First Data.

Exploration and Production and Servicing Firms (Energy) – As oil prices moved higher, despite natural gas prices continuing to fall, E&P index has rebounded in the YTD period. Oil prices were lifted early in the week after Saudi Arabia signaled it would reduce output in February to levels "well below" the OPEC production agreement and as the U.S. issued sanctions on Venezuela's state-owned oil company. Watch for nat gas price volatility, with the recent natural gas prices decline reflecting the possibility of the market looking beyond the polar vortex that engulfed much of the Midwest with near-term weather forecasts now calling for warmer-than-average temperatures across much of the East Coast.

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Healthcare – According to Axios, a new analysis from U.S. federal government actuaries say that Americans spent $3.65 trillion on health care in 2018. This represents $11,212 per person, with 59% of the spending going to hospitals, doctors, and clinical services. Prescription drug spending was up 3.3% year over year. Most of the increase was due to higher prices, not increased use of services. Under private health insurance, spending per person rose 4.5% between 2017 and 2018, even though the same number of people were enrolled. Members of the Senate Finance Committee grilled pharma executives during a public hearing in last month about their role in rising drug costs, and while the executives noted that they want to do something about the costs, they would not commit to dropping list prices. Expect some long-term pricing pressure to emerge in this area. Trump administration and Speaker Nancy Pelosi's staff have had early conversations about drug pricing legislation. While there is bipartisan support behind addressing rising drug costs, accomplishing anything is likely to be difficult given the administration's new stance to try to overturn the ACA in federal court.

Tobacco – The rising U.S. teen e-cigarette use threatens the tobacco market. Tobacco stocks have been swinging lower on reports that Senate Majority Leader Mitch McConnell will propose legislation to increase the legal tobacco age in the U.S. to **21 from 18**. Over the past year, the number of high school students who have used e-cigarettes in the past 30 days has skyrocketed by about 75%, as per CDC's annual National Youth Tobacco Survey. That means roughly 3M, or about 20% of high school kids, are using e-cigarettes, up from 1.73M, or 11.7% in last year's National Youth Tobacco Survey. The Food and Drug Administration move to ban menthol cigarettes, amid its ongoing crackdown on e-cigarettes would prove a particularly big blow to BAT, whose Reynolds American subsidiary paid $25B in 2015 to acquire Lorillard Inc. and Newport, the top menthol brand in the U.S. Menthols last year represented 55% of BAT's U.S. cigarette sales by volume and ~20% of sales for Altria's cigarette sales. Competition from Marijuana is a very real threat, with legal sales of marijuana in the U.S. catching up to beer and wine, potentially reaching $47B in ten years, implying a 17% CAGR. Thirty-two states have now legalized medical weed in some capacity, with the residents of Missouri and Utah also joining in. Meanwhile, residents in Michigan voted overwhelmingly to become the 10th state to legalize adult-use cannabis during midterms. California, which is already the fifth-largest economy in the world by GDP, is forecast to generate between $6B and $7B in annual cannabis sales.

Wireless Providers – Competition in wireless is heating up. We expect the change in data plans to be essentially neutral to ARPU, but watch for SG&A spend.

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