Charon Special Situations Group

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INFORMATIONAL RESEARCH UPDATE

Weekly Recap

10/29/2018 – 11/04/2018

"The company is effectively insolvent in both its financial and personnel assets. It will at best will limp along for the foreseeable future. I feel that my role in Faraday Future is no long a path that I can follow, so I will leave the company effective immediately."

- Nick Sampson (Verge)

MARKET SUMMARY

- Equities dropped off at the beginning of the week before recovering and tapering off at the end. The tumble on Monday was caused by fears that the Trump administration would escalate trade disputes by imposing tariffs on remaining Chinese imports. (NYT)
  - US appears to be joining Europe, Japan, Shanghai, Hong Kong, Argentina, and Canada in correction territory – a 10% or more drop from recent highs. Optimism for global growth has reversed from 2017 due to a slowing Chinese economy, geopolitical tensions in EMEA, the US China trade war, and tech underperformance. (WSJ)
  - Although the S&P has been dropping off, P/E ratios are falling even faster which means they have become relatively more attractive. Forward P/E ratios declined for all of the 66 companies in S&P's IT sector except two; they improved for Red Hat (which is being bought by IBM) and Western Digital. (MarketWatch)
  - Only 20% of the recent selloff can be tied to tech companies compared to the 50% of the gains they were responsible for earlier in the year. (NYT)
  - Strategists at Wells Fargo and J.P. Morgan believe a double-digit market rally is possible. Causes include a potential short squeeze from hedge fund repositioning. Morgan Stanley strategists believe now is a key time to reconsider sector and asset allocations. (CNBC, CNBC, MS)
- The US Labor Department announced that the US added higher-than-expected 250k jobs in October with an ongoing trend of increasing wages. US Treasury yields jumped as a result since these may lead the Fed to continue raising rates. (CNBC)
  - Barclays chief US economist believes the Fed will raise short-term rates four times in 2019 bringing the benchmark to 3.25-3.50%. Currently, the market is pricing in two and a half moves at 2.85%. (MarketWatch)
- Home sales plummeted 18% given rising mortgage rates and overheated home prices – specifically hitting Southern California worse than elsewhere. Sales of new homes are suffering more as of late because of lower production and price premiums, affecting homebuilding companies. (CNBC)
- 13F filings have come in – hedge funds that have steadily increased their exposure to tech and healthcare have posted losses from 5-15%. Other factors that hurt the funds include a selloff in biotech, bets against retail that rallied, and weakness in European equities. (WSJ)

DEALS & CORPORATE ACTIONS

October 29, 2018

- Berkshire Hathaway has added positions totaling $600MM in Brazilian payment processor StoneCo and the parent company of India's largest mobile payments service, Paytm. Led by PM Todd Combs, the two reflect a broadening of Berkshire's portfolio into fintech, the beginning of offloading $111BN cash, and continued investment in locally leading regulated companies. (WSJ)
- Sheldon Adelson and Warren Buffett have contributed over $100MM in one of the most heavily financed political battles of the current US election cycle. NV Energy, a Berkshire Hathaway portfolio company, holds a virtual power monopoly in Nevada which is at risk if voters back the 11/06/18 ballot that lets customers choose their own provider by 2023. (Bloomberg)
- US has said it would block a Chinese semiconductor manufacturer, Fujian Jinhua Integrated Circuit, from buying American components. In July, Micron accused Jinhua of stealing intellectual property. (NYT)

October 30, 2018

- Andrew Left, short-seller and founder of Citron Research, is in talks to launch Citron Capital. Terms include $2MM minimum investment, a one year lock up, 1.5% management fee, and 20% performance fee. It is interesting to see how this turns out given Left's recent flip-flopping on Tesla. (CNBC)
- Arconic is in advanced talks with Apollo concerning a potential $11BN acquisition offer. Blackstone and Carlyle were also interested in a deal, but needed three more weeks to complete due diligence according to Reuters. (CNBC)
- Barclays has named Rothschild veteran Nigel Higgins as its next chairman. This role will define how the bank's strategy will change with regards to its trans-Atlantic diversification strategy. (WSJ)
- Coinbase has raised $300MM in a massive Series E funding round that values it at $8BN. (Fortune)
- Commodity trading food company, Bunge, is finalizing settlements with two activists that will add four directors to its board and set up a strategic review committee – a result that could lead to its sale. D.E. Shaw and Continental Grain hold an undisclosed amount above 0.06% and 1% respectively. (WSJ)
- Millennium Management and Citadel are both changing fees and lock up terms, a new five year class of shares for the former and a new 1% management fee and expenses for the latter. This follows Citadel's decision to remove a number of fund of funds as clients in 2017. (WSJ)

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Notable Trends

1) Asset managers and custody banks are seeing record outflows and declining share prices. Hedge fund closures are rising, while larger, more successful funds are adopting more restrictive structures to maintain AUM. Specifically, macro funds have been struggling of late. (Boston Globe, WSJ)
2) Investors are now citing large market capitalization as a reason to buy credit, independent of cash flow and collateral. While investors may believe companies could cut expenses and issue more equity, a large factor is likely the belief that "there is no need for us to do credit analysis before buying the debt, because someone else has already analyzed the equity and decided to buy it." Matt Levine notes, "The credit analysts are supposed to be the cynical pessimists, while the equity investors are supposed to be eternal optimists. Why would the pessimists outsource their pessimism to the optimists?" (Bloomberg)

CSSG's Weekly Recap is a resource that provides links to news that our analysts found interesting during the week. While not proprietary in nature, we find that publishing these reports helps hold ourselves accountable and aware of the economic climate.

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October 30, 2018 *(continued)*

- Papa John's is facing a high level of buyout interest from Bain, CVC, KKR, and Roark Capital. Founder John Schnatter still owns about 30% of the company and has asked company management to reduce its poison pill provision. Lastly, Trian Fund Management has expressed interest in an investment, should a buyout deal fall through. (CNBC)
- Private equity firms are circling two dozen channels that Disney is divesting as a part of its $71.3BN purchase of Fox. Valued by Guggenheim at $25BN, these networks will be sold to firms such as Apollo, Blackstone, KKR, and Providence. (WSJ)

October 31, 2018

- Bridgewater has launched its first onshore Chinese investment product, Bridgewater All Weather China Private Fund No. 1, following its offshore fund from April 2018. In June, Bridgewater was granted a Private Securities Investment Fund Manager license from the Asset Management Association of China, allowing it to develop and market domestic products to qualified investors. (PR Newswire)
- UBS is said to be weighing potential US / UK acquisitions and JVs for its asset management business, although unlikely to make any single large buyout. Deliberations are currently private. (Bloomberg)

November 01, 2018

- Carl Icahn, following his public disapproval of Dell's IPO plans, has sued Dell alleging that the company did not disclose financial information related to its plans to go public by buying back its tracking stock. (Reuters)
- Douglas Braunstein, founder of Hudson Executive Capital and former J.P. Morgan CFO, has announced a 3% stake in Deutsche Bank. The CEO change was the catalyst for initiating the position. (CNBC)

November 02, 2018

- Dan Loeb's motion for expedited discovery into Campbell's board was denied by a New Jersey judge, allowing Campbell's 11/29/18 annual meeting to proceed as planned. (NY Post)
- Faraday Future has signed on Stifel as a financial adviser after co-founder Nick Sampson resigned earlier this week, stating in his resignation letter that the company was struggling to stay afloat. It received emergency relief from the Hong Kong International Arbitration Centre. The company is currently seeking funding from sources other than Evergrande Health, its largest holder. (TechNode)

November 03, 2018

November 04, 2018