Jefferies Prime Services Quarterly

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Talent is Hitting a Target It's Hard for Others to Hit. *Genius* Is Hitting a Target It's Hard for Others to *See*.

There are many talented investors – but some are able to identify invisible emerging trends *early* that we may come to take for granted as obvious in the future.

Here are some of the early stage trends we have been hearing more frequently from forward thinking alternatives managers. As the world evolves and the pace of change accelerates, it's possible:

1. **Ethical consumption trends s p r e a d across multiple sectors**. As demand for more ethically and sustainably sourced products grows – from protein to diamonds to everything in between – and technology allows supply to catch up, it's possible consumers of nearly all products will come to expect their purchases be more in line with sustainable lifestyles. **From Chanel to Charles Schwab, brands across diverse industries are keenly benefitting from and changing strategies and product lines to adapt to this growing market dynamic**. Of note:
   - **$8.4 billion: amount of ESG fund inflows** in the first six months of 2019. The 2018 total? $5.3 billion. Hedge funds witnessed net outflows over the same period, though redemptions are slowing.
2. **Asia is the epicenter for some of the most exciting eSports, food tech and fintech private companies**. Jefferies is hosting its Second Private Company Disruption Summit in Hong Kong on August 16th – playing host to some of the fastest growing start ups globally. As an increasing number of investors turn their focus to the private market, the Asia Disrupt Summit has become a must-attend those looking to keep a finger on the pulse of what's coming next.
3. **Content is powering financial services firms forward.** Having taken the media, consumer – and even energy – sectors by storm in the last decade, a growing number of alternatives funds have turned their resources and focus to **building differentiated content strategies**. With twice as many hedge funds as publicly traded companies in the U.S. – managers are increasingly resonating with partners and prospective LPs by building differentiated content offerings to connect with various stakeholders and be viewed as a thought leader in their space. A quick survey reveals about **10% of the Billion Dollar Club** funds support or disseminate a formal content driven strategy.

2019 Hedge Fund Performance Review I HFRI		
Strategy	**June 2019**	**YTD**
HFRI Event Driven	1.47%	5.61%
HFRI Macro	2.33%	5.01%
HFRI Relative Value	0.95%	5.38%
HFRI Equity Hedge	3.24%	9.47%
HFRI Fund Weighted Composite Index	**2.48%**	**7.44%**

Source: HFRI as of 7.31.19

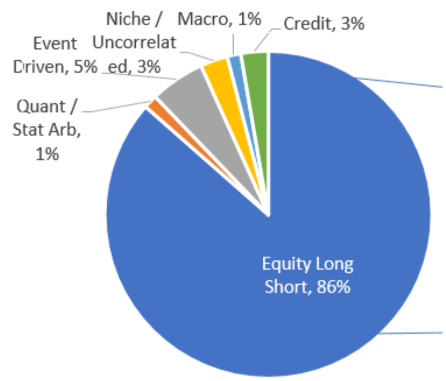
Specialization Trend Continues to Accelerate

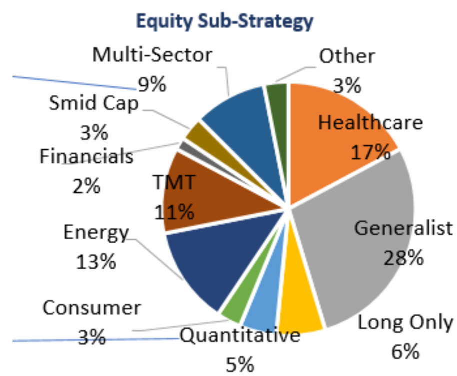
We recently updated our **New Launch Summary** and found that of the Equity Long/Short new launches over the past few years continue to be dominated by specialists of all stripes.

Only 28% of Equity Long/Short launches between 2016 – 1H2019 were generalists. Health care, Energy, and TMT are top industries in focus for new managers.

And a growing number of allocators and managers alike are squarely focused on the long-only space.

Jefferies' Emerging Managers 2016 – 2019 by Strategy

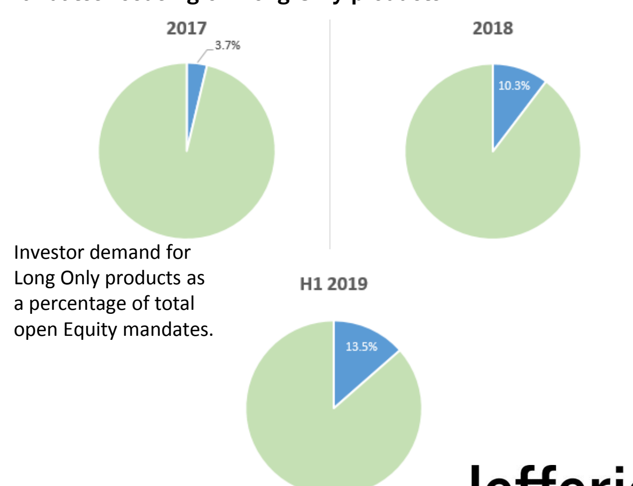




Source: Jefferies

More Than 300% Growth In 2 Years: The Rise of Long Only

Demand for Long Only Equity strategies has grown more than three fold in just two years – with about **one in eight Equity mandates focusing on Long Only products.**



Source: Jefferies Capital Intelligence

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WHEN THE MARKET MOVES THE MARKET

This summer, the Jefferies Equities Content team published *When the Market Moves the Market*, a white paper that explores **how and why market structure has fundamentally changed** over the past two decades—and what this means for everyone in our industry.

First: a comparison. For decades, football players have played their game on a 100-yard gridiron. The rules are clear - if complex - and more or less endure over time. But what would happen if these football players showed up and realized their field had turned into a baseball diamond? Not overnight, but over time and bit by bit – the parameters, size and shape of the turf morphed into something else entirely?

They would still know how to dominate a football field, but other changes would mean the game, the rules and the very ground they played on had changed considerably. What if that is what's happened to trading and execution over the last decade?

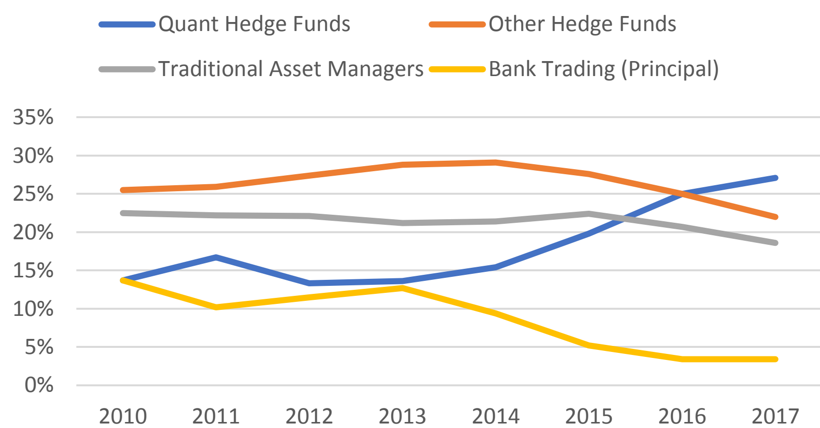
We outline how the **who**, **what**, **when**, **how**, and **where** of trading today look nothing like they did 20 years ago—and explore what the implications are for the future leaders of our industry.

What's changed? Everything…

WHO:

Passive investors now account for ~17.5% of market cap

Share of Stock Trading by Type of Investor

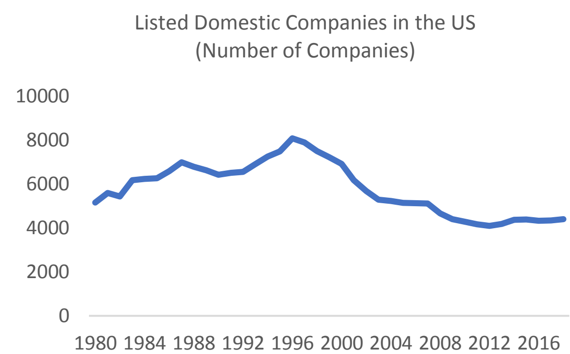


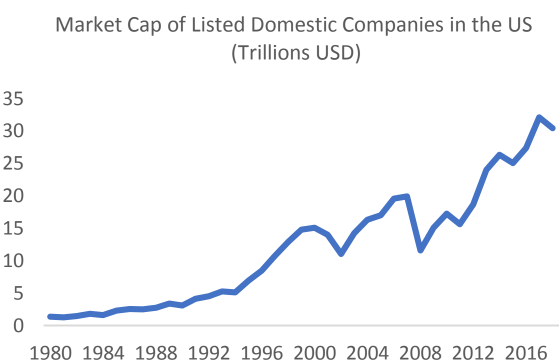
WHEN:

The closing auction now sees ~8% of NYSE volume.

WHAT:

Today, there are **less companies** with a **greater combined market cap** than 40 years ago.





And ownership is **concentrated**—5 firms now hold ~20% of the 20 largest companies by market cap.

AROUND THE WORLD IN 30 DAYS

Members of the Jefferies Capital Intelligence team are all over the map, and this summer is no different. In the past month alone, the Jefferies footprint has extended across the United States—from New York to Chicago to the West Coast—all the way to Europe and Israel.

Here's some of what we're hearing from around the country and the world—on the topics of capital raising, the landscape for alternatives allocations, business consulting, and more. As well, we preview where we're aiming our travel in the coming weeks.

Reporting from: Chicago

What we're hearing:

- The capital raising environment is **competitive** for equity long-short funds, but **appetite remains**. Even allocators who have a handle on the landscape are interested in seeing new launches, carve-outs, or other opportunities.
- Allocator interest in equity long-short funds is **geared towards specialized or bespoke products** that address unique needs including fees, liquidity, or net exposure.
- As allocators research prospective funds, they are increasingly considering risk analysis, evaluating how funds are effectively managing downside protection.

Top-of-Mind for Funds:

- As competition for allocations thickens, funds are focused on perfecting and refining their approaches to pipeline management, communication, and marketing.
- As funds consider launching new products, discussions around differentiating these products—both from their own preexisting offerings as well as their competitors'—are crucial.

Reporting from: Toronto, Canada

What we're hearing:

- Investors are **allocating opportunistically to hedge funds with niche and uncorrelated returns**. There is particular interest in alternatives funds with **global exposure.**
- Allocators we spoke to expressed interest in sector specialist funds to complement their portfolios of generalist managers

Reporting from: Hong Kong, China

- On August 16, Jefferies will host its "Technology Disruption Across Consumer Verticals" summit in Hong Kong
- Opening remarks will be made by Jesse Leiter, head of Jefferies's US/International equity business in Asia Pacific
- The summit will host companies dealing with everything from food to gaming to understand how technological advancement is completely upending the consumer landscape as we know it

Reporting from: Cincinnati

What we're hearing:

- Allocators we spoke to zeroed in on a few specific interests. Namely, in **Long-Only products** (whether they are carve-outs from long-short strategies or standalone funds) and **concentrated equity strategies.**
- Allocators expressed be they long-only, long-biased, or long-short strategies. In particular, our conversations revolved around **healthcare specialists**.

Reporting from: Boston

What we're hearing:

- Though capital raising is competitive, some allocators in the region are actively allocating in a targeted way. Mandates vary, but **allocators expressed interest most uniformly in long-only or long-biased funds**.
- Other **open mandates** exist for Event-Driven or Merger Arb, Fixed Income strategies, and private equity funds.
- **The fight for capital is fierce.** Allocators continue to be interested in new equity long-short funds as they arise—even while being fully allocated at the moment.

Top-of-Mind for Funds:

- In an increasingly competitive landscape, funds are finding opportunities for relationships via conversations about ESG and sustainable investing mandates

Reporting from: Charlotte

What we're hearing:

- Investors in the region seem focused on **increasing diversification** and **decreasing correlation** in their hedge fund portfolios given where we are in the market cycle.
- Asia and emerging markets are areas of interest as a way to diversify globally while getting access to attractive risk-adjusted returns.
- Several investors are decreasing correlation across their hedge fund portfolios by reducing market beta and rotating to **global macro, relative value** (both market neutral and quantitative strategies) and **'niche'** opportunities (such as litigation finance or music royalties).
- Additionally, investors continue to seek strategies that can **benefit from a richer alpha opportunity set**. Most frequently, this came in the form of sector specialists—especially **healthcare, financials**, and **energy.**

Top Reads in Equities Research

A few examples:

- Amazon (AMZN) – Deep Dive - Still Room to Run (Thill, Apr. 3) – Brent sees a road map to $3,000/sh for AMZN over the medium term even with what he believes are conservative growth estimates. AWS, advertising and 3P are all expected to grow faster than retail, and are accretive to margins. New businesses including healthcare would be generally incremental to our forecasted growth.

- Interactive Entertainment – Game Changer: A Deep Dive on Free-to-Play Console Games like Fortnite (O'Shea, Mar. 8) – While the "free to play" video game model will likely expand the market, it also presents uncertainty. Fortnite generated $2.4B in '18 revs (est), showing FTP can produce superior results, particularly as Tim estimates Fortnite's EBIT margin could be 2,000bps better than ATVI or EA. Tim believes the largest franchises like Apex (EA), COD (ATVI), and GTA (TTWO) are best positioned.

- Medical Supplies & Devices – Alcon Deep Dive: Survey Work Points To Attractive Large Cap Opportunity (Petrone, Apr. 4) – Ahead of Alcon's spin from Novartis, Anthony completed doctor and consumer surveys. Based on his findings, Anthony sees 200bps of incremental share in AT-IOLs on launch of PanOptix and a $450-$600M revenue uplift from PRECISION1. He thinks these drivers could help push topline growth over the initial LRP.

- Expedia (EXPE) – Deep Dive into Expedia's Core (Thill, Apr. 22) – Brent analyzed EXPE's major growth drivers and margin levers, which he believes will drive the stock in the next 2-3Y. Intense competition has weighed on EXPE's rev growth and margin profile, but Brent believes newer initiatives can help double OM from 7.6% in '18 to 15%+ in '23E. Shares trade at just 8.6x '20 EBITDA, the lowest multiple in Brent's large/mid cap group.

- Healthcare Services – Upgrading DGX & LH: UNH PLN To Help Growth from 2020 Onward, Valuations Are Low (Tanquilut, Apr. 2) – Brian upgraded shares of DGX and LH to Buy following analysis of the upcoming roll-out of the UNH's preferred lab network (PLN). DGX and LH combined have only about $1B of UNH's $8B lab spend, so their inclusion in the PLN should drive meaningful share gains. Brian sees EPS boosts of >2% for both DGX and LH and beginning in ‘20.

- Starbucks (SBUX) – "Third Wave" Coffee Not Impacting SSS; SBUX Growth Model Intact, Raising PT (Barish, Apr. 18) – Andy conducted an overlap analysis for SBUX and select "third-wave" competitors. Even in the most bullish third-wave growth scenario, the SSS impact on SBUX is limited to ~40bps by F22. Andy expects 3-4% SSS growth in the US.

Equity Strategy: Global Asset Allocation: From Trade Wars to Digital Wars

Access full piece here

Global equity markets continue to under-estimate the relentless expansion of the US-China trade dispute. The US Department of Commerce yesterday announced that it would put Huawei and its 70 affiliates onto its entity list. As an effective export ban, it holds back the development of 5G (the largest global capex project) and the growth of Internet of Things. It also completely disrupts the global tech supply chain. The macro and micro implications are immense.

No sooner than the US tariffs were hiked to 25% from 10% on US$200bn of Chinese imports last Friday (see Global Asset Allocation: Trade Deadlines (II)) than the US DoC decided to put Huawei and its 70 affiliates into its Entity List, thereby requiring them to obtain a US government license when they buy any components from US companies. ZTE was put onto the same list last year when it was subject to the US export ban. In effect, a broad trade war between US and China on rebalancing the trade deficit, IP and foreign technology transfer issues has coalesced into curbing China’s competitive advantages in 5G. The 5G technology will effectively provide countries with almost unlimited bandwidth at unimaginably fast speeds whilst allowing the parallel world of Internet of Things (IoT) to develop. As a source of services’ competitiveness for countries 5G provides a huge advantage once it is installed – everything from the use of autonomous vehicles to AI eco-systems. It should be pointed out that aside from the huge investment in the roll-out of 5G, enormous amounts of money are required to install fiber-optic systems and operating systems including base stations.

China has been leading the race in 5G technology and many DM and EM countries had announced plans to start procuring gear from Huawei. The Achilles heel for the Chinese telecom equipment makers is that they rely on US semiconductors and components which cannot be readily substituted (baseband chipsets for handsets (**Qualcomm and Intel**), semi-conductor for base stations (**FPGA from Xilinx**), RF/power amplifier chipsets (**Skyworks, Quorvo, Avago and Macom**), and optical components (**Lumentum/Finisar**)).

The bottom line is that investor’s are under-estimating the evolution of the US-China trade dispute. The progression from tariffs to direct actions against single Chinese companies and their inter-linked supply chains has a wide-ranging impact on profitability that investors will find difficult to quantify. We have highlighted the issues of the mispricing of systematic and unsystematic risk **(see Global Asset Allocation: BRICS, FAANG and GIPS). See Implications from US Placing Huawei on Trade Blacklist for details.**

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JEFFERIES UPCOMING EVENTS

Upcoming Conferences & Events		
August 6-8	NEW YORK	Jefferies 2019 Industrials Conference
August 8	NEW YORK	Jefferies 2019 Financial Services Investor Relations Summit
August 16	HONG KONG	Jefferies Global Disruption Summit 2019: Technology Disruption across Consumer Verticals
August 27-28	CHICAGO	Jefferies 2019 Semiconductor, Hardware, and Communications Infrastructure Summit
September 9-10	KYOTO	Jefferies 3rd Kyoto Summit 2019
September 12	NEW YORK	Jefferies Fitness & Wellness Summit
September 12	PARIS	Jefferies 2019 Satellite Summit
September 17	NEW YORK	Jefferies Home Retail Summit
September 18	NEW YORK	Jefferies Consumer Investor Relations Summit
September 25	NEW YORK	Base Metals Summit
September 26	DENVER	Denver SMID Cap Summit
September 25-26	LONDON	Jefferies Data Conference London– Alternative Data Discovery Day

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