Jefferies Prime Services Monthly

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We Need to Start Thinking E*x*p*o*n*e*n*t*i*a*l*l*y

A mere three years ago, the **World Economic Forum** surveyed nearly 1,000 executives and experts from the IT and Communications sector to predict the **Technology Tipping Points** of the next 20 years. The report attempted to identify some of the shifts occurring as a result of the explosion of software and services.*

But some of the predictions are already outdated – revealing how rapidly, and *exponentially* our world is changing. The technology that is the lifeblood of progress and shift is materially impacting how we live, invest and manage our businesses, and our mindsets need to adapt accordingly. Among the highlights of the 2015 report, and what's already evolved since then:

1. **Storage prices have dropped exponentially.** The basic infrastructure required to house the explosion of data has become commoditized, with researchers noting the price of storage has dropped by a factor of 10 approximately every 5 years. Makes me wonder why some of us still have to "clean out our Inboxes to make room" every few months…
2. **Sensors connecting home, office, the internet and *you* have grown exponentially.** About 75% of respondents expected 1 trillion sensors connected to the internet by 2022. But given the number of relatives who received Alexa or other IoT or smart devices for the holidays…it seems we're poised to "tip" sooner than that.
3. **Your next accountant may be an A.I.-ccountant.** A.I.'s strengths include identifying patterns (or anomalies) and automating processes, making accounting and audit functions particularly susceptible to computerization. Over 75% of respondents believed 30% of audits would be conducted by A.I. rather than humans by 2025 – but KPMG, PWC and Ernst & Young were all in the news this year piloting A.I. technologies for use in audit.
4. **Respondents expected 10% of all U.S. cars on the road to be driverless in 2026…**but this month GM announced plans to mass-produce self-driving cars in 2019. A growing number of hedge fund managers are launching new vehicles (no pun intended) to take advantage of this trend.

The report itself is fascinating, and the rapid shifts since its publication in the last three years only make questions about the future of work and productivity in the coming decade even more pressing.

As William Gibson noted, the future is already here – it's just not evenly distributed.

**All information drawn from The World Economic Forum's* Technological Tipping Points Report, 2015. The report is available here.

2017 Hedge Fund Performance Review I HFRI	
Strategy	**2017**
HFRI Event Driven	7.73%
HFRI Macro	2.21%
HFRI Relative Value	5.11%
HFRI Equity Hedge	13.46%
HFRI Fund Weighted Composite Index	**8.68%**

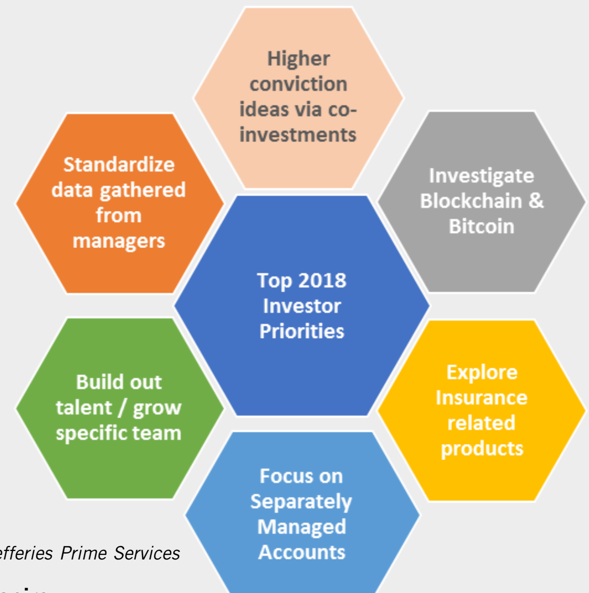
Source: HFRI

Investors' 2018 Priorities

While resolutions get all the headlines in January, *priorities* are often what actually get completed – at least from a business perspective. We decided to kick off 2018 by checking in with 75 of our investors, to gauge *their* top priorities for the coming year *(besides performance)*.

Responses ranged from a **heightened focus on insurance related products** to **building a standardized system for gathering and updating manager information,** and much in between. Some of what we expected, we heard (looking at you, blockchain) – but we also heard from investors who are using the relative calm of the markets to get into the weeds on things like retaining and training their employees or exploring differentiated product opportunities for the next 3 years.

Sentiment was overall highly positive, and a number of investors mentioned now is the time to be adding hedge funds ahead of potential future periods of stress when they expect these firms to outperform their long-only investments.



Source: Jefferies Prime Services

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Capital Consulting Spotlight on Florida

Given many will be heading south for the upcoming MFA, Battlefin and Context summits in Miami, a few thoughts on our recent travel to the Sunshine State.

- **They're not in Florida just for the sun and Vitamin D.** Many investors are deep in the weeds on tax implications for specific investments. Given the recent tax legislation – the subject continues to be a focus for residents and non-residents alike.
- **Considerable appetite for scaling funds** – those between $100 – 500 MM of AuM, and
- **A 2018 focus on non-correlated investment options**, whether managers, vehicles or specific co-investments.

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Top Jefferies Research Reads in recent weeks

Leaders of the Pack:

- JEF's Macro Weekly: Further on up the road; Bulls on parade
- 2018 Outlook: Still Room for Appreciation Despite Rich Valuations
- PYPL: PayPal 'Pulse' – Expect Robust Q4 Results
- VIDEO: The Most Important Things in Just 25 Minutes for You
- CELG: More Deals Likely to Come – Consistent w/Our Comments Last Week

Other Notable Reads

- 2018 Outlook Report Compendium: US and Global Macro
- LW: Favorable Environment Expected to Last For a While

Jefferies Franchise Picks

ABBV (Holford), **ATVI** (O'Shea), **BA** (Kahyaoglu), **CASY** (Mandeville), **CVX** (Gammel), **DISH** (Goldman), **DLPH** (Kelley), **DXC** (El-Assal), **FANG** (Lear), **FLT** (El-Assal), **GPS** (Konik) **GOOGL** (Thill), **HAIN** (Jagdale), **IR** (Volkmann), **KEY** (Usdin), **NVDA** (Lipacis), **OC** (Ng), **PX** (Alexander), **SC** (Hecht), **TXT** (Kahyaoglu), **UAA** (Konik).

Global Asset Allocation*

- The new highs being made by the S&P 500 Transports and MSCI World Airfreight indices are supported by expanding global manufacturing PMIs, improving global trade and a weakening dollar. With higher fuel charges on the horizon, the sector provides one of the most important conduits for inflation to pass into the global economy.
- While the central banks in the G7 have experienced real negative interest rates in most cases and firming macro data, marginal global growth is actually determined by the Emerging markets. According to the IMF, after the global financial crisis, emerging market and developing economies' contribution to global growth rose to about 80 percent of output growth and 85 percent of consumption growth. In market exchange-rate terms, emerging market and developing economies accounted for close to 70 percent of global output growth and just over 70 percent of global consumption growth during 2010-15. It should be noted that the IMF estimated in October'17 the global economy would grow by 3.7% (EM 4.9%, Advanced 2%) in 2018.
  Full note: Global Asset Allocation: Low PE, PB & Ship Ahoy!

Source: Bloomberg, EPFR, Jefferies. All references to mutual funds and ETFs

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Gaming & Casinos

David Katz initiated coverage on the Gaming sector – with a new note out explaining why the casino industry reflects the best operating environment in many years:

"...with solid top line expectations, heightened cost management and stable capital structures. The benefits of the advent of Opco/Propco structures are higher asset values and increased cash returns for Opcos, albeit with accounting complexity. In this context we initiate coverage on 11 casino stocks with a broadly positive stance."

Among the top picks: WYNN, ERI and PENN.

Full note available here.

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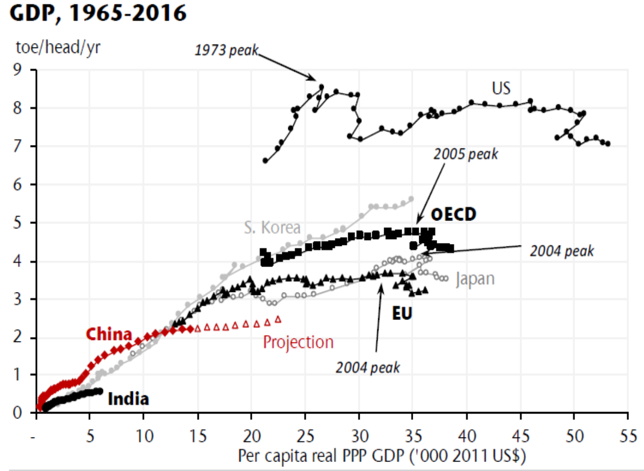
The China Effect: The Consumption Commodity Supercycle?

Laban Yu (Equity Research, China) is out with a new note: "With diesel demand stabilizing, we believe we are finally witnessing China's oil demand inflection. Jefferies Global Energy Team has also revised oil price forecasts partially based on China demand growth.

Oil demand inflection will be driven by accelerating gasoline demand which we believe has been outgrowing China's passenger vehicle fleet since 2015. This is a reversal of a decade-plus trend where China's installed base of passenger vehicles increased at +20% CAGR while gasoline demand increased at less than 10% CAGR. This discrepancy was the result of a massive increase in private passenger vehicles, which are rarely driven, while high mileage commercial vehicles like taxis barely increased.

Full note available here.

Chart 1: Energy consumption intensity vs. per capita PPP GDP, 1965-2016



Source: World Bank, BP, Jefferies

U.S. Equity Strategy: Made in America (III)

With the US considering to leave NAFTA, new tax incentives to repatriate profits in place and the dollar weak, the ingredients for a domestic investment boom are in place. Capex intentions are strong. This should be good news for the materials sector (steel) and some lateral plays in the industrials sector.

While the corporate sector is obviously euphoric over the tax changes, it is not often highlighted that it has improved US's competitive position. Although the tax changes are designed to encourage company investment, the lowering of the headline tax rate is equally an incentive for foreign companies to base their operations in the US.

The NAFTA trade agreement encouraged 'off-shoring' or the placement of US manufacturing in its neighbors due to better labor laws, cheaper exchange rates and/or lower wages. The incentives for investing overseas are beginning to diminish.

Coincidentally, next Tuesday, the US DOC is expected to provide formal recommendations to the President regarding possible action to combat US steel imports on national security grounds through Section 232. The government has several potential tools including: tariffs, quotas, tariff-rate quotas and Voluntary Restraint Agreement (VRA) – a form of import cap.

The cocktail of tax reform, NAFTA, steel tariffs, and booming investment intentions comes at a time when the ISM manufacturing index is surging and industrial new orders are rising (see US: Contradictory Bulls). It is good news for both industrials and materials.

Steel producers with greatest exposure to niche markets are perhaps the best positioned to benefit from the steel tariffs.

US Steelmakers We Like

Ticker		Company Name	PE (x, 12M)	PB (x, 12M)	DY (%, 12M)	FCFY (%, 12M)	ROE (%, FY1)	FY1 EPS Growth (%)	FY1 EPS Revision (%, 3M)	FY2 EPS Revision (%, 3M)	Net Debt/Equity (%, FY0)	Jef Research Rating
STLD US	**STLD US Equity**	**STEEL DYNAMICS**	13.8	2.78	1.37	7.3	20.7	67.7	(2.3)	16.1	52.5	**BUY**
X US	**X US Equity**	**US STEEL CORP**	14.1	1.96	0.67	3.0	12.4	167.7	9.6	20.1	66.6	**BUY**
NUE US	**NUE US Equity**	**NUCOR CORP**	14.8	2.30	2.20	6.3	14.0	43.3	(3.8)	8.0	26.2	**BUY**
MT US	**MT US Equity**	**ARCELORMITTAL-NY**	10.8	0.99	1.36	8.0	11.9	NA	15.4	12.3	31.8	**BUY**
CMC US	**CMC US Equity**	**COMMERCIAL METAL**	15.5	1.85	1.90	7.1	12.1	511.9	(2.7)	19.8	40.8	**BUY**

Source: Bloomberg, Jefferies

A lateral way to play the domestic investment boom might be through prefab metal building companies. Although these 'factory shells' are simple structures that are often used for warehouses and are made from prefabricated steel. Jefferies Industrials team highlight that the overall market size is around US$21.5bn. The industry leader is Butler Manufacturing and its North American business represents about 40% of Bluescope Steel (BSL AU). Number 2 player would be Nucor which has a number of metal building companies, and number three is NCI Building Systems (NCS US), which makes buildings and other similar products and is probably the closest to a pure play.

The bottom line is that the backdrop for the US materials sector is improving. Corporate investment spending plans are surging while the lower headline tax rate ought to encourage some reshoring. Investors seeking beneficiaries of automation should see US: Made In America (II) and US: Does What Goes On In Philly, Stay In Philly? (IV) for those companies benefiting from the capex boom.

Full note available here or click here to watch the video.

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Upcoming Conferences & Events

January 31	SINGAPORE	Jefferies India & ASEAN Internet Day in Singapore
February 1	HONG KONG	Jefferies India & ASEAN Internet Day in Hong Kong
February 21-22	DALLAS	Jefferies 2018 Cybersecurity Summit & NSS Labs Visit
March 6	NEW YORK	Jefferies Payments & IT Services Investor Relations Summit
March 14	LONDON	Jefferies 2018 Paper & Packaging Summit
March 15	NEW YORK	Jefferies brands Still Matter Conference Series
April 3	NEW YORK	Jefferies Healthcare REIT Summit
April 9-10	LAS VEGAS	Jefferies 3rd Annual Broadcast Roundtable at the NAB Show
May 9-10	BEVERLY HILLS	Jefferies 2018 Global Technology Conference
June 3-6	ISRAEL	Jefferies Israel Tech Trek
June 5-8	NEW YORK	Jefferies 2018 Global Healthcare Conference
June 19-20	NANTUCKET	Jefferies 2018 Global Consumer Conference

Jefferies Stock Loan Corner

- The composition of shorts have held steady from December to January with a **marginal increase of short exposure to Industrials**. Tech continues to be the most shorted sector as a percentage of short interest versus float.
- We saw **supply volatility on a few equity ETFs** as yearend trades unwound in January. IWM saw considerable outflows with assets down 11% (~$5 billion in MV) over the past few weeks. XRT float was reduced by more than half by a large redemption in the first week of January – followed by more redemptions as trading desks reduced their long positions to avoid being classified as an affiliate. We also saw similar redemption activity in the fixed income ETFs, specifically HYG and JNK, as we have seen material outflows from both of these funds that is still continuing. HYG assets are at its lowest point since June 2017.
- Going into the end of the year and continuing in early 2018 there has been a sizeable increase in companies turning to blockchain technology. The volatility of these stocks has increased interest from the short community and demand for borrow has outpaced available supply for most stocks. Of particular note:
  - Kodak (KODK) borrow fees moved steeply more expensive after announcing their own coin. Rates were near easy to borrow at the beginning of January but have moved well into the 200% + fee range and the open borrow interest has increased from 2 million to 12 million shares over the same time period.
  - Long Island Iced Tea (LTEA) which NASDAQ had threatened to be removed from its exchange, pivoted towards blockchain technology and saw its price and borrow fee increase substantially during December and January. The company has changed names and symbols to Long Blockchain Corp(LBCC). There has been consent demand for borrow but company is closely held by insiders.
  - RIOT Blockchain (RIOT) was one of the first bitcoin companies that drew interest from short sellers. RIOT borrow fee has stabilized in the low 100s fee area recently while shorts continue to press for borrow. Open borrow interest is in the 3 million share range.

High To Borrows of High Interest

Orange highlighted rows reflect Bitcoin/blockchain related securities

Security	Utilization	Indicative Rate	Days to Cover	SI % of Float	Market Cap
RIOT	97.26%	-105	0.19	28%	$206,408,709
KODK	100.00%	-150	12.65	9%*	$402,299,352
OSTK	82.16%	-16	1.49	42%	$1,893,014,763
GBTC	42.61%	-7	0.14	3%	$3,139,647,705
ROKU	100.00%	-27	0.95	37%	$4,063,646,096
SHLD	83.02%	-65	9.51	38%	$377,724,150
MBI	100.00%	-15	16.88	42%	$678,238,954
DO	85.76%	-8	23.51	45%	$2,711,620,972
QD	98.47%	-70	7.6	n/a	$4,023,316,448
RDFN	93.96%	-100	10.92	42%	$2,130,962,830