Dear Clients,

For our first letter of calendar 2018, we decided to write about our experience working with our employee-partners over the years to build Jefferies’ Investment Banking business. While similar stories can be shared about our equally important Equity, Fixed Income, Research and Support efforts, Investment Banking now represents over 50% of Jefferies’ Net Revenues and, by focusing on only one area, we can more easily make some important observations. For background, one of us has been at Jefferies for only 28 years, and the other a mere 18, but over our combined nearly five decades with the Firm, we have had more than our fair shares of twists and turns, ups and downs, and failures and successes. Our goal is not to brag or gloat in any way, and to be clear, we acknowledge we are in the early stages of building every one of our businesses and have a very long way to go to achieve our potential. The point of sharing some of our experiences and observations is to highlight the realities of dedicating oneself to helping build something special that one cares deeply about.

Below is a graphical representation of the past 28 years of Jefferies’ Investment Banking Division:

### JEFFERIES INVESTMENT BANKING REVENUES SINCE 1990

Below is a graphical representation of the past 28 years of Jefferies’ Investment Banking Division:

#### Net Revenues (1)

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<thead>
<tr>
<th>Year</th>
<th>Predecessor</th>
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<td>2016</td>
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It is said that a picture is worth a thousand words, but the reality is that the 28 bars on this graph cannot begin to explain even one percent of the hard work, incredible accomplishments, painful setbacks, and good and bad luck that every one of us at Jefferies has experienced along this journey. The following are some of our thoughts about our experiences, some of which you may want to emulate and some of which you may want to avoid if at all possible as you build your respective businesses:

1. **You have to start somewhere.** In 1990, Jefferies had one product: riskless trading of cash equities, essentially as a third market agency broker. We had no research, no fixed income, no capital markets, and certainly no investment banking. A small handful of us joined Jefferies with experience in advising and raising capital for companies and we wanted to see if we could do it on the Jefferies platform. The thought was brash and without strategy or forethought. Our team had a total of $30 million of trading capital, with 10% of that seemingly large sum ($3 million) allowed to be in any one industry. That said, we just wanted to try to do a deal. We actually raised $30 million for Buttrey’s Supermarket, in what turned out to be the only LBO done in 1990, as the high yield market was completely blown up following the collapse of Drexel. We got the deal done for our good friends at Freeman Spogli who did what good friends do, took a chance by giving us the opportunity to perform for them at our new firm. The thing we learned from this deal that generated (a then whopping) $900,000 in underwriting fees, 10% of that year’s investment banking revenues, was this: it was more gratifying for us to do this small deal at Jefferies than it was for us to be involved a few months prior at Drexel in the $26 billion buyout of RJR, which was at the time the biggest deal ever done. We learned something from that first small deal: for us, being a partner even in something small is much more rewarding than being an employee of something big. That was the day we decided we wanted to build Jefferies into something truly meaningful. (Talk about coming a long way — in 2017 Jefferies was the number one underwriter of loans for LBO’s on Wall Street according to Bloomberg and we are incredibly proud of our entire team).

2. **If you only have a hammer, everything looks like a nail.** From 1991 through 1996, we used our expertise to do high yield deals regularly. This was basically because it was all we knew how to do. If a convertible bond walked in the front door, a high yield bond went out the back door. If an M&A deal came in the same front door, a high yield bond went out the same back door. Restructurings, equity deals, whatever the capital need was, a high yield deal was our answer. It is hard to imagine that so-called “unconflicted” M&A boutiques that have sprouted up today don’t suffer from a similar affliction. We learned the hard way that if you want to build a real Wall Street firm or even just an investment banking business, you need a lot of quality people with vastly diverse and complementary skill sets. We realized it was not about what we could do, but rather what was best for our client. This is the core value we have used as the foundation for much that we have built since.

3. **Concentration works great until it does not.** By 1997, we had hired our first research and equity capital markets teams and decided to invest heavily in a single industry — energy. Oil was around $20 per barrel in 1997 and we had our first breakout year in investment banking, with nearly $200 million in net revenues, primarily as a result of our plethora of energy transactions. It felt really good and smart. In 1998, oil collapsed to $12 per barrel and suddenly we weren’t as smart as we thought. Our revenues dropped by close to 50%, and the infrastructure we had built up to handle all of our deals became a major drag on profitability. It was then that we realized that the only way to build a truly sustainable banking business was to be as diversified as possible by industry, product and geography. This was going to take a lot more money, hard work and patience than any of us had ever thought. If you don’t have all three, it just isn’t going to work.

4. **Brands don’t come easy.** From the late 90’s to early 2001, we had critical mass in people and had done enough deals to be credible, but our brand was mediocre at best. When you start a new venture in finance, you get business a few ways. First, your friends who know and trust you will give you the benefit of the doubt and, if you perform, you
have a business — if you do not, you have fewer friends. As an aside, one of our early friends who gave us a chance was the investment grade company Leucadia, which had every large firm on Wall Street begging for their business. They gave us one deal and we performed, and another and another, and the rest is history. The second way you get business when you are the new guy or gal on the block is to do the toughest deals that the larger competitors don’t want to devote the extra time and energy to figure out. As much hard work as this is, it makes you great at doing tough deals and going the extra mile for your clients. The negative is that it is easy for other competitors to say they “didn’t want to do that deal” when the reality is they just wanted the low hanging fruit. Upstarts can get easily pigeonholed as the firm to do tough deals and that is generally not the place where people want to bring their easier transactions (not that any are truly that easy). We spent a long time doing harder deals and proving to the world we could keep going, and then year by year we broke into a much wider assortment of transaction types. Our client list today is the envy of our competitors and we are very proud of it. By the way, the clients for whom we did the early tough deals became loyal for life and our competitors can’t understand why they cannot penetrate them (e.g., Landry’s and many more). Our brand today has never been better, and is an advantage that we will never take for granted, as we fully recognize how fragile it can become with even one stupid mistake.

5. **Critical mass and industry expertise move the needle.** From early 2001 to the third quarter of 2007, things went great as we built up our capital base, created a bank loan underwriting capability in partnership with MassMutual and, most importantly, made the bold move to acquire several high quality single sector investment banking boutiques. This gave us teams of quality people who enjoyed working together, had true industry expertise, enjoyed an abundance of special client relationships and were able to leverage the multiple products on our larger platform to best serve their clients. This was truly the beginning of our continual journey to become industry leaders. Eventually, we realized that all the combined names with hyphens and mixed brands from the old boutiques were no longer needed, and we morphed each quasi-independent group into the cornerstone of our various Jefferies industry groups. The bottom line is that each boutique gave us the critical mass to improve our brand and capabilities in its respective industry. It became clear that coming together as one firm was the only way to truly best serve all our clients’ needs.

6. **The first rule for building a business is to stay in business.** When you are building a business, you have to have no ego, be keenly aware of the challenges of volatile markets, and know where you stand in relative importance to society. Every 3-5 years, the world does appear to turn upside down and the more success you have, the tougher it will be in the downturn — due to overhead, commitments, increased capital, raised expectations and reduced flexibility. Our investment banking revenues dropped by nearly 50% from 2007 to 2008. Our firm had its first (and only — knock on wood) loss in our history. The financial world was on fire and it didn’t matter how big or small you were. We chose to raise equity dollars early (April 2008) to fully plug the hole from our operating loss and contrary to others who all believed their stock price was too cheap so they refused to dilute. Since the purpose of this note is to share our story of building an investment banking division — what credibility would we have if we could not effectively manage our own capital structure in a downturn? Avoiding a margin call and living to fight another day is always the most important rule to follow if you want to build a business. Sometimes it is not about dilution.

7. **The best time to play offense is when everyone else is playing defense.** If you want to build, the best time to do it is when competitors are disappearing or aggressively shrinking. This means you need to stay humble during the good times and not do anything too stupid — so you can take advantage of the bad times. In bad times, you can hire amazing people who are eager to join on fair terms, and they become long term partners, versus the mercenaries who always have one eye open for the next better short term deal. Our headcount grew by almost 1,000 people from 2008 through 2011 across Jefferies. We added an incredible healthcare banking team, built out our presence in Europe, hired world class professionals across fixed income and made many other strategic moves that forever changed the quality and breadth of
Jenneries. The other thing to learn about these periods of time is that one effective way to move up in the rankings quickly is to be fortunate enough to stay in business when many of your competitors do not. Easier said than done.

8. Sometimes it is personal. Unlike in 2008, when our entire industry was under siege, in 2011, we had a well-publicized personal attack on Jenneries from a “misinformed” marginal player in the financial markets who chose a very dangerous time to spread untruths, and the result was an all-out short attack on our company that we don’t wish on our worst enemy. Through the hard work, commitment, and integrity of all our people, we got through it and had a serious question to answer. How could we best continue to build our company given the reality of almost having been destroyed by lies? For that reason and many others, we decided to merge with our now parent company Leucadia in March 2013 in an all-stock transaction that gave us the firm foundation to continue building our business further. Our parent company today has over $10 billion of shareholders’ equity, only $1 billion of long term debt, ample liquidity and an appetite for further smart growth. If the foundation is not strong, it is impossible to build your business.

9. Culture is what counts. Culture is defined in challenging times. Having lived through 2008 and, more importantly, 2011, our firm learned what it truly meant to be independent, entrepreneurial, client focused, flat, honest, not too big to fail, dedicated and appreciative of each other. As soon as we combined Jenneries and Leucadia, we reignited the push to bring in new partners who were complementary, retain our existing partners who brought us to the party, and invest in our people through increased training, communication and time together. The markets were not perfect, but we made progress and saw a path to get to the next level.

10. Be careful what you wish for when you want to get to the next level. We messed up in 2015 into very early 2016, and unfortunately the new level we were striving to hit turned out to be a major drop in investment banking revenues to a level last seen around 2011. Jenneries barely broke even as our balance sheet was too big given the change in the environment and we had too much going on that all correlated. We strayed a little bit too far down the risk spectrum and, as often is the case, when it rains, it pours. The only thing you can do at such a point if you want to get back to building your business is to be ruthlessly honest and transparent, own up to your issues and enlist everyone’s help to try to fix the problems. At the end of the day, the buck stops with the two of us, so finger pointing is useless and solves nothing. Our teams created a bottoms-up plan for the trading side of the firm and we kept keenly focused on recruiting and expanding our investment banking footprint, regardless of how stupid we felt. It is very easy to panic in tough times and “pivot to safety,” but when you stop investing in your core business, your “pivot to safety” may only give yourself a false sense of security. You need to have employee-partners, boards, shareholders, debt holders and rating agencies who are all informed, and you must treat them like partners. If you do, you can still keep building prudently even after you make a mistake. That said, you had better be humble and honest about the mistakes you made and not repeat them.

So where does this leave us? As you can see from the chart above, Jenneries had $1.76 billion of investment banking net revenues in 2017 — the best in our 55 year history (only 28 years really count, we know). Our firm had a record year and our market share, deal quantity, human capital and brand are at all-time highs. The point of this entire note is to tell everyone that our steeply upward sloping diagonal arrow highlighting a 21.6% 28-year CAGR may look wonderful, but the reality is that there were almost as many downs as ups and mistakes as successes. We will continue to have setbacks. We will lose people we want to keep and fail to attract people we want to have join us. We will have investment banking and trading missteps and we will make dumb decisions. The trick in our opinion is that you can and will make many small mistakes, just don’t repeat the same ones. What cannot be allowed is to get the big decisions wrong. The big decisions include your people, culture, capital structure, strategy and brand. It also helps to be incredibly persistent, surround yourself with people smarter than you are and ignore the gossipers and naysayers. Plus, whenever possible, we strongly recommend you throw in a little good luck for good measure.
Happy New Year and we hope to help each of you build your businesses as you help us build ours,

Rich and Brian

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P.S. It is a story for another time, but for those who are curious what the same chart would look like for Jefferies in Equities and Fixed Income trading businesses over the same period, here it is:

JEFFERIES SALES & TRADING REVENUES SINCE 1990

(1) The financial measures presented herein include adjusted non-GAAP financial measures for 2011-15, which exclude the impact of the results of operations of Bache, a business substantially exited in 2015. See Appendix on page 18 for reconciliations to GAAP measures. Excludes predecessor first quarter ending 2/28/13. Adjusted Sales & Trading Revenues, Fixed Income S&T Revenues and Equity S&T Revenues for the excluded quarter total $453 million, $236 million, and $167 million, respectively.
P.S.S. And for the sake of completeness, here is the same chart for all of Jefferies since 1990:

JEFFERIES REVENUES AND EARNINGS SINCE 1990

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**Net Revenues - Adjusted** *(1)*

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<th>Year</th>
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<td>2,177</td>
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Predecessor: 144, 365, 617, 1,205, 2,177, 2,395

Successor: 3,198

**12.2% CAGR**

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**Net Earnings (Loss) - Adjusted** *(1)*

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<td>1995</td>
<td>183</td>
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<td>1996</td>
<td>357</td>
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</tbody>
</table>

Predecessor: 7, 29, 55, 157, 285, 183

Successor: 357

**15.9% CAGR**

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*(1)* The financial measures presented herein include adjusted non-GAAP financial measures for 2011-16, which exclude the impact of the results of operations of Bache, a business substantially exited in 2015. See Appendix on page 15 for a reconciliation to GAAP measures. Excludes predecessor first quarter ending 2/28/13. Adjusted Net Revenues and Net Earnings to Common Shareholders for the excluded quarter total $752 million and $88 million respectively. Net Earnings (Loss) in 1990-2012 are attributable to Common Shareholders. Net Earnings in LTM Q1 2017 are attributable to Jefferies Group LLC.

*(2)* Pre-tax loss of $541 million includes expenses of $427 million related to the modification of employee stock awards and restructuring activities offset by $434 million equity raise.
Economics and Strategy

Fiscal Stimulus: Another Force for Disinflation

In standard Macro 101 textbooks a deficit-financed tax cut generally causes both output and inflation to rise. This analysis, however, only considers tax cuts for individuals, not for corporates. When one begins to consider corporate tax cuts, a simple shift outward in the “aggregate demand” curve does not produce the correct storyline.

The main difficulty in analyzing a corporate tax change centers on distribution. And to be sure, the economics profession is having some pretty heated open-air debates on the distributional issues surrounding the current corporate tax cut proposal. On one side you have the Krugman/Summers Keynesian camp arguing that the benefits will all go to “fat cat” business owners through share price increases. Then on the other side you have the Cochrane/Mankiw/Hassett neoclassical camp arguing that workers will see the bulk of the benefit through higher wage payments.

I do not want to get into the debate on the allocation of benefits between workers and shareholders. What I want do want to discuss is a third possible outcome from the proposed corporate tax cut: disinflation. And in order to tee this idea up, I want you to first read John Cochrane’s description of who actually pays corporate taxes. The following excerpt is from a recent post on his “Grumpy Economist” blog:

“I think every economist in this debate admits, if some reluctantly, that ‘corporations’ pay no taxes. As an accounting matter, every cent corporations pay comes from higher prices, lower wages, or lower payments to shareholders. The only question is which one. And indirect general equilibrium effects are central. The question is not just, how do corporations respond immediately, but how do wages, prices, and capital in the whole economy adjust. ‘Make corporations pay their fair share’ is just nonsense.”

That paragraph is honestly a work of economic art. And what it highlights is that the costs of a tax increase, or benefits of a tax cut, can only go to three distinct entities: shareholders, workers, and consumers. It’s just accounting. So a tax cut can pass to shareholders through buybacks and/or capital deepening; it can go to workers through higher wage payments; or it can accrue to consumers through lower product prices.

The key here is the last part, “lower product prices.” No one in this debate seems to be discussing the idea that a firm with some newfound change in its pocket might decide to grab a bit of market share by CUTTING prices. Now, my best guess is that as the unwind of “Secular Stagulation” continues, competitive pressures will force businesses to think much more strategically. In the post-crisis era of large increases in regulation, incumbent businesses were able to enjoy the increased barriers to entry by reaping the benefits of monopoly/oligopoly power. I have argued many times in these notes that this has been one of the primary drivers of record-high corporate profit growth as a percentage of GDP over the last 8 years.

The idea I have in mind here is pretty simple - as our deregulation-induced positive supply shock continues to take hold, businesses will need to work harder to hold onto market share. In that setting a corporate tax cut may very well be “spent” on lower product prices. So today I want to put yet another disinflation risk on the table for the U.S. economy. I wrote a piece in July titled “The Fourth Turning of Disinflation” (reprinted below). In the piece I outlined two secular forces and two cyclical forces that are pushing inflation lower. The two secular forces are technological advance and demographics, and the two cyclical forces are monetary-policy tightening and the unwind of “Secular Stagulation.” We now have a fifth turning: corporate tax reform. It too creates a positive supply shock, which pushes inflation lower and growth higher.

As for the magnitude, I would be lying if I told you I had a model to forecast the size of this effect. I don’t think anyone can do that, even if the economics profession likes to pretend it is possible. I do however feel comfortable with the direction and with the additive nature of this corporate tax reform plan to the already heavy forces that have been pushing inflation lower.
Finally, let me just make a few quick observations on the proposed changes to individual tax rates. There are so many moving parts here that it is almost impossible to tell if this part of the proposal is actually stimulative. But I did find it fascinating (and somewhat ominous) that the WSJ op-ed page came out against the overall tax plan because they did not see stimulus for the individual. Now to be sure, there may be some stimulus for individuals in my home state of Florida at the expense of those in New York and California, but in the aggregate it is not easy to determine the overall effect. I am therefore going to run for now with the idea that this individual side of the tax reform plan, as crafted, will have minimal effect on the “aggregate demand” side of the equation. The only real story with the combined corporate and individual reform plan, if it passes, is on the supply side. And as such it is just another disinflationary positive supply shock which should be welcome news for our nicely performing “Spoos and Blues” trade. Good luck trading.

The Fourth Turning of Disinflation (July 31, 2017)
The U.S. CPI has missed market expectations on the downside for the last four months, crashing to a growth rate of 1.6% YoY most recently, from 2.7% YoY back in February. At the same time, core CPI growth has dropped back to 1.7% YoY, and core PCE price index growth has dipped to 1.4% YoY. Further, while the first cut of Q2 2017 real GDP growth came in at a reasonably strong 2.6% annualized rate last Friday, nominal GDP grew at only 3.6%. That left the implicit price deflator index for gross domestic purchases running at a meager 1% annualized growth rate over the last 3 months.

Of course, it is no secret that a rather sharp disinflationary trend has emerged in 2017. But the question is, why now? After all, employment measures suggest we are very close to full employment. And conventional Phillips curve-driven economic wisdom suggests that in the latter stages of a business cycle, as the labor market tightens, price pressures begin to appear. Now a well-trained Keynesian economist can always contort the Phillips curve so as to keep their version of reality alive in the face of incongruous evidence. But I want to argue today that the only contortion one should consider with a Phillips curve involves breaking it and binning it – not bending it. Understanding the 2017 inflation data and, actually, the entire post-crisis economic experience requires a supply-side lens, not one from the standard Keynesian demand side.

Now to be sure, soon after the Trump election win I began to argue that the forces of deregulation were setting up to unleash a large-scale positive supply shock in the U.S. economy, which would raise both potential economic growth and real rates of return on capital, while pressuring inflation lower. I dropped my pre-election concerns about populist trade and immigration policies and focused on a HIGHER real rate/positive supply shock outcome for the U.S. My concept of “secular stagnation,” introduced back on 3-Feb-17, best articulates the view. But follow-up notes such as “Stagulation rules, stagnation drools” on 5-Jun-17 and “The terminal funds rate” on 13-Jun-17, added more punch to the argument. In order to highlight the importance of this coming positive supply shock, I spent quite a bit of time in those notes reviewing the regulatory origins of the negative regulation-based supply shock that preceded it. Let’s just recap that discussion, since it is quite important as we tackle the outlook for disinflation.

There is no doubt that the post-crisis years were marked by significant increases in regulatory burden across almost all industries. This increased the overall cost of doing business and therefore shifted the aggregate supply (AS) curve. Thinking about this effect in terms of a traditional price vs. output chart from your Econ 101 textbook, each unit of output required a higher price so as to be economically viable. That translates into an AS curve that moves up and to the left – a negative supply shock. And of course this was happening just as we were (successfully) fighting off the large negative demand shock of 2008–09 with the introduction QE policies.

To see the actual numbers behind this supply shock, recall the data I put forth in the piece “Stagulation rules, stagnation drools.” The average annual growth rate of real GDP from 2008 to 2017 has been only 1.27%, a LOWER level than the 1.33% achieved during the depression decade of the 1930s. There was, however, a significant difference between the 1930s and the last 10 years. In 1930s there was deflation, -1.95% on average per year. But in the last 10 years inflation has averaged over 360bps more, at +1.62%. The ‘30s were all about a negative aggregate demand (AD) shock – a shift of the
AD curve lower took both prices and output down. But the bulk of the post-crisis period was not characterized by adverse demand dynamics. We did of course see significant disinflation in the latter half of 2008 and into 2009, when demand-side forces were certainly in play. But as mentioned above, the introduction of QE countered that demand shock quite successfully by 2010.

Sadly, though, it was right around this time when this regulatory negative supply shock kicked into high gear. By 2011, U.S. CPI inflation was pushing up towards 4%, but employment and output growth were still soft. Traditional measures of the output gap remained elevated, and significant excess capacity seemed incongruous with a Phillips curve view of the world. How could we have maintained such robust inflation rates from 2010 onwards with so much excess capacity? The answer of course rests with a regulation-induced negative supply shock. Higher prices and lower output are 100% consistent with a shift back in the aggregate supply curve. All this talk of “demand deficiency” and secular stagnation was completely inconsistent with the data – in the end it was a “supply deficiency.” Looking back at the 2010 to 2016 period, the Phillips curve provided a cloudy lens through which to view the macroeconomic forces in play. We should have binned it long ago, and we should bin it now as the coming positive supply shock enters the fray.

So how should we look at the (dis)inflation outcomes as deregulatory forces enter the U.S. economy? I suppose a 2.6% real GDP growth rate and a 3.6% nominal GDP growth rate (as per the release last Friday), along with a 4.4% unemployment rate, would be par for the positive supply shock course. Actually, those numbers might even represent a birdie. But in all fairness I think we need to widen the discussion on disinflation to allow for all the other forces at work. To that end I would like to argue today that we have four distinct disinflationary forces to consider. They are as follows:

1. A tightening of monetary policy: There have been four rate hikes since Dec 2015, and the FOMC will begin balance normalization “relatively soon.” Monetary policy tightening shifts aggregate demand lower, thereby REDUCING price pressures.

2. A slowing in labor force growth: While there is some debate on correlation versus causation, one of the most striking long-term relationships in macroeconomics is between inflation and labor force growth. Higher labor force growth associates strongly with higher inflation, and vise versa. With demographic trends pointing toward much slower labor force growth in coming years, a SLOWING in price pressures should also be on the horizon.

3. An increase in automation: Much has been written over the years on technological advances driving production costs and therefore output prices lower. Some have even gone down the rabbit hole of the singularity hypothesis. Whether or not one believes in “matrix-style” technological advance in our future, the pressures from these secular forces have been and remain disinflationary.

4. A movement toward deregulation: We have already spent most of this note discussing the disinflationary forces that are unleashed via deregulation. There is little need to discuss them further.

For me, the first three disinflationary forces have been with us for some time – and they are likely not going away anytime soon. But the fourth is a new one, and it is a sharp reversal of an inflationary force from the past. The momentum behind disinflationary deregulation policy is also likely to get much stronger in coming quarters. As I have argued in prior notes, new legislation is not required for us to see significant changes in the regulatory burden. Congressional legislation leaves much to various federal government agencies for interpretation and implementation. The new heads of the Departments of Commerce, Treasury, Labor, Interior, Health and Human Services, Education, and Transportation will have sharply different “interpretations” of the existing legislation than their predecessors. And on the financial side, at the Federal Reserve, someone like Randy Quarles will have a very different interpretation of Dodd-Frank than Dan Tarullo did. Unlike fiscal policy, regulatory policy changes do not require new legislation. I have largely rested my case for higher real rates and higher potential GDP growth on regulatory policy changes precisely for this reason. Waiting for fiscal policy to make an impact is simply too risky, given our broken legislative process.
All of this said, the most common question I get on the deregulation story is, how can we measure the size of its impact? People want numbers. They want empirical studies. They want to quantify the potential effects from deregulation. Well, I have spent an enormous amount of time looking through the work of academic economists on deregulation. I have also looked through the many studies on deregulation at prominent DC think tanks. And, as is to be expected with the economics profession, most of the work is dubious. The models are weak; the data are incomplete; and the authors typically allow their politics to drive their conclusions. I wish I had something more than survey data from the NFIB or a chart that shows increases in Federal Register pages. But I don’t. I do, however, believe that our prior analysis of the post-crisis period, which shows record-high corporate profits as a percentage of GDP and near-record-low productivity growth, is very consistent with a large increase in both regulatory burden and barriers to entry for new/small businesses. Those data suggest that regulation has had a major impact on the economy. And thus I feel comfortable arguing that unwinding regulation will have an equally large impact in the opposite direction.

I do wish there was something more concrete, but honestly it’s probably healthy for everyone to recognize the limitations of economic analysis. Even as a classically trained PhD student in economics, I see the field as an art not a science. The best economists, from my perspective, are heuristic storytellers, not frustrated mathematicians. We cannot expect precision in economics, especially macroeconomics. But hopefully today, with some acceptable storytelling, I have helped convince you that deregulatory forces from the supply side are going to add to the disinflationary trends that have already been in place for some time. There are four sharply disinflationary forces feeding through the U.S. economy at the moment. And the fourth one is just getting started.

— David Zervos, Chief Market Strategist

**Growth Convergence, Policy Divergence**

2018 should see the Global Economy in a full synchronized upswing while central bank policies diverge. The 2017 disinflation boom is likely to become more inflationary given the closing of many output gaps (full employment, full capacity) but central bankers are likely to differ in their response. The U.S. is moving towards full normalization (rates and balance sheet) while other central banks will likely prevaricate, worrying about the impact of rate hikes on their exchange rates.

The spectre of deflation is disappearing and being replaced by the ghost of inflation. Disinflation forces remain intact but the lack of investment, an uptick in demand from Emerging Markets and extraordinarily loose monetary policy has meant that output gaps have closed. In turn this is forcing labor rates up and domestic spending up.

Since 2016, global equity markets have been synchronized with multiple expansion as a series of monetary coincidences have occurred. The trade-weighted dollar has fallen alongside a massive collapse in global real interest rates. Indeed, as we have often pointed out, that no sooner had Ms Yellen begun raising rates at the end of 2015, the long end of the U.S. yield curve began to fall. With global CPI remaining tame but PPI moving out of deflation, the global economy (and equity markets) has enjoyed what we have termed a ‘disinflationary boom’.

Companies (capital holders) continue to be the major beneficiaries of disinflation with labor (stakeholders) still unable to capture their share of profits. Wage growth is muted. Similarly, U.S. corporate profits-to-GDP are close to their record highs while capex-to-GDP is at almost all-time lows. The question remains how long the current environment can last and when will profits be recycled into the wider economy.

Companies are enjoying a ‘goldilocks’ backdrop for profits with corporate pricing power growing in line with or faster than CPI and volume of shipments rising. In particular, the base effect for many cyclical companies has been exaggerated by the low base effects in 2015 and 1H16. To date over the cycle, governments have become poorer, households have seen little obvious wage increases while companies have seen cash flows surge. Aside from share buybacks, dividend
payments, and some M&A, the benefits of the disinflation boom have been saved by corporates. This has been noted from the U.S. to Japan and from South Korea to China.

Indeed, the current returns generated relative to a unit of risk (the Sharpe ratio) is one of the highest in the past 50 years. We continue to favor Japan, North Asia and Europe ex-UK. We expect stock and sector rotation within the U.S. to offer the best opportunities for active investors while Emerging Markets ought to see very divergent performance in 2018.

— Sean Darby, Global Head of Equity Strategy


With the enactment of tax reform, and as Jerome Powell assumes the mantle of leadership for monetary policy, 2018 will be marked by the passing of the baton from monetary policy to fiscal policy as the primary source of economic stimulus.

U.S. Economy Ended 2017 in a Good Place, Growth Profile to Continue to Improve

Consumer spending will be boosted by continued job growth, increased wealth, rising disposable income, and increased confidence. Many, but not all households, will benefit from tax cuts, and increased disposable income.

The cumulative effects of business deregulation and corporate tax relief will foster a more business-friendly environment. Rebuilding housing stock in regions devastated by natural disasters will boost construction activity in a market that is already struggling with a shortage of construction workers.

An Acceleration in Inflation Lies Ahead

With six million job openings, tightening labor markets, and rising voluntary separations wages should accelerate in a more meaningful way.

The supply shock in housing caused by the natural disasters will accelerate the upward trend in the shelter component of the CPI. In addition, the rising prices for imported goods will then get passed on to a stronger consumer sector that is able to absorb price increases, and inflation measures will also be boosted by supportive base effects.

Monetary Policy Normalization to Accelerate, Composition of the Balance Sheet More of a Focus

We believe new Fed Chairman Jerome Powell will continue a monetary policy of gradual rate and balance sheet normalization. The Fed should react to the stronger economy and fiscal stimulus with four rate hikes and continued balance sheet normalization that is pre-programmed to accelerate.

We also see Powell guiding a more tailored approach to financial deregulation that moves away from the one-size-fits-all post-crisis regulatory approach.

With the departure of Janet Yellen, Stanley Fischer, and Bill Dudley, there will be increased policy uncertainty until replacements are on board. With the addition of Marvin Goodfriend to the Fed Board of Governors, however, the Fed has added a world-renowned monetary policy expert.

The composition of the Fed balance sheet—the lack of bill holdings and the slow MBS roll-offs—is likely to become a policy topic. At some point in the year, the focus of balance sheet normalization will shift more to composition and the desire to increase Treasury bill holdings and decrease MBS holdings at a more accelerated pace.

“Tax Cuts & Jobs Act” (TCJA)

The “Tax Cuts & Jobs Act” (TCJA) is far from perfect but will create a more business-friendly environment and boost long-term growth in the US. The consequences of the TCJA for the consumer sector are more ambiguous and mixed. While tax cuts will increase disposable income for most households, the housing sector in high-tax states is at risk due to the SALT and mortgage caps.
Many Downside Risks Emanating from Washington
The perpetually poisonous political environment in Washington will continue to generate uncertainty, frustration, a surplus of investigations, and a shortage of progress on important issues. The evolution of protectionist policies could threaten global trade and adversely affect both growth and inflation.

Geopolitical risks and tensions will continue to provide an uneasy backdrop to a US economy that is otherwise in a happy place. Additionally, the abrupt emergence of cyber currencies adds an elusive element of risk.

— Ward McCarthy, Chief Financial Economist

European Outlook – QExit and Brexit: Mario and Mark’s Adventure Is about to Get Bumpy
With the ECB preparing to end QE, the BoE eyeing further rate rises and the US Fed on a path of rate normalisation, the decade of extraordinary monetary policy is coming to an end. The direction of travel is clear, but the timing of central bank policy steps is anything but certain. Will the strength of the recovery allow the ECB to forego tapering altogether? Will the BoE be in a position to raise interest rates if the UK is seen to be aimlessly drifting out of the EU? And would the Fed follow through on multiple rate hikes next year, even if inflation continued to undershoot expectations? These are likely to be some of the main points of debate in 2018.

Inflation, in a familiar way, remains the missing piece of the puzzle. After years of disappointment, few are forecasting anything other than subdued growth in wages and prices for the year ahead. But if inflation were to surprise on the upside, market interest rates could surge higher, with the Central Bankers playing catch up.

The ECB, will take its time winding down QE, but the pace of its sovereign bond purchases could fall by more than half from the start of the year, with all eyes on what happens to periphery spreads in the aftermath. Globally too, with almost 50% of ECB QE purchases made from foreign investors and recycled into overseas assets, a less active ECB will impact the US and the UK markets.

The Catalan issue remains unresolved, but generally, the political obstacles of 2017 were navigated without major damage; now the focus is on the upcoming Italian election on 4 March. The 5 Star Movement lacks an obvious route to power, but substantial market volatility still seems likely around the event. At the ECB, all eyes will be on the departure of Vitor Constancio - Draghi’s dovish vice president - at the end of May. A hawkish replacement (perhaps Knot) could signal an important shift at the heart of the institution.

In the UK, the clock is ticking down to the March 2019 Brexit departure date, while the BoE is essentially trying to guess what the new set-up will mean for the long-term prospects for the economy. The February BoE Inflation Report should help guide interest rate expectations for the rest of the year & the markets may once again be caught out by the MPC’s hawkish leanings. Politically, the lull during the EU/UK trade negotiations in the first half of the year could be followed by a frantic sprint for the finish line in the final months of 2018, as the provisionally agreed Brexit terms are scrutinised for final approval. Indeed, if the MPs are given a ‘meaningful vote’ on the final deal, the government’s slim majority could be severely tested in passing the final legislature through, raising the prospect of a new General Election a & the possibility of Article 50 being extended to buy all sides more time.

— David Owen, Chief European Financial Economist
— Marchel Alexandrovich, European Financial Economist
**Actionable Ideas for Companies and Sponsors**

**MERGERS AND ACQUISITIONS**

**Partial Stake Sales by Private Equity On The Increase**
In 2017, 24 percent of exits by private equity firms were thru partial stake sales, as financial sponsors sought to reduce risk at this stage of the economic cycle, while preserving further upside. In addition, partial sales provide a valuation peg for private equity fund raising, capital to return to limited partners, and potentially better refinancing terms. Investors in these partial sales have expanded from traditional participants, such as pension funds and sovereign wealth funds, to the broader financial sponsor universe. The benefit for the acquiror is participation in an attractive company earlier in its growth cycle, risk-sharing with the original investor and potentially more favorable debt financing.

In 2017, Jefferies was actively involved in several partial stake sales, including (i) advising EQT in October 2017, in the sale of a 19% stake in Anticimex AB to a consortium of Swedish private equity firms and a pension fund; (ii) advising Ares in July 2017, in the sale of a minority stake in National Veterinary Associates to Canadian pension fund, OMERS; and (iii) advising Apax Partners in its sale of a 45% stake in Garda World to Rhone Capital, who now owns majority control.

**Corporate Boards Successfully Challenging Activist Campaigns**
Activist shareholders have deployed over $45 billion on campaigns in 2017, more than double the total for 2016, and there are no signs of abatement in new campaigns heading in 2018. However, as activists have pursued larger and better-resourced targets, companies have shown an increased willingness to fight back aggressively.

DuPont defeating Trian’s proxy fight with an aggressive investor communication plan focused on reiterating management’s strategic vision in 2015 was a turning point for defending against activist campaigns. ADP and Accorda, both companies with strong, consistent investor communication, also successfully fended off their activists. The playbook became clear – reacting to the specific approach was not a sustainable defense strategy. Management and boards need to maintain a proactive investor communication strategy, involving (i) regular outreach to both institutional and retail shareholders, (ii) clear articulation of the company’s strategic vision, (iii) direct participation by independent board members, along with (iv) real-time monitoring of the shareholder base.

**2017 Tax Reform Will Favorably Impact M&A Activity Levels**
The Tax Cut and Jobs Act of 2017 will have a significant favorable impact on M&A deal activity. Specifically, the resulting increase in U.S. profits, coupled with the “deemed repatriation” of profits back to the U.S., should create additional dry powder for investments, including acquisitions. And with more money available for deals, acquisition multiples could expand further in the near-term. In addition, there is an expectation that tax reform will lead to increased economic growth, which should lead to enhanced confidence in the executive suite and corporate boards further strengthening M&A activity.

The reduction in the corporate rate to 21% should increase after-tax cash flow, resulting in higher cash balances, driving up company values and the prices acquirors should be willing to pay in an M&A transaction. While there will be offsets to the lower rate, including limiting deductibility of interest expense, other factors, such as the immediate expensing of certain qualified property, will accelerate tax benefits on capital investments (albeit at a lower tax rate), further adding to cash balances. In addition, other elements affecting taxes, including the movement from a worldwide system of taxation towards a territorial system, the addition of an excise tax on payments to foreign affiliates and the proposed tax on “foreign high returns“ are expected to incentivize the on-shoring of overseas profits.

**EQUITY CAPITAL MARKETS**

**Increasing Trend of Concurrent Share Repurchases with Secondary Equity Offerings**
In 2017, 24 secondary block trades or follow-on offerings were executed with concurrent share repurchases totaling $10.4 billion. A concurrent share repurchase is mutually beneficial for both the selling shareholder and the company. The
company’s repurchase serves as an anchor order in the sell down and is immediately accretive to EPS, resulting in improved file-to-offer pricing. 2017 secondary share offerings with concurrent repurchases priced, on average, over 160 basis points tighter than secondary transactions without a concurrent repurchase. Typically the size of the share repurchase is approximately 25% of the secondary block or follow-on offering. Jefferies recently led a $145 million marketed follow-on for MedPace Holdings Inc., in which the company concurrently repurchased $63 million from the selling shareholder.

**144A Equity Private Placements Provide Access to Sizeable Institutional Capital**

144A equity private placements are sales of unregistered stock to institutional investors, where the issuer agrees to complete an IPO or listing within 12-24 months after the private placement. The 144A structure provides issuers with the ability to access the institutional equity market in size – typically $200 million to $1+ billion – without the SEC review and delay. For private equity sponsors and private company business owners, 144A offerings provide institutional equity capital to facilitate portfolio acquisitions, add-on acquisitions, organic growth prior to becoming a public company or as an exit alternative to a corporate sale.

Jefferies recently hired Ken Slosser to run our 144A business within Equity Capital Markets. Ken previously ran investment banking at FBR, which specialized in 144A, and during Ken’s 21 year tenure at FBR, FBR was the dominant market leader in 144A offerings, executing 90+ 144A bookrun offerings raising $20+ billion in proceeds.

**The European IPO New Issue Market Will Continue to Be Strong in 2018**

European IPO issuance in 2017 rose 54% in volume year-on-year, as 181 IPOs priced across the region, raising gross proceeds of $52 billion, and we expect this trend to continue. The UK, Italy, Switzerland, Spain and Germany were the most active markets with 61% of the total IPO volume. Financials, technology, real estate, automotive and healthcare were the leading sectors, contributing 67% of total volume. Despite having the largest number of IPOs priced since 2014, the median IPO size in 2017 was $131 million, meaning the market has been receptive to offerings from mid-sized companies. Corporate issuance was very strong, and the percentage of sponsor-backed IPOs was at its lowest since 2012 at 23%. The IPO environment was more subdued in the UK in the second half of 2017; however, successful UK IPOs can still be achieved through early investor engagement before launching the deal publicly, and by generating demand from anchor investors to offset any volatility during the public marketing period.

**DEBT CAPITAL MARKETS**

**Issuance of Delayed-Draw Term Loans**

The strength of the leveraged loan market has led to acquisitive borrowers incorporating delayed-draw features in their term loans. This allows borrowers to have pre-arranged financing for future tuck-in acquisitions without the more expensive committed financing process, while keeping their revolving credit facilities undrawn. The delayed-draw tranche is often only available for a period of time (3, 6 or even 12 months), subject to a maximum leverage level pro forma for the drawing, and requires some type of fee construct over the period of the commitment. Jefferies recently led the financing of Young Innovations to support the LBO by The Jordan Company. The first lien term loan facility consisted of $270 million of funded term loan and $68 million of delayed draw term loan. The delayed draw commitment period was for a year with a 1% ticking fee that started after 60 days.

**Increased Prevalence of Pricing Step-downs**

As the leveraged loan market has strengthened throughout the year, the prevalence of pricing step-downs has increased dramatically. Step-downs lower the coupon spread above Libor, based on achieving a certain threshold of ratings or leverage level. Traditionally, pricing step-downs have been reserved for higher-rated (i.e., B8-rated) issuers but the strength of loan market now has allowed coupon step-downs to be used by both smaller issuers and lower-rated companies. The additional benefit of step-downs is that rate reductions are hard wired into the deal, and therefore, are realized by the issuer even in
increasing rate environments. Ratings-based pricing grids are more common with higher-rated and lower spread loans, while leverage-based grids have been used with the lower-rated and highly leveraged loans.

HoldCo Bond Issuance to Fund Dividend Recaps
Holding Company (“HoldCo”) issuance to fund dividends is highly infrequent, as only 6 have been completed in the last two years. However, the strength of the high yield market is allowing issuers today to tap the often-closed HoldCo note market. Issuing notes at the HoldCo level allows companies to avoid the debt incurrence restrictions of their existing capital structure. This structure is particularly useful when these notes have the option to be paid in-kind, with additional notes, as the cash flow generating OpCo will often not have enough restricted payment capacity to service the HoldCo notes with cash.

RESTRUCTURING AND RECAPITALIZATION
The Telecommunications Sector Will Face Increasing Distress in 2018
For decades, traditional wireline service providers enjoyed protected monopolies and operated under a regulated return on assets framework. Due to the stability of cash flows, the independent ILECs were able to finance with significant leverage and were often attractive leverage buy-out candidates. However, due to wireless, cable and “over the top” competition, the entire ILEC industry have been experiencing access line losses for several years. This negative and compounding operating trends has started to erode both cash flows and investor confidence. For example, Frontier Communications has seen its stock price decline by 81%, equity market value decline by over $3.3 billion and its bonds trade from par to the 70s over the last 12 months. Moreover, the largest independents have aggregate indebtedness in excess of $55 billion.

As Windstream, Frontier, Consolidated and the other ILECs face continuing customer churn and secular pressures, these companies will need to examine asset sales and exchange offers in order to enhance their financial flexibility to garner enough time to redesign their business models to meet the realities of the evolving telecommunications market.

MUNICIPAL FINANCE
Municipal Borrowers Must Evaluate Refinancing Existing Bank Direct Placements As A Result of Tax Reform
Over the past few years, municipal borrowers have funded an increasing amount of their tax-exempt capital needs thru direct placements to commercial banks. These Bank Direct Placements often include provisions whereby the municipal borrower shares certain risks with the Bank lender, which can result in the borrowing rate increasing. One such risk is the reduced after tax benefits to the Banking lender holding tax-exempt bonds due to a reduction in corporate tax rates. Municipal issuers should review their Bank Direct Placement documents to determine the cost/benefit of refinancing their bank debt using lower cost market based products including tax-exempt fixed rate or variable rate bonds. Market-based products will likely offer lower interest rates, because the broader investor base will include investors who are less sensitive to corporate tax rates.

Best Research Ideas

AMERICAS

Jefferies U.S. and European Equity Research and Global Strategy teams published a collaborative report looking at investment opportunities across the firm’s coverage in the U.S. and Europe. Jefferies highlights that while the U.S. market is more expensive than Europe from a valuation standpoint, the margin is not wide relative to history, even prior to factoring in the potential impact of U.S. tax reform. When accounting for tax reform, Jefferies believes the U.S. is the clear winner among large caps and more or less equal among small-caps. Jefferies analysts compared several single stock names in both regions and were asked to express a preference when possible. In seven of the 13 “clear” preference cases, the analysts chose a U.S. stock over a European/UK stock. The “clear” preferences expressed in the report are as follows: Royal Dutch
Shell over ExxonMobil, Gap over H&M, Comcast to BT Group, Kennametal to Sandvik, Estee Lauder to L’Oreal, Roche to Merck, Boeing to Airbus, Bank of America to Barclays, BMW to General Motors, Ashtead to United Rentals, Praxair and Linde to Air Liquide and Air Products, and Kingfisher to Lowes.  

— Jefferies U.S. Equity Research & Global Strategy

Johnson & Johnson – Upgrade to Buy: Pharma TIRADES to Drive EPS Growth & Dividend Momentum

Jefferies upgraded [JNJ] shares to Buy as the firm believes that JNJ’s Pharma division is under-modeled by the Street and will drive above consensus revenue and EPS growth. After completing a deep dive analysis of the division, Jefferies found that a number of specific products could collectively make a significant difference to the growth outlook for the entire company. Jefferies currently forecasts that Pharma is likely to drive 52% of revenue and 65% of profit for JNJ by 2021. The majority of anticipated upside is expected to come from the oncology and immunology assets, as well as under-modeled Actelion synergies. Jefferies’ revised 2021 EPS estimate is now 12% ahead of consensus and the firm expects shares to re-rate to a market premium once the company’s diversified growth platform is fully recognized.  

— Jeff Holford, Equity Research Analyst, Pharmaceuticals

EMEA

European Franchise Picks List – Many Happy Returns

Approaching the first anniversary of our Franchise Picks List launch (11 October 2016), we review performance to date and look to maintain the impetus with nine new stocks added (Allianz, EDF, Meggitt, RBS, Royal Dutch Shell, Siemens, Swisscom, ThyssenKrupp and Yoox Net a Porter). We choose to remove five names (Airbus, Aviva, Danske Bank, FiatChrysler and Just Eat), all of which remain at Buy, except Airbus (cut to Hold on 22 September).  

— Jefferies European Research Team

Generali – Now We Are Free: Upgrading to Buy

Following decades of political intrigue, Jefferies believes Generali is finally free to forge its own strategic destiny. Cash earnings are accelerating, and together with the capital being released from non-core assets, Generali will soon be ready to redeploy capital. Jefferies calculates the annual potential uplift from such capital actions at 3-4% and upgrades to Buy.  

— Mark Cathcart, Equity Research Analyst, Pan-European Insurance

ASIA

Telecom Services – The Geopolitics of 5G and IoT

Behind the complicated technology lie significant geopolitical forces that drive the current development of 5G and IoT standards, as well as selection of 5G spectrum. China wants to be a leader, and the U.S. thinks it is ahead in mmWave. Japan and Korea lean toward supporting the U.S., and Europe is more relaxed but practical. A deeper look at the tech explains the geopolitical landscape, and supports Jefferies’ view that China will roll out 5G fast and big.  

— Edison Lee, Equity Research Analyst, China Telecom/Technology

India Oil & Gas E&P – Assuming Coverage on the Inexpensive ONGC and Oil India with Buys

Jefferies resumes coverage of ONGC at Buy, expecting 14% FY18-21E EPS CAGR as Brent rises to US$65. The HPCL acquisition, likely EPS-accrative, is an overhang but the dilution to fair value may be modest. In any case, with the stock 20-50% cheaper than peers, there is adequate cushion, with investors underweight too. Risk/reward looks favourable, hence, with 18% potential upside to Jefferies’ Rs200 PT. With Oil India 15% cheaper than ONGC, Jefferies also resumes at Buy with a Rs465 PT.  

— Somshankar Sinha, Equity Research Analyst, India Energy
Investment Banking | Equities | Fixed Income | Wealth Management

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NOTABLE RECENT TRANSACTIONS

- **Technology**: October 2017
  - **Broadsoft**: $1,900,000,000
    - Cisco Systems, Inc.
    - Lead Financial Advisor
  - **Soitec**: $1,619,000,000
    - The Hennessy Company
    - Sole Financial Advisor
  - **CPI Global**: $940,000,000
    - Credit Facility to Finance Acquisition by Leonard Green & Partners and Partners Group
    - Joint Lead Arranger
  - **KSS Safety Systems**: $1,588,000,000
    - Acquisition of TakeAll Corporation
    - Joint Lead Financial Advisor

- **Energy**: November 2017
  - **Energy Logistics**: $8,100,000,000
    - Acquisition of Refining, Logistics Assets and Fuel Distribution Services from Marathon Petroleum Corp.
    - Financier Advisor to the Committee
  - **Mplex**: $1,260,000,000
    - Senior Unsecured Notes Offering
    - Sole Bookrunner
  - **Avantor**: $3,401,000,000
    - Credit Facility to Finance Acquisition of VWR Corporation
    - Joint Lead Arranger
  - **Medallion**: $1,825,000,000
    - Sale to Global Infrastructure Partners
    - Lead Financial Advisor

- **Consumer**: November 2017
  - **LHC**: $1,042,000,000
    - Lead Financial Advisor
  - **National Vision**: $400,000,000
    - Initial Public Offering
    - Joint Bookrunner
  - **IEQT**: $875,000,000
    - Acquisition of MLP Interest in Global Gateway South
    - Sole Financial Advisor
  - **Medallion**: $725,000,000
    - Credit Facility to Finance Acquisition by Global Infrastructure Partners
    - Sole Lead Arranger

- **AeroDefense**: November 2017
  - **Standard Aero**: $652,000,000
    - Credit Facility to Finance Acquisition of Vector Aerospace Holdings
    - Joint Lead Arranger
  - **Aerovestalo**: $762,000,000
    - Initial Public Offering
    - Joint Bookrunner
  - **Everi**: $818,000,000
    - Credit Facility
  - **Fusion**: $375,000,000
    - Senior Unsecured Notes Offering
    - Joint Bookrunner

- **Healthcare**: October 2017
  - **PureGym**: Undisclosed
    - Leonard Green & Partners
    - Joint Financial Advisor
  - **Medallion**: $768,000,000
    - Credit Facility to Finance Acquisition by Genstar Capital
    - Joint Lead Arranger
  - **SailPoint**: $276,000,000
    - Initial Public Offering
    - Joint Bookrunner

- **Telecom**: October 2017
  - **Amplify**: $1,940,000,000
    - Credit Facility to Finance Acquisition of Synacore’s Wireless Security and related FSI solutions business
    - Joint Lead Arranger
  - **IntNCT Communications**: Undisclosed
    - Secure-24 Intermediate Holdings, Inc.
    - Sole Financial Advisor
  - **Fusion**: $260,000,000
    - Senior Unsecured Notes Offering
    - Joint Bookrunner

- **Technology**: November 2017
  - **Terveystalo**: $672,000,000
    - Initial Public Offering
    - Joint Bookrunner
  - **Municipal**: $818,000,000
    - Credit Facility
  - **Westfield**: $877,000,000
    - Second Series Revenue Bonds
    - Joint Bookrunner

- **Real Estate**: December 2017
  - **Unisys-Paragon SE**: $22,500,000
    - Sale to Nortis
    - Sole Financial Advisor

JEFFERIES KEY FACTS & STATISTICS

(as of November 30, 2017)

- **Founded**: 1962
- **Total Long-Term Capital**: $11.2 billion
- **Number of Employees**: 3,450
- **Companies under Global Equity Research Coverage**: 2,000+

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Jefferies.com
RECONCILIATION OF CONSOLIDATED ADJUSTED FINANCIAL INFORMATION

($ millions)

This presentation of Adjusted financial information is an unaudited non-GAAP financial measure. Adjusted financial information begins with information prepared in accordance with U.S. GAAP and then those results are adjusted to exclude the operations of Jefferies’ Bache business. Management believes that the disclosed Adjusted measures and any adjustments thereto, when presented in conjunction with comparable U.S. GAAP measures are useful to investors as they enable investors to evaluate Jefferies’ results in the context of exiting the Bache business. These measures should not be considered a substitute for, or superior to, measures of financial performance prepared in accordance with U.S. GAAP.

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<th>Successor</th>
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<td>Twelve Months Ended</td>
<td>Twelve Months Ended</td>
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<td>Fixed Income Net Revenues</td>
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<td>Non-Compensation Expenses</td>
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<td>Compensation and Benefits</td>
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<td>(135)</td>
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<td>Income tax expense (benefit)</td>
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<td>(45)&lt;sup&gt;(4)&lt;/sup&gt;</td>
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<td>Net Earnings (Loss) Attributable to Jefferies Group LLC/Common Shareholders</td>
<td>94</td>
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(1) Revenues generated by the Bache business, including commissions, principal transaction revenues and estimated net interest revenue, for the presented period have been classified as a reduction of revenue in the presentation of Adjusted financial information.

(2) Expenses directly related to the operations of the Bache business for the presented periods have been excluded from Adjusted non-compensation expenses. These expenses include floor brokerage and clearing fees, amortization of capitalized software used directly by the Bache business in conducting its business activities, technology and occupancy expenses directly related to conducting Bache business operations and business development and professional services incurred by the Bache business as part of its client sales and trading activities, including estimates of certain support costs dedicated to the Bache business. Estimates of certain support costs were derived based on direct support costs for the presented period in relationship to the average head count of corporate support personnel with responsibilities associated with operating the Bache business.

(3) Compensation expense and benefits, including salaries, benefits, cash bonuses, commissions, annual cash compensation awards and the amortization of certain share-based and cash compensation awards, recognized during the presented period for employees whose sole responsibilities pertained to the activities of the Bache business, including front office personnel and dedicated support personnel, have been classified as a reduction of Compensation and benefits expense in the presentation of Adjusted financial information. In addition, compensation and benefits for other corporate support personnel with duties specific to the Bache operations included in this adjustment were estimated based on an average per person cost applied to the average head count for this employee population type across the presented periods.

(4) Reflects the income tax expense (benefit) associated with excluding the items in net revenues, non-compensation expenses and compensation and benefits expenses associated with the Bache business.

(5) Non-compensation expense includes amortization expense during the presented periods of intangible assets, which arose in connection with the purchase accounting associated with the Leucadia transaction in the second quarter of fiscal 2013, which has been classified as a reduction of Non-compensation expense in the presentation of Adjusted financial information.

(6) Non-compensation expense for the purpose of the Adjusted financial information is adjusted for goodwill and intangible asset impairment losses of $59.5 million related to the Bache business.
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