QUO VADIS CAPITAL
Private Wealth Management

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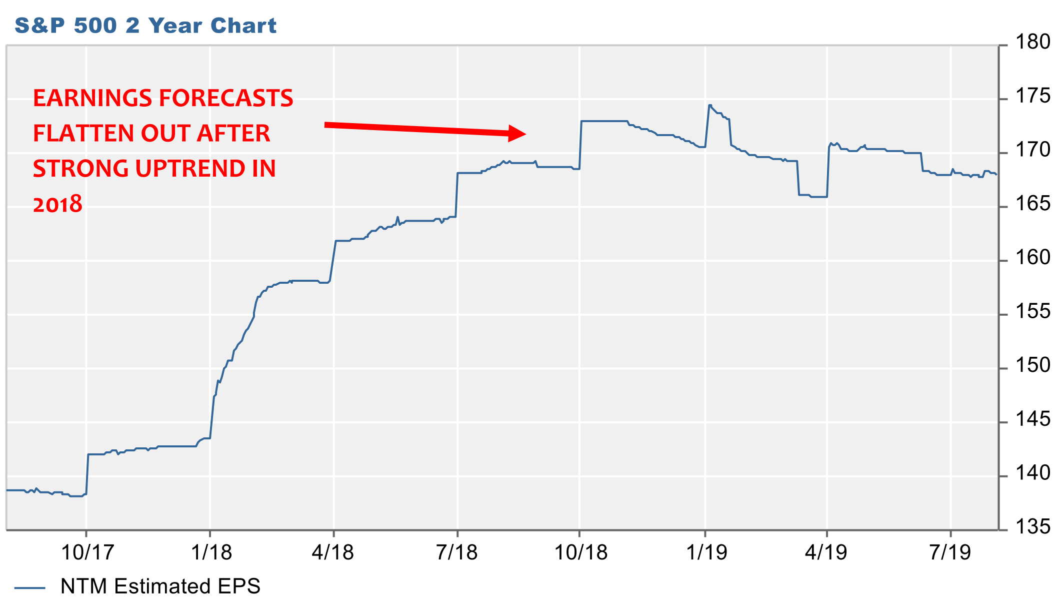
Cut Thin and Win

Summary: Threats to economic growth remain minor relative to underlying positives, in our opinion. Last week, markets fell as the Federal Reserve lowered interest rates, but signaled no future cuts. This was followed by Thursday's announcement that the U.S. would impose a 10% tariff on $300B of Chinese imports. Both events served to stoke fears of slowing global growth. Our view remains more constructive due to our focus on the strong consumer (unemployment is at 50-year low), the innovative nature of U.S. companies and industries, and favorable conditions for access for capital, among both private and public companies. We continue to see the tariff and trade "war" talk as mostly noise relative to economic momentum.

Why did the Fed cut interest rates?

Corporate earnings growth is slowing. Recall that in 2018 the government gifted companies and investors an enormous benefit by lowering U.S. corporate tax rates. This caused absolute earnings to rise and the rate of growth to also increase. This can be seen in Figure 1, which shows estimated aggregate earnings per share for the S&P500 rising to $175 by October 2018 from $140 in October 2017. The permanent reduction in

Figure 1. Expected (next-12-months) aggregated earnings for the S&P 500. Earnings forecasts show investors expect growth slowing to nearly zero or even a slightly contraction in corporate earnings.



corporate tax rates was also supposed to jolt the overall economy into much faster, sustainable growth. (It was thought that companies would use the incremental cash provided by lower tax rates to reinvest in their respective businesses, thus spurring accelerated growth.) Figure 1 also shows that this has not occurred. Expectations for future corporate earnings have basically flattened out post the benefit of lower taxes, and stopped growing altogether. In fact, aggregate estimated S&P500 earnings for the next year now sit around $168, below levels of last October. The cause for this unexpected outcome is up for debate and we're not going to address it here. Our point is to call attention to this air pocket in growth as perhaps the most important consideration behind the Fed's decision last week to lower rates. Lower interest rates reduce companies' and consumers' borrowing costs, and should, normally, stimulate growth. If this move is successful, it should contribute to estimated earnings to head back higher again. Whether it works or not won't be known for some time (if ever).

How We are Managing Our and Client Money:

Our assumption is that our ability to forecast the overall market and macroeconomic conditions is highly limited. Accordingly, while we try to understand current conditions and trends, we try to make investment selections based on a long-term view and look for companies we can own throughout the economic cycle. The stocks of the best companies will still go down in a recession, but these businesses oftentimes benefit from challenging economic conditions as weaker competitors fail and cede share.

Selection from our model portfolio: Our approach is to own high-quality companies, bought opportunistically if possible, and own them long-term with the intention to minimize trading costs and taxes. Our portfolio is concentrated (~20 positions) and generally we are favorably inclined towards companies we *know* or at least find easy to understand.

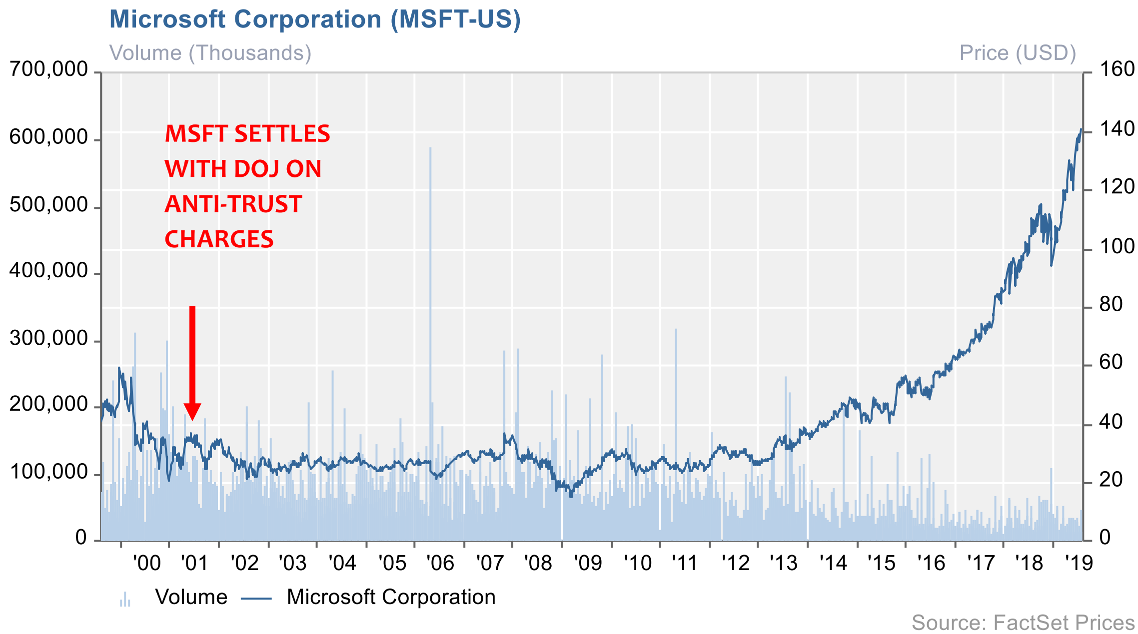
Market Dominance is Among Our Favorite Investment Themes

Microsoft (MSFT): Should investors in large tech companies fear anti-trust investigations? Warrant Buffet and value investors have popularized the use of the term "moat" to describe a business that has a durable advantage which reduces the probability of losing market share. Many things can comprise a moat. One we like as an investment theme is scale. Scale can serve as a moat if it lowers a company's cost to deliver a product or service and/or raises barriers to entry for competition. If scale is combined with market dominance, it can become self-reinforcing. In this situation, completing products or services face an uphill battle even for trial. We view Microsoft's market position via its Windows operating system and suite of corporate applications (Word, Excel, PowerPoint, etc.) as this kind of self-reinforcing combination of scale and market dominance. Who wants to learn a new operating system or accept the risk of ordering software that is incompatible with those of clients? In our portfolio we also own Alphabet (aka Google; GOOGL) which controls the world's internet search, Apple (AAPL), which is an dominate provider of consumer electronics, and Facebook (FB), which dominates social media. Each of these businesses has some scale advantage or market dominance in its respective domains. But what of the risk of regulation and anti-trust investigations currently underway into these businesses? Rather than risks, we see these investigations as reinforcing our opinion about each company's respective strengths and market position. Of course, we could be wrong here, and perhaps governmental overreach, buttressed by election-year politics, will create legitimate headwinds for these businesses or damage their brands.

Returning to Microsoft, in the late 90s the company was pilloried for its anti-competitive business practices, bullying, and lack of ethics, and statements like "Internet Explorer is an essential and integral component of Microsoft Windows" while it was busy strong-arming weaker-positioned rivals. Saturday Night Live even ran a skit mocking the company's defense of its strategy.* The company endured a multi-year investigation and trial, eventually settling with the DOJ in November 2001. Maybe it's the case that this distraction and bad press did slow the company down. However, the ultimate outcome is that MSFT's dominance within computer operating systems and corporate software has remained unchecked to this day. The company now uses the cash flow from these products to invest in developing other services where it is growing. The bottom-line is that you can see how Microsoft's stock has done since the anti-trust settlement in Figure 2, below. We feel comfortable that Google, Apple and Facebook will also survive pending investigations. It certainly seems a better bet than investing today's equivalent of Netscape or WordPerfect.

*After an exhaustive search, I couldn't find the skit on YouTube. It's possible I made this up.

Figure 2. MSFT shares are up 27% over the last year and the company is currently valued over $1 trillion.



August will mostly be spent in the south of France. The Parisian tradition is to flee the capital during a good portion of the summer months. This leaves the city to the purview tourists who are happy and don't seem to notice or mind that half the restaurants are closed. I admit it was a very difficult decision, but I've decided to follow along with the French and head to the countryside for August as well. That said, I will continue to do calls with companies, analyze corporate earnings and follow markets when not enjoying a glass of pastis or a bike ride in the Cevennes.

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Yours,

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Mr. Zolidis started his career in finance in 1996 following degree studies in Philosophy at Kenyon College and Oxford University. He has followed U.S consumer companies as a senior analyst since 1999, mostly on the sell-side, writing research for institutional investor clients. He also managed money in a buy-side role at a long-short equity fund over 2013-2014. He was named in the Wall Street Journal's Best on the Street list in 2005. Mr. Zolidis founded Quo Vadis Capital, Inc., a Registered Investment Advisor and research boutique, in 2017 and works from New York and Paris, France.

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