



YEAR TO DATE
As of September 30, 2018

BROXTON +3.90%

MARKETS

DOW JONES +6.88%
S&P 500 +8.94%
NASDAQ 100 +19.27%
HIGH YIELD -0.01%
REIT INDEX -2.77%

BOND YIELDS

10 YR TREAS 3.06%
YTD CHANGE +65%

30 YR TREAS 3.20%
YTD CHANGE +46%

SINCE INCEPTION

THROUGH DEC 31, 2017
BROXTON 488.15%
S&P 500 170.59%
DOW JONES 209.91%

BROXTON PERFORMANCE



Broxton Portfolio

In September Broxton was up .5%, bringing the average returns to 3.90% for the year. The Federal Reserve raised interest rates in September into the 2-2.25% range with a signal that raises will continue and bond yields began to move higher. This may mark the end of the high-flying tech shares which have been the primary driver in the current market. In addition, the rising yields will effect overpriced dividend shares. Global trade tariff news had a diminishing effect on the U.S. market as participants reacted less to new developments. There were several positive news items on Broxton Holdings during the month.

Genworth (GNW): Genworth reported compliance with new regulations regarding U.S. mortgage insurers. This gives the company enhanced visibility on large dividend increases from the U.S. mortgage subsidiary and substantially improves the financial outlook. Broxton is renewing its activist campaign to convince the company to abandon the buy out at \$5.43 per share from China Oceanwide. We believe the shares are worth over \$10.

Harmony Gold (HMY): African gold producer Rangold was effectively purchased by Barrick Gold for around 10 X EBITDA. This multiple would value HMY at over \$8 per share. HMY trades for about \$2 per share currently. Gold prices have been rebounding slightly on short covering and strong orders from India after a slow 2018 start.

Viacom (VIAB): CEO Bob Bakish [outlined plans](#) for positioning the company in the SVOD market (subscription video on demand). VIAB supplies content to Amazon and Netflix (but trades at a low PE multiple while Amazon and Netflix trade at over 100).

Ford (F): Ford suffered from a rash of downgrades as analysts reacted negatively to the early turnaround plan and the pressure from tariffs. Although the automaker has the number one truck in the North American Market and has shown strong increases in SUV sales, investors are said to be suffering from fatigue. We lightened up our position as it may be early in terms of perception. F trades at less than 2 X working capital and about 1 X book value.

Qudian (QD): We are reaching out to Qudian to help them explain their story. The company seems to fit the definition of orphaned equity with very little institutional investor support! The fast-growing loan originator fell to new lows after reporting its best quarter since the IPO and trades at 3 X 2019 projections.

Oi Telecom (OIBRC): Large institutional investors have been buying Oi. Brookfield Asset Management, Inc., purchased 123 million shares of OIBR for a total initial position of 5.7% and on October 4th Solus Alternative Asset doubled its ownership in OIBR to 18%. Since bondholders have taken over the company Oi has shown improvement in the important post-paid subscriber category!

General Market

We are actively investing in shares that are not a part of the tech bubble

This is probably the end of the multi trillion dollar high flying market in technology shares. We have been highly skeptical of these shares because historically none of these types of shares have ever survived their inevitable correction. To Broxton this is a complete repeat of the year 2000 fiasco. From 2000 to 2002 the average tech share lost 85% of its value. Why is this happening again? The original participants from 2000 were mostly annihilated and the current participants are a new crop of investors. The lure? New technologies can show fast adoption rates and fast earnings increases but the opposite always becomes true for these shares. Earnings growth stabilizes or shrinks or goes negative and the shares trade at normal price ratios. In addition, many new companies want to enter these fast-growing markets and technologies putting pressure on the high flyers profit margins. Since many of the shares trade at more than 100 X earnings at their highs, this leads to a share price catastrophe. In 1999 and 2000 there was America Online, Juniper Networks, Dell and others. Juniper networks reached over \$250 per share before falling to \$4 in 2002. America online was worth as much as \$225 billion before being purchased by Verizon for \$5 billion. We are beginning to see the right side of many of these Matterhorn or Eiffel tower charts. This is where the stock price makes an unbelievable ascension right before it turns around and goes the other way. As the shares rise it takes more and more participants entering and buying to keep the shares going up. Inevitably the shares destabilize and crash because there are not enough new entrants. Speculators flee as the price crashes. Unfortunately, the lure of easy money or fear of missing out pulls in many of the knowledgeable and experienced participants towards the end. One or two of these charts is not a concern but we are beginning to see 40 or 50 of these. Similar to 2000, many of the charts represent shares that are trading at over 100 X earnings such as Amazon, salesforce.com, Netflix, Workday, Square and Red Hat (Yes!! Red Hat again, it fell over 95% after 2000).

These shares also seem to have a gravitational effect that can be transferred to normal shares or suddenly transferred to newfangled ideas as the investment community becomes increasingly emboldened. Today we have marijuana stocks suddenly becoming worth billions of dollars although many of the companies have no revenue. Many normal shares seem to get caught up in the excitement as well. Lockheed Martin, Costco, Walmart & Microsoft are all trading at over 30 X earnings. The normal PE ratios for these shares is around 15 or 20. For many of the shares it is not mathematically possible to make a positive return. For most it is mathematically improbable. This current situation has been compounded to some degree by two factors. The introduction of non-gaap accounting and the permanently low interest rates. Interest rates are the primary variable in pricing all earning assets. Interest rates were kept so low for so long that the risky assets were pulled higher as investors searched for returns. The normal spectrum for credit quality, duration and asset class was crushed into one homogenous group with a 2% annual return. This has a 100% probability of reversing as the interest rates on bonds rise. The current yield of the S&P 500 index is around 1.85%. If the S&P 500 fell to its normal Price-to-earnings ratio the yield would improve to the 2.5% area, but this would equal a loss of around 25% for the index. If the index were to yield 3.5% the price of the shares would fall on average 50%.

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We are actively investing in shares that are not a part of the second 2000. We are encouraged by the fact that our portfolios are not down in October (as of Oct 19) as the average index is down 4-8% so far. We may need to prune some of our holdings or hedge to protect the portfolios as things develop but we are encouraged because we have seen some money flows being redirected towards value shares this month. It is still early to be certain but at this time it looks like the we have seen the top.

Amazon Eiffel Tower chart



Broxton Capital Advisors

Broxton Capital is an investment manager located in Los Angeles and employs The Primary Broxton Strategy or “PBS.” The Primary Broxton Strategy or “PBS” for managed accounts. The PBS is a bottom up, fundamental strategy that seeks higher total returns with lower risk. The focus is on low risk investments with attractive return (LRAR Securities) with an average holding period of 18 to 36 months. The strategy invests in high yield, fixed income, and equities but does not have any allocation mandates.

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