

# The July 2018 Client Note

## Technology Stocks Stay Resilient

The first half of 2018 is behind us, and technology remains the driver of stock market returns. Technology fund inflows are running at \$37B annualized for the year, which is 10x higher than any of the 15 years prior to 2017. This influx of capital has led to unprecedented performance amongst technology stocks. Per the attached exhibit, Amazon (NASDAQ: AMZN) has contributed to 36% of the S&P500's returns for the year.

*The top 10 S&P500 stocks, which are nearly all tech companies, have comprised 122% of the total S&P500 return this year.* It has been a historic start to the year for tech, however dependence on a singular industry is generally not sustainable, and is why diversification into value oriented stocks is advisable.

## Stock Pick In Focus: Volaris Aviation (NYSE: VLR)

Volaris is a Mexican discount airline, which has lost over 75% of value since 2016. The stock had benefited from a series of tailwinds, which have since reversed, leaving the stock deeply out of favor.

### How Volaris fell from \$21 to \$5 per share:

**Mexican Election:** The left wing candidate Lopez Obrador is bad news for Mexican stocks, though this result should have already been "priced-in". Any further decline in Mexican stocks on the election result should reverse quickly.

**NAFTA & Trump:** As a Mexican stock, Volaris has been susceptible to headline news regarding the NAFTA agreement, Trump policy, and the associated currency fluctuations.

**Rising Oil Prices:** Volaris has an unusual amount of leverage to the price of oil, as can be seen by the plummeting share price over recent months, during which oil has rebounded sharply. However, the company only achieves this leverage to oil due to its extremely low and efficient cost structure. As such, Volaris is negatively affected by higher oil prices at a marginally higher rate, since oil accounts for a higher percentage of total costs. This should not be mistaken for an absolute effect. Volaris can make money at fares where their rivals would be unprofitable.

**Increased Competition:** The new "Open Skies Agreement" has allowed more route pairs between the US and Mexico, and airlines are fighting (on cost) to obtain rights for these new routes. However, as the lowest cost airline, Volaris will be able to outlast competitors and is best positioned when capacity growth slows down.

### The Opportunity:

A plethora of headwinds have left Volaris selling at distressed prices. However, it has a pristine balance sheet with \$400 million in unrestricted cash on the books, boasting \$200 million in net cash (cash minus debt). Positive net cash is highly unique in the airline space.

Airlines tend to be valued on the Enterprise Value to EBITDAR ratio, typically trading around 5-7x EV/EBITDAR. Volaris is under 2x, a vast valuation gap to its competitors. We expect the stock to trade back up to 5x once the cycle turns (trading above this level in 2016), to a share price of \$15/share or a 200% gain.

There are no clear catalysts for an immediate turnaround, and as such market sentiment is exceedingly low. However, Volaris is a hyper cyclical company that tends to overshoot on the upside as well as the downside. Volaris has the best cost-structure out of its peer group. It has a fortress balance sheet, which means it can ride out an extended wave of industry unprofitability, without lasting harm. At some point the cycle will turn, and patient investors will likely be rewarded.

Exhibit 3: 10 stocks have contributed more than 100% of S&P 500's YTD return as of June 28, 2018

Ticker	Company	Cons. 2019E sales growth	Total return	Mkt cap weight	% of SPX Return
AMZN	Amazon.com Inc.	23 %	45 %	2.1 %	36 %
MSFT	Microsoft Corp.	10	16	2.9	18
AAPL	Apple Inc.	4	10	3.8	15
NFLX	Netflix Inc.	24	106	0.4	15
FB	Facebook Inc.	27	11	1.9	8
GOOGL	Alphabet Inc.	18	7	2.8	7
MA	Mastercard Inc.	12	31	0.6	7
V	Visa Inc.	11	17	0.9	6
ADBE	Adobe Systems Inc.	19	37	0.4	5
NVDA	NVIDIA Corp.	14	25	0.5	5
<b>Top 10 contributors</b>		<b>16 %</b>	<b>20 %</b>	<b>16 %</b>	<b>122 %</b>
<b>S&amp;P 500</b>		<b>5</b>	<b>3</b>	<b>100</b>	<b>100</b>

Source: FactSet, Goldman Sachs Global Investment Research

**Max J. Greb**  
O&G Capital Management  
Research & Trading  
+86 135 6409 5307