

A Quick Survey of Some of Our Top Holdings

This article by MOI Global instructor Glenn Surowiec has been excerpted from a letter of [GDS Investments](#).

“From whence shall we expect the approach of danger? Shall some trans-Atlantic military giant step the earth and crush us at a blow? Never. All the armies of Europe and Asia . . . could not by force take a drink from the Ohio River or make a track on the Blue Ridge in the trial of a thousand years. No, if destruction be our lot we must ourselves be its author and finisher. As a nation of free men we will live forever or die by suicide.” -Abraham Lincoln

In our 2017 Mid-Year Letter, GDS Investments commented upon the fundamental strength of the American economy and our confidence that, because of that strength, the political tomfoolery on display in Washington, D.C. would have little long-term impact upon that economy. We expressed our belief that, with its optimal mix of geographic fortune and structural stability, America exists is something of an economic Goldilocks zone where, notwithstanding the tweet-of-the day, the conditions for prosperity are enduringly “just right.”

A year removed from that letter, and many hundreds of tweets later, we retain our confidence in America’s indomitable economic strength. With political rhetoric now giving way to actual tariffs, deficits, and other actions which some see as self-inflicted economic harm, the question is whether we are now ripe for the national ‘suicide’ which President Lincoln feared.

We think not! Indeed, we reiterate our caution ... don’t bet against America. Though improvident and rash, tariffs, trade wars, and ballooning budget deficits shall not imperil that which survived civil war, reconstruction, world wars, assassinations, multiple recessions, and the Great Depression.

Though tempered by the knowledge that tariffs served to exacerbate the Great Depression, we think that conditions remain well-suited for growth within the GDS Investments portfolio. We will continue to look with a contrarian view upon individual fact patterns and individual companies and will base our long-term investment decisions upon nothing less than that research.

We again start with **General Electric Company (NYSE: GE)** and note that a cornerstone of successful investing is the ability to look ahead without dwelling on past mistakes. As present-day General Electric investors, we are buying into the future of the company, and not the past.

In our 2017 Year-End Letter, we commented upon the appointment of new CEO John Flannery and looked ahead with our expectation that Mr. Flannery would reverse General Electric’s well-documented recent troubles by restructuring the company’s non-core businesses. That expectation is now reality.

On April 26, 2018, *The Wall Street Journal* reported that General Electric turned down an offer from **Danaher Corporation (NYSE: DHR)** to purchase General Electric’s Life Sciences unit

at a price in the \$20B range. That unit generates approximately one-quarter of GE Healthcare's total sales, and General Electric's refusal to sell in the stated price range speaks volumes about the value which the company places on Life Sciences. Further cementing that valuation is the fact that **Siemens AG (FWB: SIE)** recently spun-off its medical imaging and diagnostics division (Healthineers) for \$35B. If the same valuation metrics which were applied to Healthineers were applied to GE Healthcare, General Electric shareholders could realize more than \$60B from a spin-off of that unit . . . a spin-off which we expect will be completed within the next 12 to 18 months.

General Electric will soon close on a transaction to merge the transportation business component of GE Aviation with **Wabtec Corporation (NYSE: WAB)**. In that \$11B deal, General Electric will realize nearly \$3B in cash while its shareholders will own 40.2% of the new company. The structure of that transaction will bring significant advantages while allowing General Electric, under Mr. Flannery's leadership, to continue to optimize its portfolio of businesses.

We expect that optimization will include (A) General Electric's sale of its gas engine business to private equity firm Advent International for \$3B, (B) the company's sale of its 62.5% stake in **Baker Hughes (NYSE: BHGE)** over the next 36 months, and (C) as noted, the spin-off of GE Healthcare.

The General Electric turnaround will not be quick, and it will require a healthy dose of the patience about which we wrote in our 2017 Year-End Letter. We remain confident, though, that patience will be well-rewarded.

Another position which we featured in our 2017 Year-End Letter is **Under Armour, Inc. (NYSE: UAA)**. Since that letter, Under Armour's share price increased approximately 60%, and is up 100% from our cost basis. The company posted stronger-than-expected results in the first quarter, and the market appears poised to acknowledge something on which we commented six months ago . . . a growth strategy focused upon the company's core products and brand cache (as opposed to rapid expansion) will be recognized with an appropriate valuation.

We wrote extensively, too, about **QUALCOMM, Inc. (NASDAQ: QCOM)** and explained efforts by **Broadcom Limited (NASDAQ: AVGO)** to effect a hostile takeover of Qualcomm. On March 12, 2018, the Trump Administration cited national security concerns to forbid that acquisition. Those concerns centered upon a belief that a Broadcom-owned Qualcomm would endanger the United States' competitive position in 5G technology by allowing a Chinese company to gain unfair advantage.

Looking forward, we expect that, ultimately, Qualcomm will close on its long-pending acquisition of Netherlands-based **NXP Semiconductors, N.V. (NASDAQ: NXP)**. The only necessary regulatory approval for that acquisition which now remains outstanding is from the government of China. That approval should rise or fall with the success of the United States' ongoing trade negotiations with China.¹¹

Furthermore, Qualcomm recently announced a \$10B stock repurchase program. As such, Qualcomm's share price should perform well for the foreseeable future regardless of the fate of the NXP Semiconductors deal.

GDS Investments continues to hold **TripAdvisor, Inc. (NASDAQ: TRIP)**. While realizing free cash flow in both the hotel and non-hotel segments, the company reported strong revenues

and earnings in Q1 which well-exceeded analysts' expectations. In the past, TripAdvisor overinvested in brand and consumer-centric initiatives. Those investments caused earnings contractions when made, but they are now delivering returns which we expect will continue past 2018. Chief Financial Officer Ernst Teunissen is optimistic, and recently commented that the company's "good start has made [management] more positive about our 2018 profitability outlook."

We also mention here **Exxon Mobil Corporation (NYSE: XOM)**. The company recently outlined its long-range guidance on capital expenditures and return on invested capital, and its plan to increase ROIC to at least 15% over the next five years. As the most disciplined capital allocator within the oil and gas industry, and with its fully integrated business model, Exxon Mobil can remain profitable throughout the entirety of the oil and gas cycle.

In the first half of 2018 GDS Investments started a number of new positions. One of those is **Newell Brands, Inc. (NYSE: NWL)**. The owner of some of America's most well-known brands, Newell historically employed an ill-advised "growth by acquisition" strategy which culminated in a 2016 merger with **Jarden Corporation (NYSE: JAH)**. That acquisition left Newell saddled with too-much debt and difficulty integrating its pre-existing brands with Jarden's.

More recently, Starboard Value LP and other activist investors took notice of Newell's post-acquisition struggles. Starboard acquired a 4% interest in the company, and Carl Ichan built a 6% stake. As a result of internal pressure from those investors, as well as other changes, Newell expects to sell at least 25% to 40% of its existing portfolio. For example, on June 5, 2018, Newell announced plans to sell Rawlings to a private equity firm for \$395M.

Between mid-2017 and mid-2018, Newell's share price dropped more than 50% and, at current pricing, the company can be owned at compelling value as asset divestiture and restructuring play out. This position should yield good returns, especially in light of the company's recent announcement that it will expand by \$2.5B its currently ongoing share repurchase program.

Another new GDS Investments position is **JD.com (NASDAQ: JD)**. This Chinese e-commerce company enjoys significant consumer trust in that country where, unfortunately, the marketplace is plagued by counterfeit merchandise and unreliable delivery execution. By combining that reputation with a strategic willingness to realize very low operating margins, JD.com became the e-commerce brand of choice for China's most affluent customers in its largest cities and is second in size only to **Alibaba (NYSE: BABA)**. News reports suggest that JD.com may be looking to re-enter the Russian market and the company recently announced plans to begin operations in Western Europe. A new arrangement with **Alphabet, Inc. (NASDAQ: GOOGL)** should also allow JD.com to begin to penetrate the Americas.

The Chinese e-commerce market has a long way to go to catch-up with the activity in Europe and North America. JD.com is perfectly positioned to enjoy growth in that market as Chinese wealth and internet usage expand.

We also reiterate our outlook regarding bonds, which are in the early stage of a bear market as interest rates continue to rise from artificially low levels. The last bull market in bond prices lasted for 35 years. There is no reason for us to expect that this nascent bear market will be any less long-lived.

To say that these are interesting times in the life of our nation would be something of an

understatement. The soul of the country is deeply divided and our national leaders appear to revel in what seems to be a game of political Russian Roulette. As investors, though, we take solace from the facts that the foundations of the American financial system are strong and that, even now, there is no place on Earth where conditions are better suited for long-term economic growth.

In that regard, and not without a small dose of humility, we'd amend Mr. Lincoln's warning to state that "as a nation of hard-working, patient, disciplined, and well-informed investors, America's place as the world's leading economy will endure forever, or die by suicide inflicted through irrationality, demagoguery, and fear." None of those negative characteristics has ever defined the American economy in the long-term, and this morning's tweet-of-the-day certainly won't change that!

[\[1\]](#) As the date of this letter, American tariffs on some Chinese exports (and China's retaliatory tariffs on some American exports) are in effect. We will carefully monitor the now ongoing trade dispute between these two (and other) trading partners, and make investment decisions accordingly.