DECALIA

INVESTMENT INSIGHTS

MONTHLY ISSUE #44

September 1st, 2018

THE SHOW MUST GO ON

Editorial View

The Show Must Go On

- From vinyl records to digital files, a *wind of change* has blown over the global music industry
- Streaming & concerts have overtaken physical sales – Revenues back to their 2006 peak in the US
- Digitalization has created new opportunities but not all players will top the *Billboard* charts

Jukeboxes & *CDs* are dead, long live the music streaming industry! Indeed, the time is long past when one wandered around record stores for hours contemplating new album covers and expanding his (physical) music library as he completed his personal (non-shared) collection. Like so many others, the global music industry has significantly evolved in the past decades, spearheaded by technology changes impacting not only the way music is purchased, but also played, shared and ultimately monetized. While the format transition, from physical to digital, of albums & soundtracks is by far the most apparent change for consumers, the implications of this revolution are much deeper, affecting all players of the music industry. Bob Marley once famously said *"One good thing about music, when it hits you, you feel no pain"*. Unfortunately, this has not proven true for all traditional actors of the industry, unable to adapt as the balance of forces shifted, hence giving way to new entrants as many business opportunities emerged. Meanwhile, and for once, the end consumer (listener) has been the main beneficiary of this transformation.

Today, streaming, downloading, and subscribing actions have all by far and large replaced the *physical* purchase of a record. As a result, not only has the volume of instantly available music content massively increased but the number of new distribution channels has also proliferated. Indeed, whereas in the past, record shops acted as the main, if not sole, intermediary between content creators and listeners, this equation no longer holds true with both higher internet speed & penetration levels paving the way for online platforms such as *iTunes, Google Play, Spotify, SiriusXM* and *Pandora*.

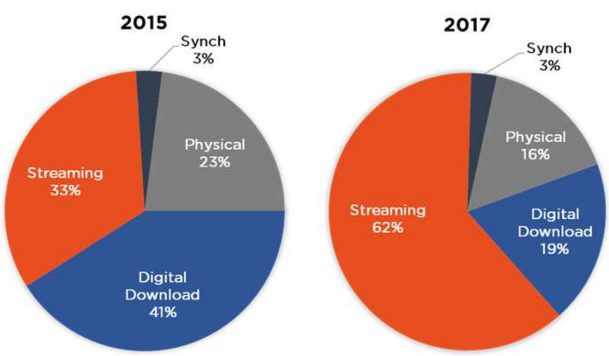
The consequences of the global music industry's disintermediation did not take long to come. Whereas on the one hand, the arrival of such new players implied less revenues for both record labels and artists (sharing agreements), on the other, the accessibility and affordability of music has significantly improved for listeners.

The US music industry peaked in 2006 (USD 43bn), struggling to get back in synch… until today. The sales mix has significantly changed, however. Indeed, concerts, previously used for promotional purposes only, have become the main source of revenue for popstars (60% or USD 5bn in 2017). As a result, live concert producers (e.g. *Live Nation*) have doubled their revenues over the last 6 years, taking advantage of both higher supply (artists needs) and ever-stronger demand, leading to a highly lucrative business. This in turn has led music record labels in desperate need for revenues (*Sony, Vivendi*) to reconsider vertical integration strategies by adding ticket resellers and concert venues to their portfolios. Even e-commerce giants such as *eBay* have pounced on the opportunity, acquiring highly profitable *StubHub*, a key future driver.

This *wind of change* is widely seen as beneficial in reviving the global music industry to its former glory but hurdles remain. Consumer piracy may well be less of an issue today but cybersecurity remains crucial to curb leaks and protect user data. Moreover, the death of *net neutrality* rules comes as a blow to many record labels & digital platforms (need to reward bandwidth access). As usual, these costs will be more easily absorbed by big players (*Amazon, Google, Apple*) with smaller ones (*Pandora, Spotify*) likely having to step off stage… and leaving the *FAANG* show go on.

Chart of the Month

SURGE OF STREAMING IN THE MUSIC INDUSTRY



Global Strategy

Turkey On The Grill As US Equities Top The Bill

- Weaker economic momentum vs. *Expansion* mode – Expect a stabilization of global trends
- Core inflation levels still under control – Smooth global monetary tightening at a diverging pace
- Brace for further volatility in global financial markets – But fundamentals remain sound

Notwithstanding the recent end of the markets' *Goldilocks* era and the start of a transition period for most financial assets, we keep our constructive global macro scenario broadly unchanged supported by healthy fundamentals. How ironical, just as risk metrics and volatility spiked across most asset classes (equities, FX) due to renewed Turkey & EM fears, the US equity market his hitting all-time highs, marking its longest rally in history. Such discrepancies are likely to persist in our view as both decelerating macro & micro trends take their toll selectively. Hence, we stick to our cautious stance both on Emerging (downgrade of debt in June & equities in late 2017) and European assets (downgrade of EUR/USD in June & Eurozone equities in May 2018) due to de-coupling economic momentum, rising political uncertainties (e.g. Trade War), and diverging central banks (USD & rates risks).

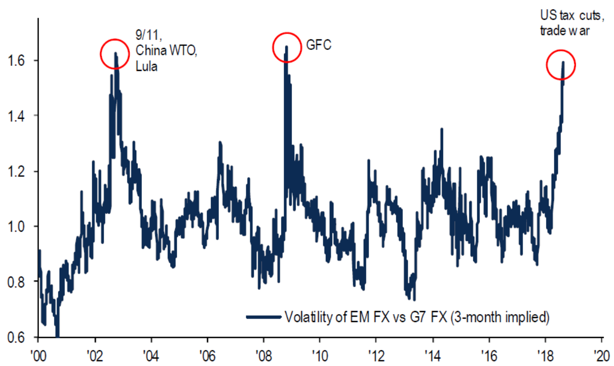
Admittedly, the global economic momentum has faded since the start of the year but latest data suggest the soft patch seen in Q1 may already be over. Indeed, global activity levels remain in healthy *expansion* territory, suggesting a potential stabilization of economic trends in the coming months. Moreover, though steadily rising in the US, other regions' inflation remains under control, i.e. below their respective central banks' targets. After years of *accommodativeness*, the age of loose money may well be coming to an end but global tightening is has been implemented in a smooth and agile manner so far. In particular, the latter is occurring at a different pace around the globe with the FED remaining ahead of other major central banks (ECB, BOJ, SNB) for now as confirmed by its latest statements at Jackson Hole symposium.

Within this context, we remain selectively constructive on equities as we enter a period of transition deserving a note of caution. Corporate EPS upgrades may well have peaked but growth expectations for 2019 look reasonable to us. Moreover, valuation levels are back in line with multi-year averages and we do not view investor positioning as crowded nor too bullish anymore. That said, both higher risk metrics across the board and geopolitical uncertainties still need to be monitored closely. Regionally, Switzerland's defensive growth remains our preferred equity play followed by the US and we reiterate our cautious view on Emerging Markets. Sector-wise, we continue to favor a more balanced approach by selectively adding to Defensives again.

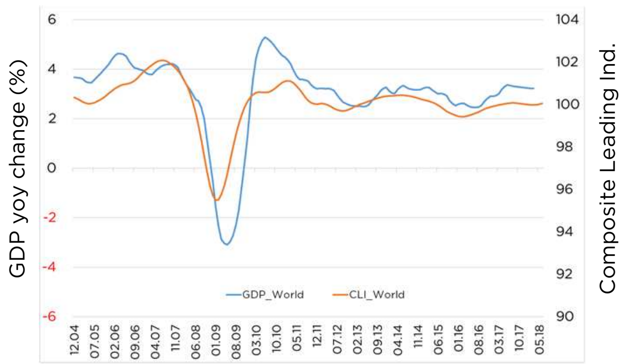
In Fixed Income, we keep our cautious stance unchanged after our recent downgrade of Emerging Markets Debt with both a stronger US dollar and higher rates likely to keep EM economies under pressure. We nevertheless keep our US Treasury 10-year position as a hedge against geopolitical turmoil. Finally, we still prefer US duration to Europe as we believe the latter provides greater downside risk.

On FX, we keep our cautious short-term view on the euro unchanged after last month's tactical downgrade (vs. US dollar). Even though valuation & fundamentals (current account, fiscal deficit, debt to GDP) should benefit the euro in the medium term, the currency may remain under pressure for now due to the region's less favorable economic momentum, a more dovish ECB, and revived political tensions. Meanwhile, the US dollar should further benefit from the attractive rates differential, stronger economic growth, a hawkish FED, and investor positioning.

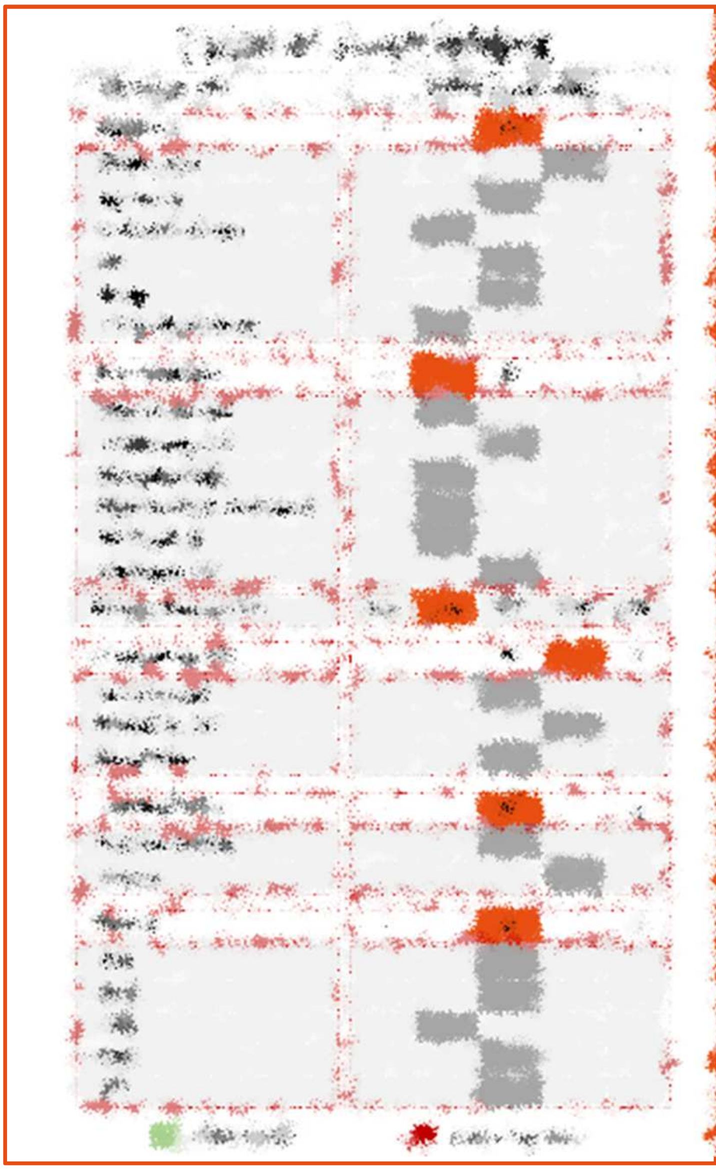
EM FX Volatility at 10-year high

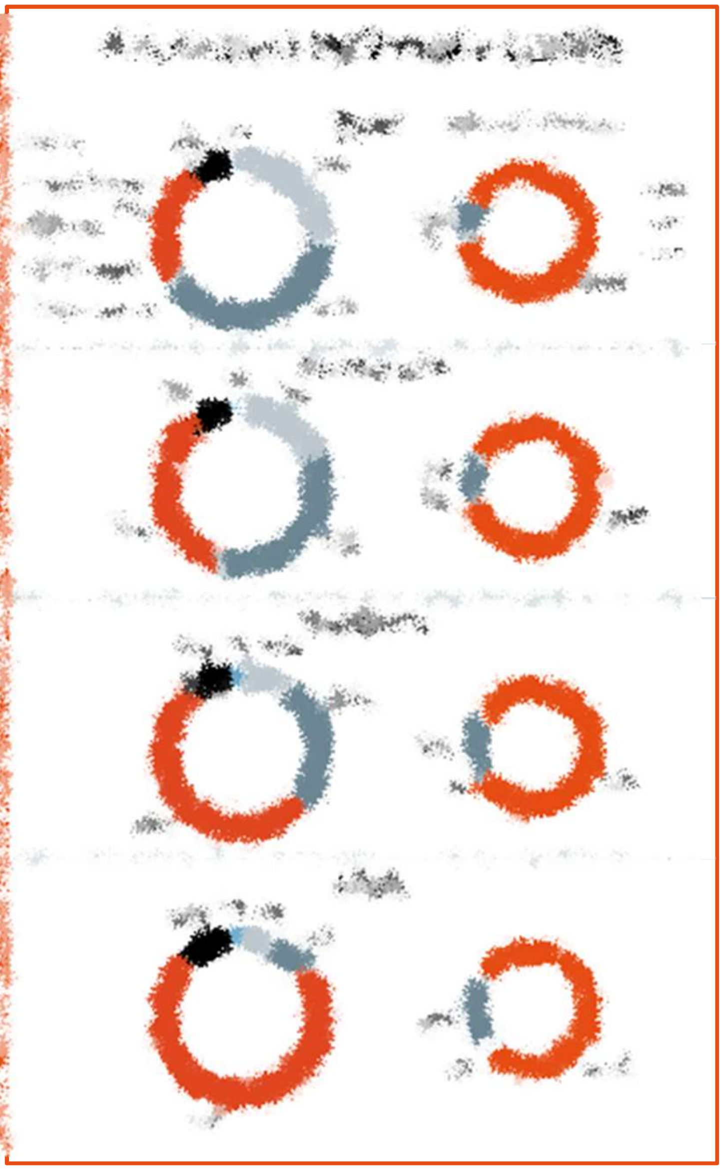


Global Leading Indicators



Asset Allocation





- Equities – Remain selectively constructive as we enter a period of transition deserving a note of caution
- Fixed Income – Still prefer US duration to Europe as the latter provides greater downside risk
- Alternatives – Continue to favor uncorrelated strategies & Private Equity in the current environment

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External sources include: Bloomberg, Thomson Reuters DataStream, OECD, Citi, Nielsen, Medium.com, BofA Merrill Lynch

Finished drafting on August 30, 2018