Trinity Student Managed Fund
Research Team

Bi-Weekly Markets Update

NOVEMBER 27TH, 2024

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Past Weeks in Review

- US manufacturing PMI 48.8
- Japan GDP growth 0.2% QoQ
- US core CPI at 2.6% YoY

The Next Two Weeks

- Non-farm payrolls
- China manufacturing PMI
- Europe CPI data

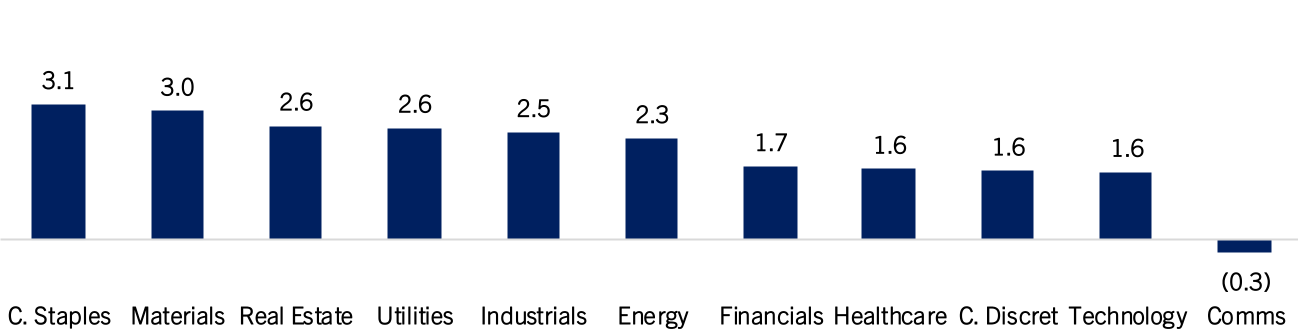
Microstrategy Share Price YTD ($)

Figure 1:

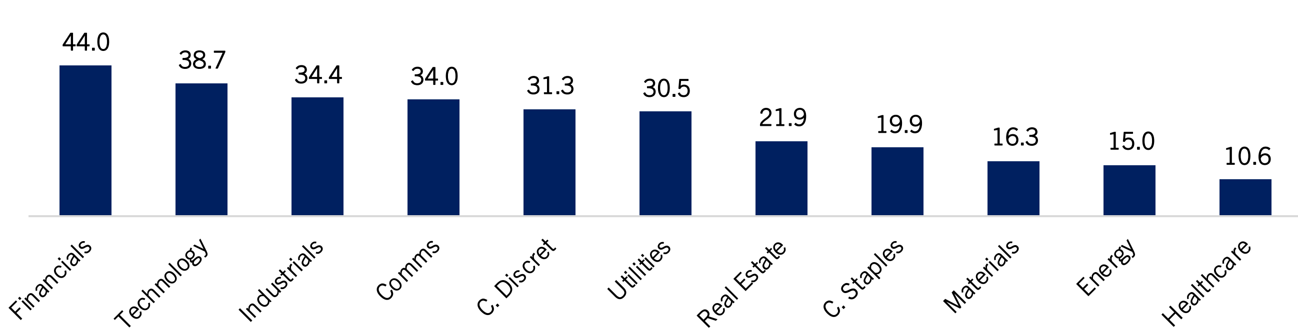
Index Returns (%)						
Equities	Level	1 M	YTD	1 Year	3 Year	5 Year
MSCI	3766	1.6	18.8	25.2	17.6	64.4
S&P 500	5969	2.8	25.9	31.2	29.9	90.5
Dow Jones 30	44297	5.2	17.5	25.4	26.9	57.8
Russell 2000	2407	9.0	19.6	33.6	7.2	48.4
Russell 1000 Growth	3968	2.9	32.0	35.8	32.0	131.7
Russell 1000 Value	1943	4.3	18.8	26.9	22.0	47.8
NASDAQ	19004	2.6	28.7	33.4	22.7	120.1

Levels (%)						
Key Rates	25/11/24	31/10/24	31/08/24	31/05/24	29/02/24	31/10/23
2Y U.S. Treasuries	4.3	4.2	3.9	4.9	4.6	5.1
10Y U.S. Treasuries	4.3	4.3	3.9	4.6	4.3	4.9
30Y U.S. Treasuries	4.5	4.5	4.2	4.7	4.4	5.1
10Y German Bund	2.2	2.4	2.3	2.7	2.4	2.8
10Y Japanese Gov Bond	1.1	0.9	0.9	1.1	0.7	1
10Y U.K. Gilt	4.4	4.4	4	4.3	4.2	4.5
SOFR	4.6	4.9	5.3	5.3	5.3	5.4

1W Returns



1Y Returns



As Boeing's Debilitating Strike Comes to an End, What Does the Company's Future Hold?

Boeing, a leader in the aerospace industry, finds itself at a pivotal moment as it encounters a range of escalating financial, operational, and cultural challenges. While the recent resolution of its labour strike offers some relief, the company faces significant hurdles in restoring stability and achieving its ambitious production goals.

THE ISSUES FACING BOEING

Historical context and scandals

Boeing has faced a series of scandals, including crashes of its 737 Max jets, manufacturing issues, and failures in the space sector. (1) In October 2018, under CEO Dennis Muilenburg, a Boeing 737 Max crashed off the coast of Indonesia. Five months later, another 737 Max crashed shortly after take-off in Ethiopia, killing 346 people. Investigations revealed that a faulty sensor activated an anti-stall feature, repeatedly forcing the aircraft's nose downward. In July of this year, Boeing agreed to plead guilty to a criminal fraud charge for misleading regulators about the plane's design. Families of the crash victims oppose the deal, arguing it fails to hold Boeing accountable. (2)

After the 737 Max was cleared to fly again in November 2020, Boeing's troubles continued. In January 2024, a door panel blew off an Alaska Airlines flight due to missing bolts, causing rapid decompression. No serious injuries occurred, but the FAA launched investigations that exposed lapses in Boeing's manufacturing and quality assurance processes. CEO Dave Calhoun faced intense scrutiny during a Senate hearing. (2)
Boeing has also faced setbacks in its space programs. In September 2024, its Starliner capsule returned prematurely due to a software malfunction, leaving two astronauts stranded in orbit until SpaceX retrieved them. These issues highlight broader systemic failures within the company. (3)

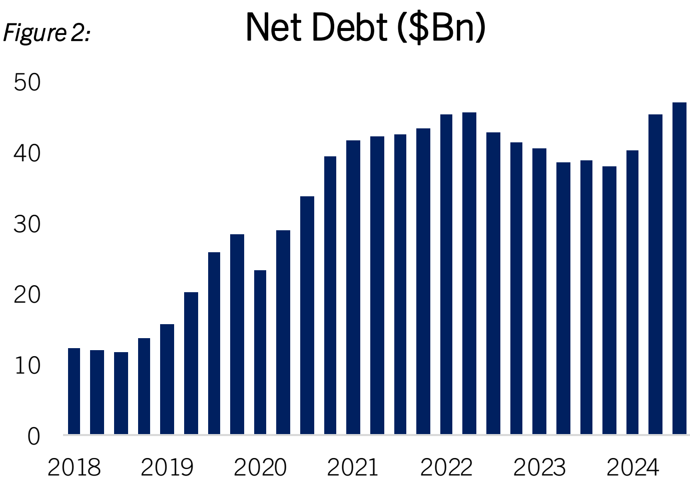
Supply chain & Operational Challenges

Boeing's operational efficiency has been significantly hindered by supply chain issues, production delays and strict regulatory oversight. The COVID-19 pandemic severely impacted the company, denting demand for air travel and slowing parts deliveries. These challenges reduced production capacity, making it difficult for Boeing to stabilize operations and meet consumer demands. (2) Boeing was forced to issue $24 billion in debt to navigate the crisis. (2) Recovery from these setbacks remains ongoing.

Quality control failures have further slowed Boeing's supply chain, prompting strict Federal Aviation Administration (FAA) oversight and additional production caps. (1) Following the labour strike, Boeing has agreed to a new Quality Plan in collaboration with the FAA to address these manufacturing quality concerns. (1) Due to these disruptions, the company's ambitious 737 Max production goal of 38 planes per month has been delayed by an estimated 9 to 12 months. (2) These constraints further complicate the company's effort to achieve production targets and recover financial losses.

Boeing also faces a backlog of over 5400 commercial planes, valued at $428 billion - equivalent to five years of revenue. (1) While this could secure future revenue streams, the delays in fulfilling these orders may strain customer relationships and give airlines leverage to seek greater discounts. (3) Rising manufacturing costs further challenge Boeing's ability to turn a profit from these orders.

Figure 2:



Cultural and Structural Issues

Boeing's cultural and structural challenges stem from years of mismanagement and a shift in priorities, with the 1997 merger with McDonnell Douglas often cited as a turning point. (2) The merger redirected the company's focus from engineering excellence to financial performance which placed an emphasis on production speed and cost-cutting over quality and safety. (2) New CEO Kelly Ortberg, who took over in August, has openly addressed the firm's deep-rooted cultural issue. In a company-wide interview, he criticises the company's leadership culture, suggesting that inefficiency, internal conflicts, and a lack of accountability were key issues contributing to Boeing's struggles. (4) To address these issues, Ortberg plans to reform Boeing's employee incentive program, emphasizing the need for a uniform approach across all units, as inconsistent rewards are ineffective. (4) Additionally, there are rumours that he may relocate Boeing's headquarters back to Seattle, which would place leadership closer to operations- a move seen as a step in the right direction. (3)

RECENT LABOUR STRIKE

Boeing's eight-week labour strike recently came to an end after workers voted 59% in favour of accepting a contract for a 38% pay rise over the next four years. (5) The strike, involving 33,000 members of the International Association of Machinists and Aerospace Workers District 751, cost Boeing an estimated $50 million per day, totalling approximately $2.7 billion. (5) The deal marked a significant win for employees who had previously rejected a 25% increase in September and a later proposal of 35%. This will cost Boeing around $1.1 billion in higher wages, with an additional $526 million in signing and performance bonuses. (5) The workers were motivated to strike over a 2014 agreement that

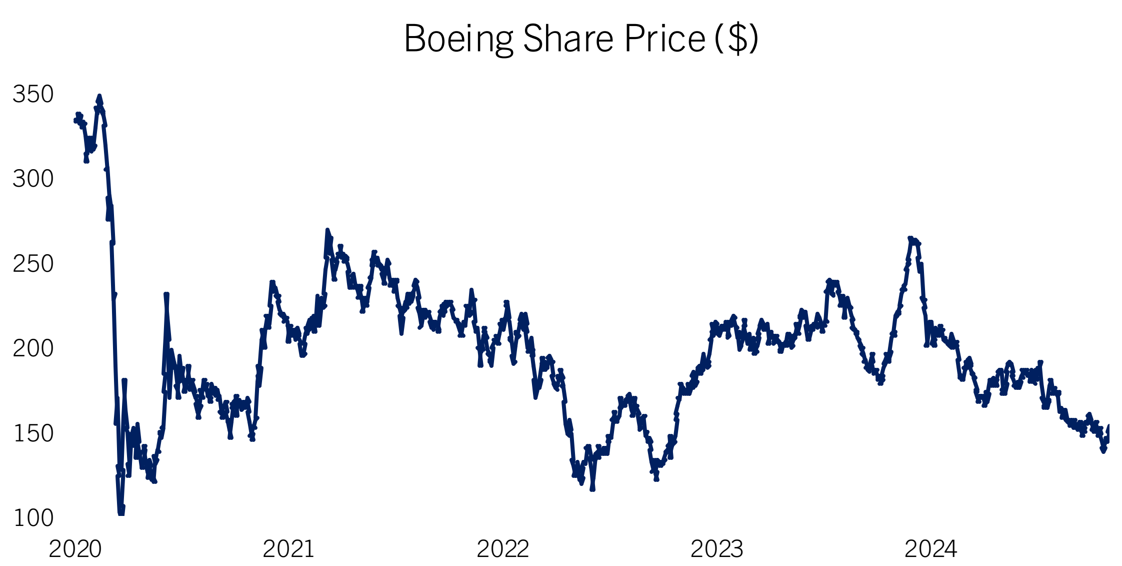


Figure 3:

replaced traditional pensions with defined-contribution retirement investments. (5) The agreement also guarantees that Boeing's next aircraft will be built in Washington, a key union win given the company's history of moving work away from its unionised factories. (5)

Boeing furloughed workers during the strike while production was disrupted as well as halting supplier deliveries to preserve cash. They also delayed the delivery of the 777X by another year, making it six years late. (5) The strike highlights the tension between Boeing and its workers, fuelled by dissatisfaction of past agreements and reflects the challenges the company faces in addressing labour concerns as well as meeting their production targets. While the resolution brings higher wages and bonuses, it adds long-term financial pressure, potentially impacting the company's recovery efforts.

RECENT EQUITY RAISING

Boeing has undertaken substantial equity initiatives to address its mounting financial challenges and safeguard its credit rating. The company raised $24.3 billion in a record-breaking equity offering, exceeding market expectations of $10-15 billion. This offering, priced at $143 per share – a 5% discount – mitigated concerns over Boeing's financial stability and staved off a potential credit rating downgrade to junk status. Notably, the stock price demonstrated resilience, dropping just 2% on placement day and rallying to $150 shortly after. (6) The equity raise included a $5 billion mandatory convertible bond, yielding 6%, which appealed to diverse investors while reducing pressure on the stock price. Boeing strategically prioritised stabilising its balance sheet over maximising offering prices, showcasing commitment to long-term recovery. (6)

Despite raising $24 billion, Boeing's balance sheet remains burdened with $58 billion in debt, $44 billion higher than six years ago. The proceeds will cut borrowings by approximately $15 billion, alleviating financial pressures but still leaving challenges ahead. Analysts remain concerned about the timeline for recovery, given ongoing losses, and production issues. (7) However, as previously mentioned, with the major backlog of commercial planes, there is cautious optimism that Boeing can regain its footing, potentially reaching profitability by 2027. (1)

OUTLOOK FOR BOEING

Boeing faces a challenging yet potentially recoverable outlook as it grapples with significant financial, operational, and reputational hurdles. The company reported a $6.17 billion quarterly loss and faces rising debt service costs, (8) with $10 billion in equity needed to prevent a credit downgrade to junk status. (1) Production delays, exacerbated by a machinist strike and ongoing quality issues, have disrupted the ramp-up of the earlier noted 737 Max production to the 38-per-month target, preventing them from achieving positive cash flow. (4) These delays strain Boeing's ability to cover its rising fixed costs. (1)

Despite these challenges, CEO Kelly Ortberg is implementing measures to restore Boeing's culture of engineering excellence and improve quality control. Ortberg relocated himself from Florida to Seattle, closer to production facilities, signalling a shift from his predecessor's detached leadership style. (2) He has also spearheaded agreements to acquire Spirit AeroSystems and maintain supplier relationships, reflecting efforts to stabilise operations. (9) While Wall Street predicts losses of $14 per share this year, observers remain cautiously optimistic, expecting Boeing to recover as a key player in the global duopoly with Airbus. (1) However, full recovery may take years, requiring a robust turnaround plan, improved operational efficiency, and cultural reforms to regain market confidence. "The worry is not that Boeing will never be fixed. It is whether the wait will be so long that it is not worth holding the stock today." (1)

What Threat Does the Concentration of the Magnificent Seven Pose to Investors?

"The Magnificent Seven", more commonly referred to as the "Mag 7", are seven high-performing and influential stocks covering the tech and consumer sectors. Namely, Alphabet (GOOGL; GOOG), Amazon (AMZN), Apple (AAPL), Meta Platforms (META), Microsoft (MSFT), NVIDIA (NVDA), and Tesla (TSLA). These seven companies are leaders in sectors such as Artificial Intelligence, Electric Vehicles, Cloud computing and digital services, with stocks being prized for their proximity to technological advancement and innovation that has driven business growth. The Magnificent Seven stocks have outperformed the S&P 500 significantly over the past year, driving much of the index's growth. (10) In 2020, we saw remarkable strength amid the global pandemic, as remote work leveraged the need for digital services, provided by companies such as Microsoft, Amazon and Apple. However, it's important to note that the performance of the Mag 7 hasn't been only positive. Market sentiment, regulatory concerns and AI ROI uncertainty remain factors that have led to volatility within the group. (11)

EARNINGS AND RECENT SELL-OFF

Around mid-July investor sentiment regarding the Mag 7 was losing traction, with the Russell 2000 Index growing 11% that month. (12) Fears of tighter regulation of tech companies, heightening tensions with China, concerns that the AI rally had been overshot and increased investment into other sectors, such as small caps, made market strategists call for a rotation out of technology stocks. (13)

The week starting August 5th saw the US stock market decline significantly following the previous Friday's weaker-than-expected NFP jobs report and increased unemployment numbers, which stoked fears of a recession in the world's largest economy. This confluence with the Bank of Japan's policy pivot towards increased rates prompted the unwinding of many long-established carry trades funded by what had traditionally been a 'weak' Yen. (14) This led to Japanese and other Asian markets, cryptocurrencies, oil and European equities seeing sharp declines. Wall Street's VIX index,

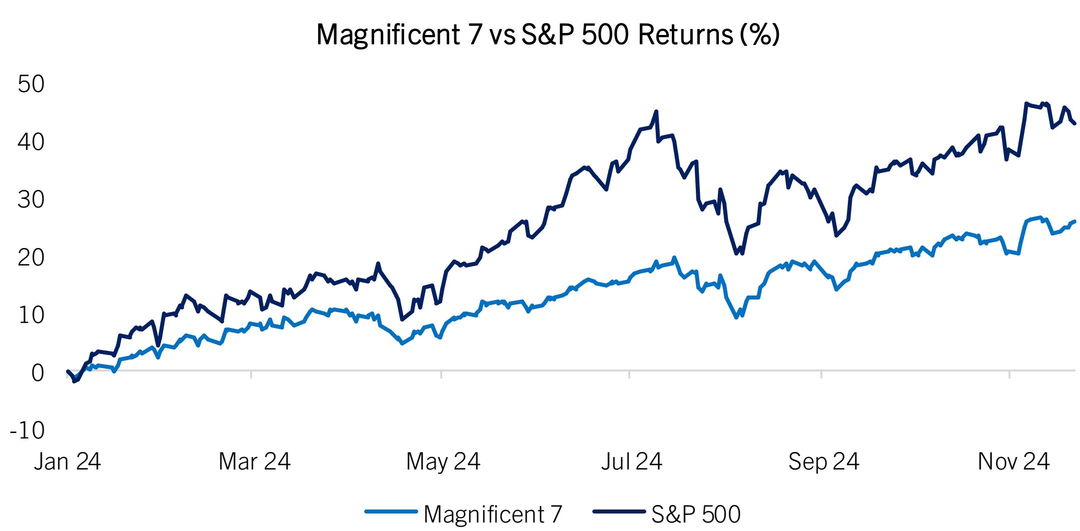


Figure 4:

commonly known as Wall Street's 'fear gauge', rose to levels not seen since the pandemic. (15) This sell-off caused the Mag 7 to collectively lose $1.2 trillion worth of market capitalisation shortly after trading began on Monday. (16)

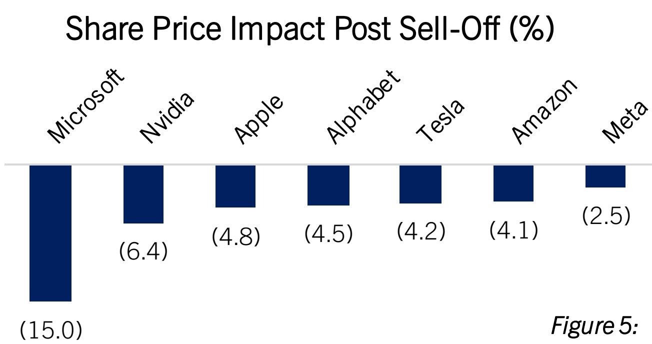


Figure 5:

The catalyst for this sell-off was undoubtedly due to concerns of a weakening US economy and overbought tech stocks. However, fears that the wave of investment into AI isn't paying off exacerbated the impact of the sell-off. See below to understand what drove the price movement for each component of the Mag 7. (17)

Company	Reason for Price Movement
Nvidia	Reports that their next generation AI chips could be delayed by 3 months
Microsoft	Surging AI spending and weak cloud revenue
Alphabet	Increased AI infrastructure spending
Apple	Warren Buffet's Berkshire Hathaway reduced its stake by almost 50%
Amazon	Missed quarterly revenue estimates and issued soft guidance
Meta	Better than expected earnings and proved how AI investments are paying off
Tesla	Q2 earnings dropped 45% and costs of AI projects surged

MARKET CONCENTRATION THREATS

The Mag 7's growth has meant that they now dominate the S&P index, currently representing about 30% of the index's total capitalization. In 2023, the Mag 7 accounted for nearly two-thirds of the U.S. equity index's returns. Amid shaky investor confidence, their outsized presence in the benchmark creates risk for investors.

The purpose of an index is to measure the performance of a basket of securities, for instance the S&P 500 index tracks the performance of the 500 largest U.S. companies. (18) However, the more a market cap-weighted index is concentrated in a relatively small number of stocks, the less effective it is as a tool for diversification. Below we outline why investors who have exposure to the Mag 7 stocks via passive indices may find themselves at risk:

Close industry correlation

All seven companies operate more or less within the technology sector, with overlapping business areas. Investor excitement within this space has been mainly centred around AI. However, if investor sentiment weakens towards AI, we could see all companies feeling the ramifications.

Interest rate sensitivity

The Mag 7 are growth stocks that derive much of their value from expected future earnings, and increasing interest rates diminish the value of future earnings, making the stocks less attractive to investors. Although we have seen cuts to interest rates, this sensitivity carries risk.

Steep valuations

The Mag 7 stocks are pricey, with investors confident that these companies will remain profitable even through challenging economic conditions. They have a high price-to-earnings ratio of around 28, compared with the S&P 500's multiples of around 20.

Index concentration is rarely sustainable as domination by sectors tends to rise and fall in multi-year cycles. Indices can become increasingly top-heavy due to extended rallies that support certain sectors, until a sizeable macroeconomic event interrupts the pattern. This can spark a sell-off with investor attention shifting to other areas of the market that they believe could be undervalued, causing the index to become less concentrated over time. (19)

HEDGE FUNDS REDUCE EXPOSURE

Hedge funds have now pared back their exposure to many Mag 7 stocks. The proportion of funds that held a Mag 7 as one of their top 10 positions fell across the board. Now Mag 7 stocks account for just 13% of the average hedge fund portfolio, and the measure of hedge fund crowding (the similarity of portfolios across the industry) has decreased. (20) The trimming of long positions started in Q12024 just before the stocks slumped in July. The pivot saw hedge funds invest into small-cap stocks outside of the S&P 500 that are listed on the Russell 3000, with their weighting in hedge funds portfolios increasing to 45%. (21)

ARE MAG 7 STOCKS WORTH THE RISK?

The magnificent seven stocks have undeniably transformed the stock market, offering exceptional returns and shaping the S&P500's performance. However, the current trajectory raises questions about sustainability and risk, and some market commentators are raising questions as to whether the Mag 7 are experiencing a bubble similar to that of the Dot-Com era. Although parallels can be drawn to the tech boom of the early 2000s, the Mag 7 have higher profit margins, larger cash reserves and are more attractively priced (via their lower forward P/E ratios). (22) While valuations may face pressure, a total collapse as seen in the early 2000s is unlikely.

With 2024 Q3 earnings recently released, the resulting performance across the Mag 7 has been poor, with Nvidia down 3.2% despite a strong earnings report and Alphabet also down more than 1%, sparked by the DoJ's push for Google to sell its Chrome business. Tesla led with a gain of 4.2% thanks to increased EV sales figures and tightening relations with President-elect Donald Trump. Amazon and Microsoft saw growth of 0.5% and 0.2%, respectively. (23) Earnings reports have been relatively strong, but investor sentiment doesn't appear to have caught up yet.

The Mag 7 stocks are neither a blessing nor a curse. They are undeniably influential companies that have driven 21st-century innovation as we know it, but their concentration within indices poses risks. Until we understand whether AI will deliver on its promise or if the tech rally will lose momentum, balancing exposure to the Tech Mega-Caps may be advisable.

Spirit Airlines Files for Chapter 11 Bankruptcy

THE DEATH OF THE BUDGET MODEL

The budget airline business model thrives on minimizing costs and maximizing revenue. Spirit Airlines once excelled in this area, achieving a cost per available seat mile (CASM) of around 8 cents pre-pandemic. However, by 2022, this metric had soared 45% to 11.67 cents, largely due to skyrocketing fuel prices. (24) With fuel costs being a fixed expense, Spirit could no longer maintain the cost advantage that defined its low-cost carrier (LCC) identity. Operational irregularities have further exacerbated these challenges. Spirit's daily aircraft utilization, which once peaked at 12+ hours, dropped to just 10.8 hours in 2023. (25) The reasons are manifold: Weather Increasingly frequent severe weather events, including hurricanes, disproportionately impact Spirit's Florida-centric routes (Spirits hub). (26) Air Traffic Control (ATC) Shortages: The FAA's controller shortage has caused delay particularly in Spirit's key markets. (26)

Fleet Issues Maintenance problems with Pratt & Whitney engines have grounded a significant portion of Spirit's fleet, reduced capacity and increasing costs. (27) These disruptions undermine the efficiency required for Spirit's business model to succeed. Delays and cancellations lead to additional expenses, such as customer compensation and higher maintenance costs. Combined with higher CASM, Spirit's cost structure now resembles that of legacy carriers, but without the same pricing power or brand loyalty.

INCREASED COMPETITION FROM LEGACY CARRIERS

Spirit once dominated leisure travel markets by offering the lowest fares, forcing larger airlines to follow suit. However, the post-COVID recovery has seen a fundamental shift. Legacy carriers, traditionally reliant on business travellers, have recalibrated their networks to capture booming leisure demand, introducing competitive "basic economy" fares. (28) This pivot has saturated popular vacation destinations like Las Vegas, where flight schedules rose by 10% in 2023 compared to pre-pandemic levels. (29) In contrast, business-heavy hubs like New York's JFK saw reduced traffic. By encroaching on Spirit's turf, legacy carriers have not only reduced its market share but also pressured it to lower fares further. The consequences are evident in Spirit's declining load factors, which fell from 84.7% in 2015 to 81.3% today. (30) While revenue per available seat mile (RASM) has remained relatively stable, the competition has made it difficult for Spirit to improve profitability. Unlike legacy carriers, Spirit lacks the ancillary revenue streams and premium offerings that could offset these pressures.

Spirit's no-frills model once resonated with budget-conscious travellers willing to sacrifice comfort for affordability. However, consumer preferences have shifted in the post-pandemic era. Leisure travellers, the backbone of Spirit's customer base, are increasingly willing to pay for upgraded experiences, such as extra legroom or premium cabins, especially for vacations. (31)

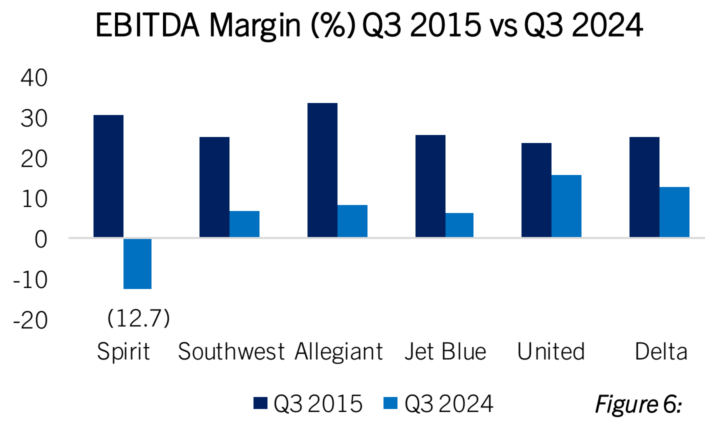


Figure 6:

This change has left Spirit at a disadvantage. While legacy carriers have captured this demand through premium offerings, Spirit's attempts to introduce fare bundles with added perks have been insufficient to compete. Moreover, operational inefficiencies and delays have further tarnished Spirit's reputation, eroding customer loyalty at a time when travellers expect reliability. (32)

FAILED JET BLUE MERGER

JetBlue Airways and Spirit Airlines terminated their $3.8 billion merger plan in March 2024 after a federal judge blocked the deal, citing antitrust concerns. The Justice Department argued the merger would harm consumers by reducing competition and eliminating Spirit's ultra-low-cost model, which helps keep fares affordable across the industry. (24) The ruling marked a significant regulatory victory and a devastating setback for Spirit. The merger was intended to serve as a lifeline for Spirit, which has suffered $1.9 billion in losses since 2020. (25) JetBlue's plan to phase out Spirit's low-cost model was central to its strategy to compete with the "Big Four" airlines—Delta, United, American, and Southwest.

However, regulatory resistance and mounting financial challenges on both sides ultimately doomed the merger. Now, Spirit faces an uncertain future. It owes JetBlue a $69 million breakup fee while grappling with mounting debt, grounded planes due to engine issues, and stiff competition from legacy carriers. (26) Analysts doubt Spirit can recover independently, especially as its stock has plunged more than 60% since the court's January 2024 ruling. (27) The failure of the merger highlights the growing challenges for low-cost carriers in an evolving airline industry.

DETAILS OF THE RESTRUCTURING

The restructuring plan offers Spirit Airlines several strategic advantages, designed to stabilize its finances and lay the groundwork for long-term growth. Chiefly, the agreement to equitize $795 million in funded debt (32) will substantially reduce the airline's financial burden, allowing it to reallocate resources toward operational enhancements and customer-centric investments. This financial flexibility is critical for Spirit to remain competitive in the low-cost carrier sector, especially amid industry challenges. Additionally, Spirit has secured strong financial backing from its existing bondholders, with commitments of $350 million in equity investments and $300 million in debtor-in-possession (DIP) financing. (33) This demonstrates confidence in Spirit's recovery and provides the liquidity needed to support ongoing operations during the restructuring. The availability of these funds, combined with Spirit's existing cash reserves, ensures that flights, ticket sales, and loyalty programs continue uninterrupted, preserving customer trust and loyalty.

The plan's structure also safeguards operational stability. Employee wages and benefits will remain unaffected, and payments to vendors, aircraft lessors, and secured creditors will continue in the ordinary course, mitigating potential disruptions. Spirit's ability to maintain business-as-usual operations during the Chapter 11 process reflects a well-organized approach that minimizes the impact on stakeholders.

Moreover, the streamlined bankruptcy process is designed for efficiency, with Spirit aiming to emerge from Chapter 11 by the first quarter of 2025. This rapid resolution reduces uncertainty and positions the airline to focus on future growth initiatives, such as improving passenger experiences and expanding its route network. Together, these measures highlight the restructuring's potential to not only stabilize Spirit's finances but also strengthen its position

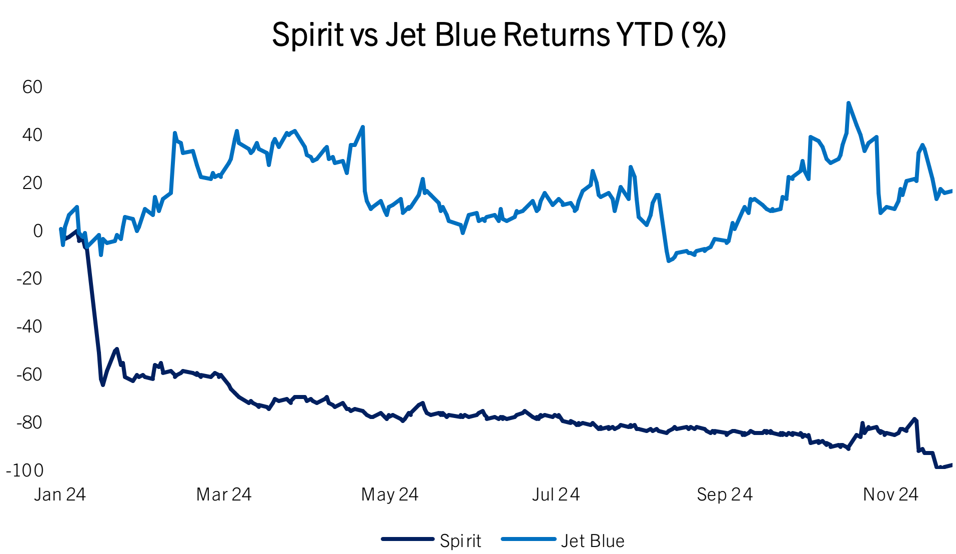


Figure 7:

as a leading low-cost carrier.

FUTURE OUTLOOK

Spirit Airlines' restructuring offers a chance to reset its strategy and emerge as a leaner, more resilient competitor. By reducing its debt burden by $795 million and targeting $80 million in annual cost savings (35), the airline is well-positioned to stabilize financially. However, long-term success will depend on Spirit's ability to refine its ultra-low-cost business model. Focusing on uncontested or underserved routes could help Spirit rebuild profitability. Currently, only 6% of its capacity serves markets without direct competition, compared to Ryanair's 30%. (36) Shifting its strategy toward less crowded markets could allow Spirit to avoid the intense fare wars that have eroded its margins.

Enhancing customer service without compromising its low-cost DNA will also be critical. Spirit's reputation for bare-bones service has contributed to poor customer satisfaction rankings, but incremental upgrades like onboard Wi-Fi and seat selection show potential to align with evolving traveller expectations. With disciplined growth and operational improvements, Spirit could leverage its restructuring to play a pivotal role in maintaining competitive airfare dynamics in the U.S. market. However, navigating economic volatility and regulatory challenges will require a clear focus on operational excellence and financial discipline.

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