# CRYSTAL WATERS PARTNERS

## Market Outlook

May 2020


As in-person commercial activity has ground to a halt due to COVID-19, people and businesses are finding unique ways to keep going, either through entirely new methods or by accelerating existing trends that are better suited for a world that is now conducting business remotely. Many of these trends digitize activities and enable them to be dome wherever people are in the world. Proximity is no longer a requirement. Many of these products and services have been in place for years, but we now see their adoption accelerating, and we predict that this is will not just be a one-time boost, but a tailwind that will push many of these businesses into the mainstream for years to come.

Finally, unrelated to the pandemic, the fund continues to see climate change as a major global threat, but also a big opportunity for companies in the space of renewable energy and with or without a pandemic, companies in the space will thrive for decades to come and will likely play an increasingly important role providing the world its energy.

# Notable Holdings & Developments

- Remote work is pushing digitization of almost all commercial activity, from buying and selling to planning, negotiations and legal agreements.
- Companies positioned for adoption of digitization are uniquely able to benefit from the Pandemic and the changes it is ushering in
- Climate change remains a big focus o=for the fund, and as the world transitions from fossil fuels to cleaner energy sources, CWP will be investing alongside them.

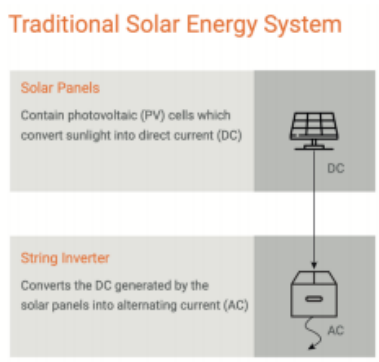
**DOCUSIGN:**
One of our long-term investment themes is that everyday activities, especially for knowledge workers, is being pushed into the cloud. This plays especially well into "Remote Work" and DocuSign (DOCU) is at the heart of that theme. While DocuSign has been a big beneficiary of the COVID-19 pandemic, we initially added the stock to the fund because we are familiar and impressed with the management team and decade-long potential for digitizing the entire agreement process. The process looks like this:

- Electronic Signature
    - Send and sign documents on any device, anywhere.
- Contract Lifecycle Management
    - Automation of agreement workflow and management
- Document generation and negotiation
    - Streamlining agreement generation, review and approval
- Agreement analytics
    - Artificial intelligence to, index, search and analyze by legal concepts

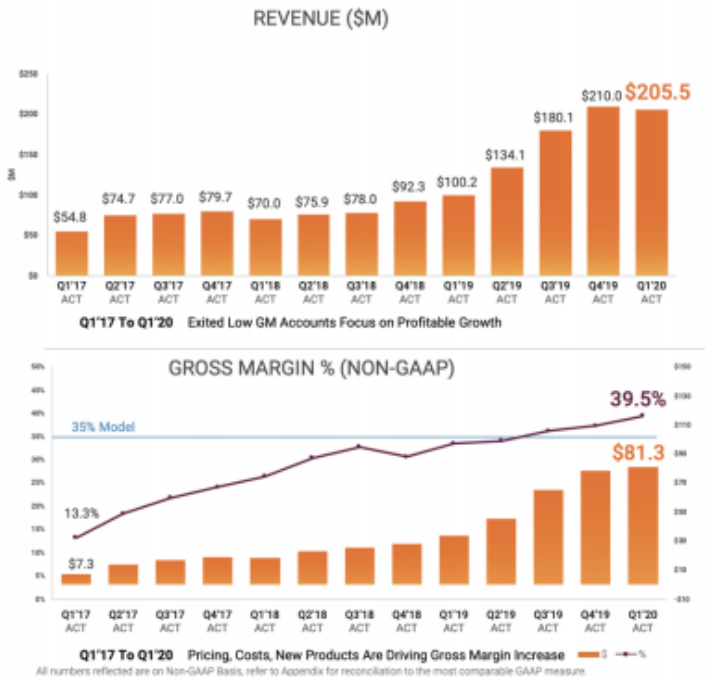
DocuSign has developed industry-specific solutions for financial services, communications, Construction, Government, Healthcare, Education, Insurance, Legal Services, Life Sciences, Real Estate, Retail, and Technology. Within each solution segments, DocuSign enables higher efficiencies and accuracy for facilities management, Finance, Human Resources, IT/Operations, Legal and Procurement to do their job. With over 50,000 customers and over 200 million documents digitally prepared, reviewed, signed and managed; DocuSign is the leader in digital document workflows.

**ENPHASE:**

Another of the fund's long-term themes is "Alternative Energy" in all its forms. Enphase is specifically an investment in solar power. Solar power companies cover a wide range of services, products, financing, and technology. Enphase is the #1 microinverter manufacturer in the world. Prior to Enphase, if you had a solar system on your house, you also had a large and often unreliable box called an inverter to convert DC power to AC power. Enphase changed all that with the microinverter and a cloud management system. The microinverter ensures each solar panel works independently at its maximum capacity rather than having the weakest panel in the series of panels constrain the output of the rest. Cloud management enables owners to understand and manage all production and consumption of power from anywhere on any device.


Enphase Energy has a $6.69 billion-dollar market capitalization and has managed to consistently grow revenues and margins for the past several years. One of the driving forces of this performance has been the company's ability to upgrade existing customers to their latest technology, which is quickly evolving to also include batteries, which is in direct competition with Tesla.



Prior to the COVID-19 pandemic, Enphase projected that in 2020, in Europe alone, they would triple sales headcount, transfer some top talent from the US, enter 8 additional countries, grow their small and medium installer base, and make a significant marketing push to homeowners. While the pandemic has obviously slowed plans and made business more difficult, Enphase has continued to perform exceptionally well. In fact, the stock has rallied 123% from the March lows and is just shy of it's all time high.

One the many things we like about Enphase is that the business is light on capital expenses and operationally efficient with capital. With no large complex factories to own and manage, Enphase is more nimble and able to scale their business faster than a traditional hardware manufacturer.

Enphase was originally focused just on the microinverter market but is now in the midst of a strategy change that we feel offers more upside potential. Enphase was a solar microinverter company and is now becoming a home energy management systems company. We should note that Enphase has just started taking on commercial customers which will expand their market opportunity even more. Because Enphase provides a semiconductor and software solution their products deliver higher quality, higher efficiency, fewer components and over the air upgrades. With no high voltage DC ,and Lithium Iron Phosphate chemistry, their systems are safer. The modular design provides greater flexibility and grid independence. Combined with a lower cost architecture and supply chain efficiencies, Enphase is a clear leader in the solar energy space.

Revenue comes from three sources today, with a much bigger opportunity ready to launch in 2020. Currently Residential solar accounts for ~$2K in revenue per home and IQ8 is expected to add additional value. With expansion in North America, Europe and entry into Japan expected soon, residential solar is a good business by itself. Residential Storage adds over $8K in revenue per home. Enphase sees approximately $80M in retrofit revenue for every 1% of installed base. The Small Commercial business launched in 2020 and the revenue model looks the same as residential for now. The big opportunity is Off-grid solar and Storage. Originally expected to launch in 2020, we'll be looking for announcements in the 3rd and 4th quarters.

**MERCADOLIBRE:**

- eCommerce and digital payment combined makes MercadoLibre the Amazon and eBay of Latin America, which is in a long-term secular growth cycle for ecommerce which lags the US by about a decade.
- The recent numbers from MercadoLibre show that the company keeps executing well and delivering solid performance in a challenging economy.
- MercadoLibre has enormous room for sustained growth and further appreciation in the years ahead.
- Currency risk is a major risk factor, and investments for growth are hurting profit margins.
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MercadoLibre (MELI) reported earnings for the first quarter of 2020 on Tuesday, May 5, and the numbers were outstanding. The company outperformed expectations, and the main indicators in both e-commerce and fintech look clearly healthy. Importantly, MercadoLibre still has enormous potential for growth going forward, and our thesis for the stock looks stronger than ever.

No company is immune to the global recession produced by the COVID-19 pandemic, but the online eCommerce and fintech leader in Latin America is clearly handling it well, and in some respects actually benefitting from the circumstances. Management has said that MercadoLibre was seeing strong demand in the first quarter of 2020 until the business started feeling the impact of the lockdowns in March, especially in big markets such as Brazil and Argentina. However, demand was already rebounding in April, and the company is actually taking share away from competitors.

The company continues to grow unique active users, items sold, and gross merchandise volume. However, the payment business is quickly evolving into the long-term winner for the company, and transactions have more than doubled year over year, showing that their online payment solution, Mercado Pago, is a popular choice. PayPal made a big investment in MercadoLibre last year, and they clearly see the same things we are seeing. Online commerce in Latin America accounts for 3% of total retail sales versus 10% in the U.S. However, the e-commerce industry in Latin America is expected to grow at a compounded annual rate of 19% from 2015 to 2021, and MercadoLibre is positioned as the main beneficiary from this trend, and Crystal Waters Partners is along for the ride.

# Economic Outlook

Markets ground higher during the holiday-shortened trading week as optimism on reopening efforts resulted in a huge, multi-day rotation out of "stay at home" stocks, healthcare, and high growth tech and into cyclical, reopening, and value stocks that had been previously been left out in the cold during the recovery in the stock market.

It is too difficult to predict when market rotations from growth to value will occur, but some form of participation in them is still needed. We continue to believe the most suitable approach to the market is a barbell, one side focuses on traditional defensive names, secular growth stocks, and stay at home winners, while the other features companies that benefit from reopening that will be in a stronger position once we are past the pandemic. We mix this with higher than normal cash levels due to volatility, economic uncertainty, an overbought market condition, and rising tensions between the U.S. and China. On May 29th the S&P 500 closed above 3,044 a 36% rally from the March 23rd low.

**ADP Jobs Report**

Job losses have been very concerning, but we expect to see many of those jobs restart again soon. While it doesn't show up in the unemployment number, many of the newly unemployed are out of work temporarily until businesses reopen, and we could see unemployment decrease at a faster rate then usual. The ADP National Employment Report forecasted a loss of 2.76 million jobs in private sector for the month of May, which is better than most previous expectations. It doesn't negate the fact that the U.S. has lost tens of millions of jobs since the start of the coronavirus pandemic and with companies possible going out of business while others are finding ways to do more with less during the pandemic, the question still remains how many of those jobs lost will still be there as the economy reopens.

**Friday's jobs report is one for the history books.**

The Department of Labor came out with an unexpected jobs report. Economists' estimates of an 8.3 million drop in May payrolls were met with the reality of a 2.5 million increase, sparking a stunning rally in stocks.

Tom Lee, head of research at Fundstrat Global Advisors, thinks stocks that benefited from the economy reopening have more room to run even after the sharp rebound. Lee was one of the first Wall Street strategists to call the massive comeback from late-March lows.

"The 'epicenter' groups, which are about 25% of the S&P 500 market cap, are the most cyclically sensitive, they could be more than 60% of the gains we get in the next few months," Lee told CNBC on Friday. The epicenter groups refer to stocks such as airlines, casinos, cruises and real estate among others.

While the rally in stocks continues to intensify on optimism about a swift economic recovery, interest rates are likely to increase as a result, and bond investors have an elevated risk. We could potentially see extremes move in Treasuries in the coming months, which could put stocks under pressure again. We are watching rates closely and while we are long-term investors and won't rotate our of our core holdings we may use treasuries as a hedge against sharp declines in equities.

The Federal Reserve has continued with aggressive policy measures aimed at improving credit and lending which provided clarity to investors and an unprecedented amount of additional liquidity. With interest rates near zero percent, investors have been pushed further out on the risk curve which is pushing valuations into thin air. Eventually the Federal government will need to pay for all the lending and stimulus programs which it does through the issuing of bonds and taxes. With the national debt at $25 trillion and bills piling up as the government works through the pandemic; the U.S Treasury has issued a new20-year bond aimed at raising $20 billion in the first auction and thereby pushing the duration of debt further out. We think the next major stimulus is likely to be an infrastructure bill that would show up under the next administration. To fund a large infrastructure bill would require a 50- year or 100-year US Treasury Bond; something investors would welcome. Any hint of that will cause the rate in the US 10-year bond to rise, something we are watching and plan to capitalize on.

While our economic indicators remain overall negative, the stock market has acted independently and once again is becoming more bullish as investors look past the current conditions. Ultra-low interest rates and optimism that the nation is re-opening are encouraging investors to buy stocks on the assumption that a significant rally will occur once we all get back to work and a vaccine is announced. However, valuations for many companies are stretched too high so we've held enough cash to buy in the next market decline which we think could happen in the second quarter earnings season.