

ECONOMY

Real danger lays beneath the surface, absent from view



Think Strategically: Sharkasm Rules

Swain Rules Against Aurelius, States FOMB Instrumentality of P.R. Territory, Established by Congress; Its Members Are Not 'Officers of the U.S.'

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Week in the Markets: Earnings season in full swing

The three main market indicators closed in positive territory, with the Dow Jones Industrial Average standing at 25,019.41, or gaining 94.52 from the previous close. The S&P 500 closed at 2,801.31, an increase of 3.02, and the Nasdaq closed at 7,825.97, or a gain of 2.06 from the last close. The

markets are reacting to a plethora of issues that include the tariff wars, NATO, Fed Chair Jay Powell's upcoming testimony to Congress on economic and monetary policy and, with the earnings season in full swing, investors appear to be assessing if companies will deliver a stock rally during the second half of July.

Following is our Top 10 list of July stock earnings that appear to be poised to produce notable quarterly results. JP Morgan and Citigroup reported their earnings on 7/13, with both beating estimates.

JP Morgan Chase & Co. highlights

- Reported revenue of \$27.8 billion.
- Average core loans up 7 percent; average deposits up 5 percent. Client investment assets of \$284 billion.
- Markets revenue up 13 percent, with equity markets revenue of \$2 billion.
- Strong credit quality with loan balances up 12 percent.
- Assets under management (AUM) of \$2 trillion, up 8 percent.

According to JP Morgan CEO Jamie Dimon, the bank benefited from "healthy U.S. consumer-driven double-digit growth in client investment assets, card sales and merchant

processing volumes. The Corporate & Investment Bank had record fees for the first half of the year, maintaining our No. 1 rank year to date."

Citigroup highlights

- Earnings per share of \$1.63.
- Net income of \$4.5 billion.
- Revenues of \$18.5 billion.
- Returned \$3.1 billion in capital to common shareholders.
- Repurchased 33 million common shares. Revenues increased 2 percent from the prior-year period, driven by growth in both the Institutional Clients Group

and Global Consumer Banking, along with reduced trading revenue and increased fund costs.

Final Word: Sharkasm rules Judge Taylor Swain

This week made me think about what a college professor would say when discussing business case studies. He would say beware of "Sharkasm." You see, Sharkasm is defined as the irony when you only see the fin of a shark, with the real danger laying beneath the surface, absent from view. My professor was alerting us to unmeasured risks that we could not see or factor into our analysis.

This week, we witnessed the first "Sharkasm," with Judge Laura Taylor Swain ruling against Aurelius Investment LLC and Aurelius Opportunities Fund LLC, which argued Puerto Rico's debt-adjustment case filed under Title III of the P.R. Oversight, Management & Economic Stability Act (Promesa) must be dismissed as unauthorized. Aurelius stated this was the case because the Financial Oversight & Management Board (FOMB), which filed the Title III proceeding on behalf of Puerto Rico, was appointed in a manner inconsistent with the requirements of the Appointments Clause of Article II of the U.S. Constitution.

Swain stated that Puerto Rico became a U.S. territory and, following the Territories Clause of the Constitution, which provides Congress "shall have the power to...make all needful rules and regulations respecting the Territory or other Property belonging to the United States." Congress has provided military, and then civilian local governance of Puerto Rico under a constitution developed by the people of Puerto Rico and approved by Congress. Puerto Rico's status has been that of a commonwealth since 1952, led by a popularly elected governor and Legislature.

Key facts on how Promesa created the FOMB:

- Is "an entity within the territorial government" of Puerto Rico.
- FOMB funding is derived entirely from the resources of the P.R. government.
- The FOMB is tasked with achieving fiscal responsibility and access to the capital markets.
- The FOMB approves the fiscal plans and budgets of the government and its instrumentalities, overriding any executive and legislative actions that are inconsistent with approved fiscal plans.

Judge Taylor Swain states that while the FOMB is as an entity within the government of Puerto Rico, it is not subject to supervision or control by the Puerto Rico Governor or Legislature. It is required to submit an annual report to the U.S. President and Congress and the P.R. Governor and Legislature.

The FOMB appointment mechanism is not subject to the Appointments Clause because FOMB members are territorial officers rather than "Officers of the United States," and the Appointments Clause does not govern the appointment of such territorial officers.

In conclusion, the court finds the FOMB is an instrumentality of the territory of Puerto Rico, established according to Congress' plenary powers, that its members are not "Officers of the United States." Since the alleged defect in the appointment method is the only ground upon which Aurelius argues that the commonwealth's Title III petition fails to comply with the requirements of Promesa, Aurelius' motion to dismiss the petition was denied along with the motion to lift stay motion seeking:

- Clarification of the automatic stay.
- Relief from the stay so Aurelius may pursue an independent action for declaratory and injunctive relief outside the Title III case.

Judge Swain dismissed both actions. The big Sharkasm presented here is the fact that in her ruling we see the full scope of other matters pending for review in her court. The lawsuits filed by the government of Puerto Rico, the House and Senate, stating that the FOMB has no authority to dictate specific actions to address budget milestones. We should expect all actions filed by the government and Legislature to be dismissed, furthering the powers of the FOMB and clearing the roadblock that has ensued.

Francisco Rodríguez-Castro, president & CEO of Birling Capital, has more than 25 years of experience working with government, and multinational and public companies.

| Company | Ticker | Report Date | Quarter Earnings | Close 7/13/18 | Net Profit Margin |
|-----------------------|--------|-------------|------------------|---------------|-------------------|
| Citigroup Inc. | C | 7/13/18 | \$4.49B | \$67.00 | 26.93% |
| Delta Air Lines Inc. | DAL | 7/11/18 | \$11.77B | \$50.77 | 8.70% |
| Fastenal Co. | FAST | 7/11/18 | \$1.27B | \$55.24 | 16.66% |
| First Bancorp | FBP | 7/25/18 | | | |
| First Republic Bank | FRC | 7/13/18 | \$724.4M | \$97.74 | 28.95% |
| JP Morgan Chase & Co. | JPM | 7/13/18 | \$26.54B | \$106.36 | 31.33% |
| OFG Bancorp | OFG | 7/20/18 | | | |
| PepsiCo Inc. | PEP | 7/10/18 | \$16.09B | \$112.69 | 11.31% |
| Popular Inc. | BPOP | 7/23/18 | | | |
| Wells Fargo & Co. | WFC | 7/13/18 | \$21.1B | \$55.36 | 24.58% |