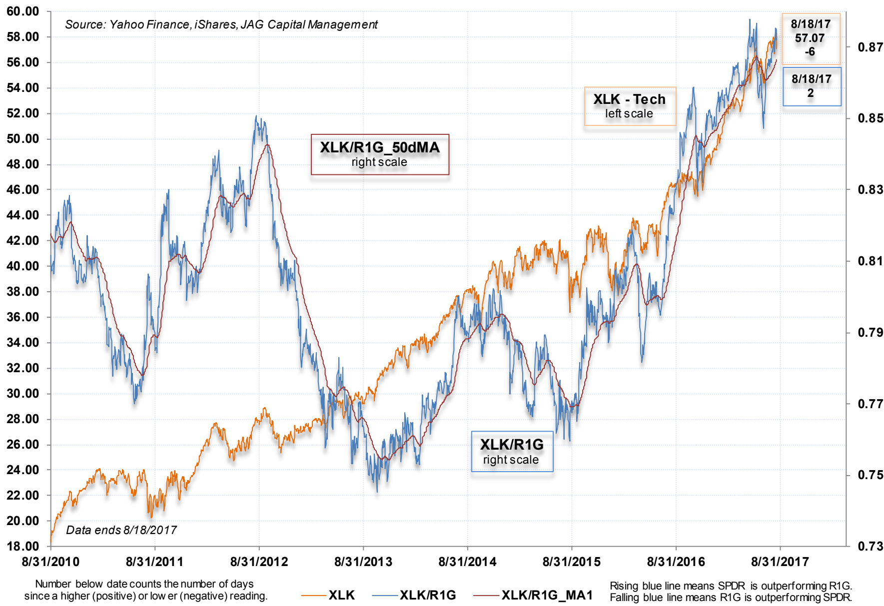
JAG CAPITAL MANAGEMENT LLC

TWO MINUTE DRILL
August 24, 2017

Timely Insights from JAG's Research Team

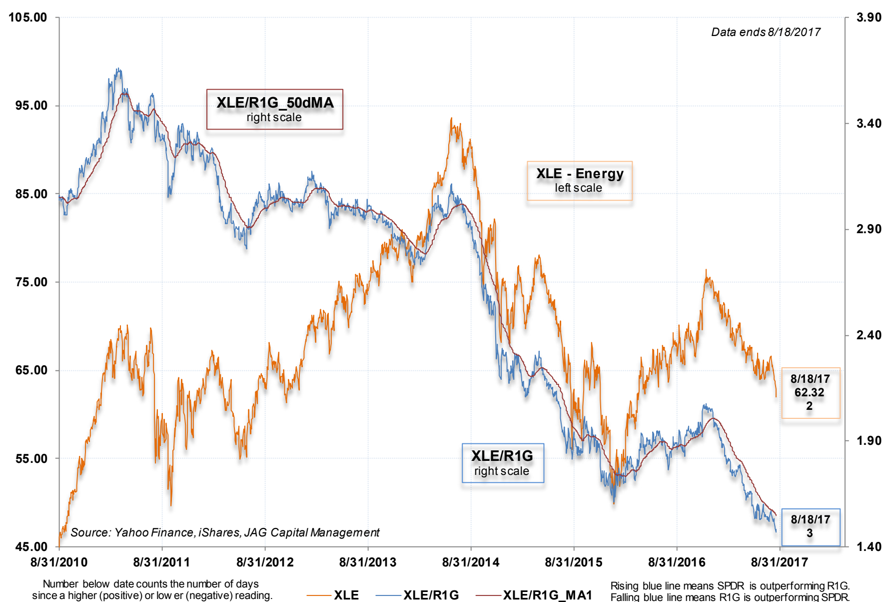
Total reading time = 2 minutes

XLK vs. XLK / Russell 1000 Growth (R1G) with Moving Average



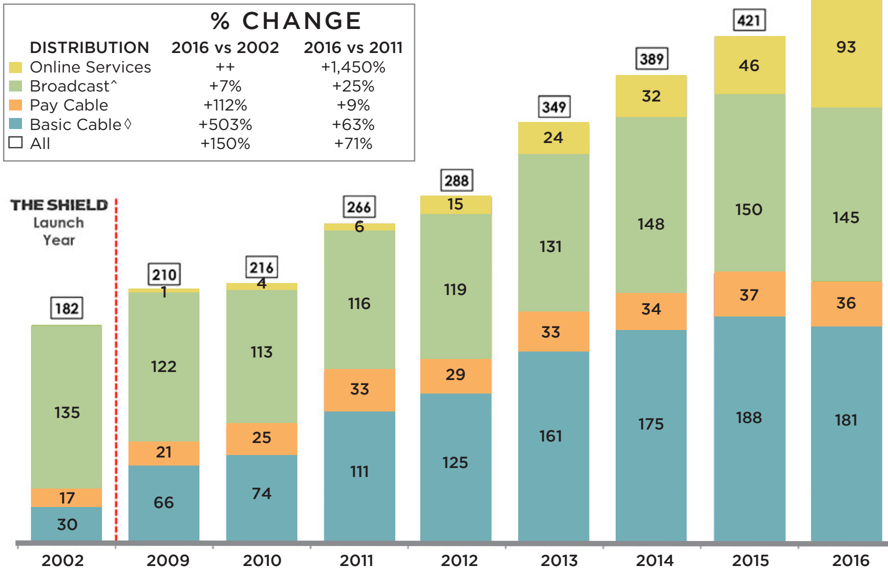
It comes as no surprise to most that the Technology sector has been a beauty so far in 2017. Not only is the group making new price highs (orange line), it is also maintaining very strong relative price strength (blue line) compared to the Russell 1000 Growth Index. Interestingly, Tech has actually been exhibiting strengthening relative strength for almost four years now, ever since the sector put in a long-term relative strength bottom in late 2013. Leading technology companies are growing their top and bottom lines faster than the broader market, as they are benefiting from a variety of secular trends in cloud computing, ecommerce, social media, and semiconductors (among others). We think they are also benefiting from a generally sluggish global growth environment, which has made revenue and earnings growth scarce resources in the investment markets.

XLE vs. XLE / Russell 1000 Growth (R1G) with Moving Average



The Energy sector has been a beast for years. After doubling between 2010 and the summer of 2014 on rising oil prices, the sector's ETF has been locked in a house of pain for almost three years. On a relative strength basis, the story is even bleaker. Compared to the Russell 1000 Growth Index, Energy stocks began to exhibit relative underperformance way back in early 2011! We are sure that there are some true values being created in the Energy space, but we are also sure that we have little appetite for trying to time the bottom in a group plagued by persistently low oil prices, strong production growth from shale, questionable global demand growth, and seemingly endless supply.

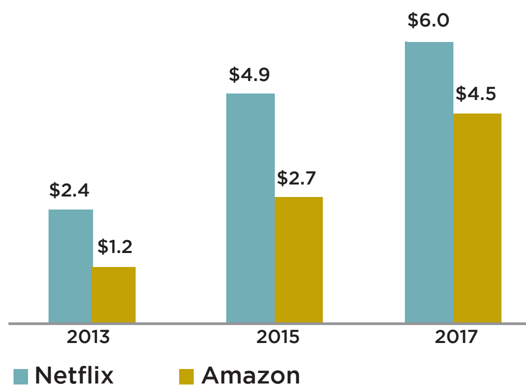
Estimated Number of Scripted Original Series* Broadcast, Cable, and Online Services



Source: *Estimated Count by FX Networks Research as of 12/14/16; culled from Nielson, Online Services, Futon Critic, Wikipedia, Epguides, et. al.
^Includes PBS
◊Includes Audience Network (DIRECTV)
Online Services = Amazon Prime, Crackle, Hulu, LouisCK.net, Netflix, Playstation, Seeso, Vimeo, Yahoo, and YouTubeRed.
Excludes library, daytime dramas, one-episode specials, non-English language, children's programs, and short-form content (<15 mins). Includes recently-produced imports.

Streaming original content has exploded over the past decade. In 2009, there was only 1 scripted series in production for online consumption. As of 2016, there were 455. This is the result of a staggering – and accelerating – shift in consumer preferences. Big, expensive monthly "bundles" of content are under fire, giving way to inexpensive monthly subscriptions to content-rich online services like Netflix, Amazon Video, and Hulu. Over the past several years, streaming services have accounted for more than 100% of all the growth in original scripted series. By way of contrast, broadcast, basic cable, and pay cable are showing signs of stagnation or outright shrinkage in the number of original series.

Netflix vs. Amazon Video Content Budgets: 2013, 2015, and 2017 (billions)



Note: includes original and licensed content
Source: IHS Markit, JPMorgan Chase & Co., Netflix and Statista as cited by Business Insider, April 10, 2017
www.eMarketer.com

Netflix and Amazon Video are engaged in a Battle Royale over content spending (full disclosure: we own both AMZN and NFLX in our model equity portfolios). Between the two of them, they will spend more than $10 billion on original content in 2017, up from a combined $3.6 billion in 2013. We expect that the market for streaming content is big enough to accommodate several large players. If we are correct, both AMZN and NFLX could "win" in an epic battle for video subscribers. To us, the traditional broadcasters and cable-based content providers seem to be the likely long-term losers, unless they can quickly pivot to meet their consumers online with a deep menu of high-quality content at attractive monthly price points. While anything could happen, business history leads us to believe that is unlikely that these massive incumbents will successfully thread the needle to maintain their dominant positions in an increasingly online media landscape.

Disclosures

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9841 Clayton Road | St. Louis, MO 63124
800.966.4596 **www.jagcapm.com**
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