PALOS

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Weekly Commentary

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Big Tech Reports

Last week the bulk of companies reported their quarterly results. This included mega-cap bellwethers Alphabet (Google), Microsoft, Meta Platforms (Facebook) and Amazon. Ranked by market capitalization, these companies are four of the largest companies in the world. The second largest, which is Apple, reports this Thursday. Given their sheer size and importance to the overall economy, investors, analysts, and economists closely follow these earnings results as a gauge.

On Tuesday, **Alphabet (GOOG:NASDAQ)** reported Q1 results. Alphabet Inc. is a holding company that, through its subsidiaries, provides web-based search engines (e.g., Google), advertising, YouTube, cloud services, analytics, and artificial intelligence (AI). GOOG generates more than half of its revenues outside of the U.S. On the earnings conference call, CEO Sundar Pichai highlighted the company's advancements in AI, deep computer science and large language models (LLMs). Pichai recently announced that a "brain" team would be formed with the combination of **Google Research** and **DeepMind** into one unit. With regards to the cloud business, Pichai confirmed rapid growth with deal volume growing "nearly 500%" over the past three years. Nearly "60% of the world's largest 1,000 companies" use on of Google's services.

First-quarter earnings per share (EPS) exceeded analysts' expectations at $1.17 per share versus $1.07 expected. Revenue beat at $69.9 billion versus $68.8. However, the uncertain economic outlook resulted in a fall in ad revenues from a year ago. Recently, the company cut 6% of its workforce (12,000 jobs) and announced further cuts designed to rein in costs. The initial reaction during the after-hours session was a 5% jump in price, however, enthusiasm waned, and shares traded down on Wednesday but closed the week higher by 3.5%. Through Friday, GOOG is up 22.0% so far this year.

Microsoft (MSFT:NASDAQ) also reported (Q3/2023) after hours on Tuesday. On the follow-up call, Chairman and CEO Satya Nadella highlighted three main priorities: Microsoft Cloud, AI adoption and "driving operating leverage" to align with "cost structure and growth." Nadella alluded to MSFT's "powerful" AI infrastructure which includes cloud computing services from ***Microsoft Azure*** and the valued relationship with ***OpenAI***, who developed ***ChatGPT***. Azure OpenAI customers have increased ten-fold over the previous quarter and an impressive number of enterprises continue to migrate to ***Azure***.

The company's ***Intelligent Data Platform*** is being used by some of the world's leading companies to ramp up data analytics. Services like ***GitHub*** and ***Visual Studio*** are simplifying and transforming the role of developers. In the Office segment, AI is enhancing ***Microsoft365*** to create a more robust experience for users. ***Microsoft Teams*** usage has

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reached an all-time high with over three hundred million users and ***Microsoft Viva*** is offering a "completely new suite for employee experience" in communications, learning, analytics and employee feedback. MSFT beat expectations on both the top and bottom lines (EPS $2.45 vs. $2.23 and revenue $52.9 billion vs. $51.0 billion) and investors clearly liked management's comments on the earnings call. Shares rose 7.2% on Wednesday and are now higher by 28.1% on the year.

Meta Platforms (META:NASDAQ) released earnings on Wednesday. CEO Mark Zuckerberg referred to the recent quarter as a "good quarter" as momentum grew for Meta's products and services. More than three billion people use at least one app every day. Zuckerberg sees two "major technological waves" driving the company's future which includes AI and the metaverse. The metaverse, summarized in a few words, is defined by a future where virtual reality will enhance human interaction, virtual experiences, and communication. While building the metaverse is a long-term commitment, over one billion avatars have now been created and the next generation of devices is expected this year.

In Q1, total revenue of $28.7 billion was up by roughly 3% (6% on a constant currency basis). EPS was $2.20 per share vs. $2.03 expected. Over hiring by technology companies following the onset of the pandemic is well known. Restructuring charges, related to two waves of layoffs, reduced EPS by $0.44 per share; however, the results of the restructuring will be a stronger financial position, improvement in recruiting and greater job security for current employees. A third and final wave of layoffs is expected later this month. Zuckerberg has pledged a leaner and more efficient company moving forward. Investors welcomed the news with META shares climbing by 14.8% over the final two trading days of the week. META has been a "double" year-to-date (+99.7%).

To cap the week, **Amazon (AMZN:NASDAQ)** reported on Thursday. CEO Andy Jassy remarked that an "uncertain" economic environment and continued inflationary pressures were impacting customers' spending and expenditures cloud services. Despite this, revenue of $127.4 billion was better than an expected $124.5 billion. The Amazon Web Services (AWS) segment generated $21.3 billion vs. $21.2 billion while Advertising brought in $9.5 billion vs. $9.1 billion expected. Customers continued to "optimize" their advertising expenditures as consumer spending slowed. Shares initially spiked roughly 12% following the positive revenue result but turned lower during the earnings call as investors crunched the numbers. AMZN shares dropped 4.0% on Friday but remain higher by 25.5% since the end of 2022.

If there is one take away from the performance of the biggest tech stocks, it's the significant outperformance compared to smaller tech companies that in many cases remain unprofitable. Investors are clearly favoring mega-cap companies that have an entrenched "margin of safety" in terms of cash flows, revenues, improving efficiencies and strong balance sheets. In addition, as inflationary pressures subside and interest rates normalize, tech companies are remarkably viewed as "safe havens." There's an irony in this; in 2022 the tech sector was "crushed" as it was viewed as the riskiest!

Not to be overlooked is the evolution of AI and deep learning and the eventual impact on society, efficiency (productivity) and the economy as a whole. The companies mentioned above are in a very advantageous position given the pending "tech revolution" that has been thrust upon us. The next era of technological change is certain to be more impactful than the telephone or the internet. The future will be very interesting indeed. This will be another interesting week with a Fed decision on interest rates mid-week and Apple reporting Thursday.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.59	6.59%
Palos Equity Income Fund - RRSP	PAL101	$6.84	5.55%
Palos WP Growth Fund - RRSP	PAL213	$12.62	1.22%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.11	14.68%
S&P TSX Composite (Total Return with dividends reinvested)			7.60%
S&P 500 (Total Return with dividends reinvested)			9.16%
S&P TSX Venture (Total Return with dividends reinvested)			7.62%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			3.42%
Canadian Government 10-Year			2.84%
Crude Oil Spot			US $76.78
Gold Spot			US $1,999.10
US Gov't10-Year/Moody BAA Corp. Spread			208 bps
USD/CAD Exchange Rate Spot			US $0.7379

[1] *Period ending April 28th, 2023. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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