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Portfolio Comments
For the Quarter Ending March 31, 2019

Getting straight to the point, the U.S. equity markets have recovered quite nicely during the past three months on the back of a very rocky end to last year. It is undoubtedly more heartening to both compose and read these quarterly missives in periods of positive returns, but our strategies have never been based on market timing. We take Mr. Buffett's cautionary words to heart when he reminds us: "All time is uncertain. It was uncertain back in 2007, we just didn't know it was uncertain. It was uncertain on October 18th, 1987, you just didn't know it." Certainty is elusive, but diligently applying our experience and skills in identifying quality investments trading below their intrinsic value, by our estimation, provides us with a measure of confidence not dictated by market sentiment, gloomy or exuberant. Still, the first quarter of 2019 was a positive one!

The S&P 500 ended the first quarter of 2019 at 2,834, delivering a return of 13.64% for the year to date. The Dow Jones Industrial Average (DJIA) ended March at 25,929 for a first quarter return of 11.80%. Almost all of these gains were a result of a strong run-up in the first two months of the year, while March saw a fairly narrow range for the indices.

Towards the very end of the quarter, the largest component of the DJIA, **The Boeing Company (BA-NYSE)**, exerted a drag on the index, and more specifically the Industrials sector, after the company's 737 MAX planes were grounded worldwide over safety fears in the wake of two fatal crashes in the past five months. Understandably Boeing stock took a steep dive, erasing about half of its year-to-date gains that had been partly attributable to the resurgence enjoyed by many cyclical stocks considered barometers for economic health.

While the sharp market recovery is welcome news and makes for great headlines – the S&P 500 is up more than 20% from its Christmas Eve low – both of these major indices are essentially close to where they were six months prior. Given the recency of the latest stumble interrupting a long bull run, we would not describe the feeling of the markets as "settled", but what is keeping investors somewhat on edge has shifted. Several major economies have reported weakening data recently, with especially close scrutiny given to a slowdown in Chinese growth.

Official data from China indicated that industrial output slowed more than forecasted in January and February, and that their economy grew at its slowest rate in nearly three decades last year. However, fears surrounding the likelihood of an all-out prolonged trade war between the U.S. and China have abated. A new round of trade talks is scheduled in Beijing and Washington aimed at finalizing a deal by late April. Meanwhile, President Trump reiterated that tariffs on Chinese imports will remain in place for a "substantial period of time" pending Chinese compliance with any agreements reached, although he held off imposing steep rises on tariffs on $200 billion-worth of Chinese goods that was threatened for March 1st.

In another act of attempted international diplomacy, Mr. Trump traveled to Hanoi in February to conduct a second summit with North Korean Chairman Kim Jong Un to discuss the denuclearization of the Korean peninsula and the lifting of U.S. trade sanctions. Ultimately, the summit was cut short with no substantive progress made.

Concerns surrounding the Fed's policy path have also receded. Coming out of its meetings on March 20th, The Federal Reserve held its benchmark interest rate steady at the range of 2.25% to 2.5%, a level that was set in December and represented the fourth rise during last year. In a telling sign that policy has shifted away from a slow, but steady, ramp up in rates, eleven of seventeen Fed officials now think that there will be no need for further raises this year. The Central Bank also indicated that in May it would cut the maximum monthly run-off in Treasuries in half as it reduces its $4 trillion portfolio of assets. The size of the balance sheet will be held steady beginning in October, two years after the Central Bank began to unwind its crisis-time stimulus programs.

The Fed reiterated that it "will be patient" in deciding on future rate changes. Some considered the Fed's policy, alongside trade tensions and slowing global growth, to be a contributory factor in the recent period of high market volatility. The Central Bank also continues to carefully monitor inflation, which has recently been dampened by lower energy prices, but is otherwise been subject to mild pressures according to Fed Chairman Jerome Powell. Inflation for items other than food and energy remains near a tepid 2%. The Fed's statement also stated that "the labor market remains strong but that growth of economic activity has slowed from its solid rate in the fourth quarter…and the unemployment rate has remained low." The estimate for GDP growth in 2019 was revised down to 2.1% (from 2.3%). Concurrently, the U.S. 10-year Treasury yield has been on a downward trend the past five months and is now sitting around 2.4% - its lowest range since the end of 2017. This is resulting in a flattening of the yield curve (where the rate for longer-dated paper is close to the Federal funds rate for short-term treasuries). Pundits are now speculating on whether this is a bearish signal for stock markets but, based on historical precedence, the interpretation of underlying data is nuanced, and knee-jerk predictions often miss the mark.

The 35-day government shutdown initiated by President Trump late last year over Congress' refusal to approve the $5.7 billion requested for a border wall ended on January 25th with an agreement to reopen for three weeks. The plan was to allow a bipartisan group of lawmakers to negotiate a compromise over spending on border security. A second shutdown was averted on February 14th with a spending bill passed that funds the government until the end of September. It included $1.3 billion for 55 miles of steel fencing at the Mexican border. Undeterred, and having agreed to sign the deal, Mr. Trump said on February 15th that he would also declare a state of emergency which would allow him to redirect defense funds to fulfill his election promise of a wall. Statutes dictate that redirected spending must be restricted to "military construction projects" and projects "essential to the national defense." As might be expected, Democratic lawmakers, as well as a number of opposing advocacy groups, are mounting staunch resistance to this invocation of unilateral powers. Ultimately, it may be the Supreme Court that adjudicates.

Members on both side of the U.S. political divide eagerly and/or anxiously waited for Special Counsel Robert Mueller to hand over a final report to Attorney General William Barr concerning foreign meddling in the 2016 Presidential election. After almost two years in the making, the report was delivered on March 24th and was lauded by the President as a resounding exoneration from any wrongdoing on his part. Specifically, according to Mr. Barr's summary, the findings "did not establish that members of the Trump Campaign conspired or coordinated with the Russian government in election interference activities." This is a watershed moment, but unlikely be the end of the matter as some still believe there were enough murky goings-on, including evidence of obstruction by Mr. Trump, that should be revealed and further examined. William Barr has promised a fuller disclosure of Mr. Mueller's findings and the saga will lumber along, with ongoing congressional probes, albeit with less steam.

We promise to keep mention of the 2020 Presidential elections to a minimum for quite some time to come, and avoid speculation, but it is a fact that Democrats are shaping up to have one of the most crowded primaries in modern history, and the contender list is not complete. Of those already declared, some of the most prominent are Senator Bernie Sanders of Vermont, Senator Elizabeth Warren of Massachusetts and former Texas Representative Beto O' Rourke. They are expected to be joined shortly by former Vice President and Senator from Delaware, Joe Biden. Before the party can present a united front to the voting public, there are patently many ideological and political stances that remain to be decided internally.

Over the Atlantic, the European Central Bank sharply reduced its 2019 Eurozone growth forecasts at the beginning of March at the same time as unveiling new stimulus measures. The U.K. also cut its 2019 economic growth forecast from 1.6% to 1.2%. In addition, uncertainty surrounding the details and timing of Britain's departure from the European Union has rattled markets on the continent. With the clock counting down towards the March 29th Article 50 deadline to hash out an agreement between all parties, two weeks ago the U.K. parliament unexpectedly voted to rule out a no-deal exit. This at least allayed fears over a chaotic dropping out, but also left much to negotiate, mostly between divided political factions in Britain. There was a subsequent vote by British lawmakers to delay the exit, which resulted in Prime Minister Theresa May going back to European leaders requesting to delay departure from the bloc.

After reportedly tense talks reflecting frustration with the U.K.'s prevarications, it was agreed that Britain's exit date would be delayed until May 22nd (the day before European Parliament elections) if Mrs. May could convince Parliament to back her plan for leaving. The Prime Minister's proposal would eventually allow Britain to control immigration from Europe, but keep it in the EU's customs and trade system until at least the end of 2020. Said plan, however, had already been overwhelmingly rejected twice and uncertainties surrounding how the Northern

Irish border will eventually be handled have caused much rancor. Otherwise the delay for leaving would be shortened to April 12th, or extended further but only if Britain were prepared to hold European Parliament elections.

Theresa May's frustrations with her fellow lawmakers spilled over as she admonished: "Do they want to leave the E.U. with a deal? Do they want to leave without a deal? Or do they not want to leave at all? So far, Parliament has done everything possible to avoid making a choice." By the time you read this, this landscape will have, by necessity, meaningfully shifted given the hard deadlines, but as we go to press, the situation remains in a state of division and uncertainty with a further Parliamentary vote scheduled. In a final, dramatic move to propel things forward, Mrs. May capitulated and promised she would resign as Prime Minister and leader of the Conservative Party if Britain agreed to leave the European Union.

And so ends another quarter in which the news has been largely dominated by large scale, political and economic goings-on that have global ramifications. Against the backdrop of these headlines, analysis of the fundamental health of corporate America is often overshadowed. According to FactSet, a market analytics provider, based on 96% of companies in the S&P 500 reporting actual results by the beginning of March, 69% of S&P 500 companies reported a positive EPS surprise and 61% have reported a positive revenue surprise for Q4 2018. Moreover, the quarter marked the fifth straight quarter of double-digit earnings growth for the index. Interesting figures when contrasted with the sharp drop in valuations attributed to almost all of the index constituents at the end of last year. It bears repeating that when we add an investment to our managed portfolios, we do so with the mindset that we are acquiring a piece of a company or fund, not a proxy bet on investor sentiment towards vacillating macro market forces.

On the basis of companies that have given guidance, the aggregate profit growth outlook appears to be more tempered for this coming quarter due, in part, to the impact of the Trump administration's tax policies fading. Again, according to FactSet, and based on percentage of 'Buy' ratings, analysts appear most optimistic towards the Energy, Healthcare, and Communications Services sectors. Crude prices achieved a four-month high toward the end of March, but are still vulnerable to lingering concerns about weakening future global energy demand. Conversely, analysts have a more neutral or negative sentiment toward the Consumer Staples Sector. We are, of course, interested in such outlooks but have no issue adopting a contrarian view if we perceive unrecognized value.

We are pleased to report more optimistic market news this quarter, but rest assured we are never complacent in our outlook or investment choices and are honored to work diligently towards helping you achieve your financial goals. We hope you enjoy spring and its wonderful reminders of flourishing new beginnings and thank you for your continued confidence in us.

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