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PORTFOLIO UPDATE – DECEMBER 10, 2018

The past two months can be summarized with one word: volatility. Dramatic market action has been a major theme this year. Prior to 2018, we experienced a relatively quiet 18 months in regard to market movement. But that changed in late January when the markets fell quickly based on concerns regarding higher interest rates and inflation. We saw another bout of investor angst in March as the trade conflict between the U.S. and China escalated. After bottoming in April, the market resumed its long-term trend and appreciated through the summer. But since early October, it has been a seesaw as investors became more skittish, latching onto negative headlines regarding the trade conflict between the U.S. and China, signs of weakening global growth, the inversion of the short end of the Treasury yield curve (and associated recession implications), and a precipitous sell-off in in crude oil. While corporate fundamentals remain healthy and the U.S. economy is in expansionary mode, it has become increasingly clear to us that there is a general lack of investor confidence. With concerns that this negative sentiment will continue to feed momentum, we made significant changes to our portfolio positioning to reduce risk and take a defensive posture. These changes included eliminating U.S. Small and Mid-Cap equity exposure, reducing U.S. Large Cap equity holdings, repositioning into defensive equity sectors, eliminating convertible bond and preferred securities exposures, and introducing a position in short-term Treasuries.

As always, we can point to a laundry list of global macroeconomic events that inform investor sentiment and fuel market action. These include the ongoing Brexit process, news "bites" from the Mueller investigation of the 2016 presidential campaign, the "yellow vest" protests in France, the rapid decline of oil prices, and the battle of tariff rhetoric between the U.S. and China. The list goes on but these developments are typically "noise" that may move markets episodically but do not have long-term implications. One of our primary functions as portfolio managers is to assess these developments and understand what really matters. What has given us pause is that there seems to be a lingering fragility regarding investor sentiment. As proof of this, we note that many benchmark indexes across global markets have broken through technical support levels, which is an alarming sign. Rather than wait for the next leg of the downdraft, we chose to aggressively step away from risk-bearing assets and move into cash.

In terms of overall positioning, we maintain a long-standing preference for the U.S. across equities and fixed income. However, with today's changes, we are now significantly underweight across both asset classes. Within U.S. equities, with the exit from Small and Mid-Cap equities and a reduction of our Large Cap holdings, we are now slightly underweight versus our benchmark. We remain significantly underweight non-U.S. equities with our sole exposure being a neutral weighting to Japan. Within fixed income, we are slightly overweight in the U.S. with a preference for short-term Treasuries and mortgages. We do not have any current exposure to non-U.S. fixed income. Our portfolios maintain lower duration than the benchmark. With this move away from risk assets, our cash position is now significantly overweight relative to our benchmark.

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