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PORTFOLIO UPDATE – FEBRUARY 5, 2019

Continuing the consolidation and subsequent reaffirmation of US markets after the severe bout of volatility that characterized the 4th quarter of 2018, we have experienced a period of US credit markets repairing themselves. In our view, two factors have been at work, one fundamental, and one emotional.

From a fundamental point of view, US corporate bonds are still strong. Even with moderating earnings outlooks for companies, there has been little to no indication that those companies are at any risk of non-payment or outright default. The rate environment also continues to be what market experts would call "benign", and what everyone else would call "low". It is not expensive for companies to obtain credit, and it is not really becoming more expensive for them to either get more credit or roll over what they have. At present there is little danger of a spike up in rates that would change any of this materially. After a stretch of the market pricing bonds as though rates were going to move higher, we have settled back into business as usual. As a consequence, rates have been falling and therefore bond prices have been rallying.

Which leads us to the emotional factor. The bond market has not truly been tested since the Financial Crisis culminated 10 years ago in early 2009. We have had glimpses of what could be ahead of us, and those glimpses were ugly but brief. What we have observed is the uncertainty of the bond market if rates move higher, credit quality declines, or something else comes into play that tests the structure of the market and its ability to withstand. There is more sophistication in all aspects of the bond market as compared to a decade ago, but there are fewer institutions for both regulatory as well as risk-management reasons that are willing and able to maintain an orderly market if things get challenging. And so, every time the Fed Chairman scratches his or her nose, the market, in layman's terms, freaks out. As we discussed in prior notes, Chairman Powell made a few comments that resulted in one of those episodes, which he subsequently walked back with the help of Chairmen Emeriti. Bonds tracked that. The Fed appears to be more circumspect about raising rates further in the near term, and the bond market reacted well.

Therefore, we have rebuilt US corporate credit allocations within the fixed income portions of client accounts by deploying cash that we had accumulated towards the end of 2018. In our Core and Disciplined Yield strategies we invested in US Convertible and Preferred securities, the most credit and equity sensitive bonds, through ETFs. In our ESG strategies, which because of the types of bonds that are considered investible had remained more oriented toward credit, we invested more modestly in a combination of Mutual Funds and ETFs emphasizing US corporate credit as well.

Globally we are overweight equities while underweight fixed income and cash. However, we are overweight US stocks and bonds within their respective asset classes. We are also overweight emerging market stocks in Asia. Counterbalancing that, we are underweight developed international stock and bond markets outside of emerging Asia.

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