PORTFOLIO UPDATE – OCTOBER 31, 2019

Trade activity on Halloween might suggest we have been spooked by current events and markets. There certainly is plenty about which to be concerned from Brexit to ongoing tensions in Hong Kong to Congress certifying an impeachment process along party lines. Yet again channeling the (not so great) orator and former SecDef Donald Rumsfeld, these are the known knowns, and we have been positioned around the threats and the opportunities presented for some time, with our latest shift in posture going back to August as conditions were deteriorating around the growing protests against the PRC in Hong Kong.

On balance, after a dramatic (relatively speaking) drop in long-term rates drove the total return of bonds up considerably, we see the next leg of return opportunity being in the equity markets at home and abroad. Bonds could stay where they are, or rise slightly. Either outcome does not provide a particularly attractive risk/return profile for bonds. We have restored a market weight in non-US equities primarily through developed economies and trimmed but sustained an overweight to US equities while also buying more into small cap companies which have not performed as well. In most of our portfolios we do not own non-US bonds, and for our ESG strategies we do selectively in the Green Bond space. Overall we are pro-market and have committed most of our portfolios' cash to stocks.

While we can never say with certitude, it does seem like the Fed is on a path of holding the line if not easing on rates. Maybe our ideal is that the Fed is independent and focuses entirely on jobs, inflation and economic health. More and more Fed watchers, economists, and academics seem to be directly saying, or at least implying, that the Fed is being responsive to the markets. The jury is very much out as to whether this is only a theoretical or structural problem in the long term, but the reality has been a pretty high correlation of Fed response to adverse market moves for a while now. Those market moves could be argued are themselves responses to more fundamental signals in the economy, but the relationship still stands. We therefore are reasserting our conviction that "lower for longer" is not going away. That is further reinforced by what some of the most trusted asset management voices to whom we listen are saying – that taken over the arc of history, we are actually closer to real normal than we want to believe. Most of us have spent our entire careers inside the 30+ year decline in interest rates from what were extraordinary highs. We would have to talk to our parents and grandparents to hear tales of low single-digit rates. Easy Fed policy combined with ongoing support from the other major central banks means equity markets should continue to benefit and the rate curve will stay fairly flat.

Europe had been a low-conviction region for us for a while now. Germany has stumbled, nations are turning inward and the benefits of cross-border mobility are being stunted in the quest to slow population migration. The parade of absurdity out of 10 Downing Street vis a vis Brexit would make Mr. Bean cross his eyes as it has the EU. To put it bluntly, things have not been good for developed Europe. We have maintained a strong underweight as a result because of the blend of poor economics and bad news. That clattering sound you hear is the Brexit can being kicked further down the street to the end of January 2020, and we are looking at snap elections for the holidays. While we can not assert that things are better, we can say that the rate of bad news is slowing, and market participants have been pretty rough on asset prices up to this point. We feel that Europe is a value play taken in totality, and there is a combination of less risk that asset prices could tumble to more bad signals and a greater probability that good news starts to flow, and once the market becomes wise to that prices could lurch higher quickly.

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