First Quarter 2019 Review

Market Performance

Equities extended their Christmas rally through all of the first quarter of 2019. The Russell 1000 index of large and mid cap stocks returned 14.0%, while the Russell 2000 index of small cap stocks returned slightly more – 14.6%

Half of the return was gained in January, with returns trailing off each of the following two months. Small caps led performance early, returning 3% more than large caps in January, 2% more in February and then giving back nearly all of that lead in March, by trailing large caps by about 4%.

Energy was the leading sector, bolstered by a more than 30% rise in the price of West Texas Intermediate. In general, defensive sectors such as health care and consumer staples, banks and insurance trailed.

From a distance it is easy to characterize the market performance over the quarter as elation followed by a gradual shift back to reality. Early returns were triggered by the late December shift to a dovish stance by the Federal Reserve. As the quarter wore on, the market became more cognizant of the underlying economic weakness that moved the Fed to that stance, and returns both overall and between smaller and larger stocks eased off.

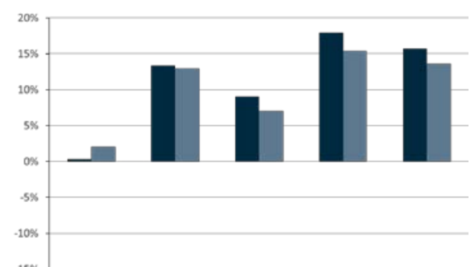
Returns to most investment styles were moderate with one exception. The change in sentiment gave strength to the weaker, more economically sensitive stocks that had borne much of the brunt of the fourth quarter sell off. Poor margins, unstable profits and a weak balance sheet became admirable qualities and were rewarded.

Strategy Performance

Our small cap strategies had mixed performance during the quarter.

The Small Cap Core strategy returned 14.39% during the quarter, trailing the Russell 2000 by 0.19%. Stock selection was strong overall, but the aforementioned 'junk rally' was a continuous headwind. We have found a very poor risk/return profile for such stocks, and tend to limit their presence in the portfolio. While that hurts in the short term during quarters like these, it solidifies our long-term performance.

Small Cap Core as of 3/31/2019



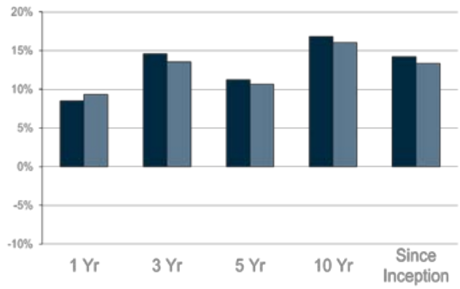
	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception
■ Small Cap Core (Gross)	0.32%	13.33%	9.04%	17.92%	15.75%
■ Russell 2000 Index	2.05%	12.92%	7.05%	15.36%	13.66%
Morningstar Ranking	58	22	13	6	

Our Small Cap Market neutral strategy, now six months since it was started, returned 0.38%. While it faced the same headwinds that the long-only strategy faces, proper allocations to software, life sciences and banks, as well as the avoidance of high momentum stocks, helped offset the low-quality headwind.

Our large cap strategies (currently run in simulated portfolios) both fared better. The Large Cap Core portfolio returned 14.98%, outperforming the Russell 1000 by just short of

1%.

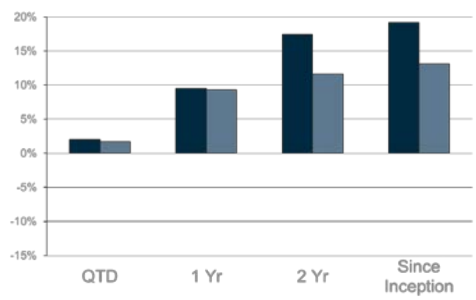
Large Cap Core as of 3/31/2019



	1 Yr	3 Yr	5 Yr	10 Yr	Since Inception
Large Cap Core Equity	8.49%	14.57%	11.22%	16.82%	14.20%
Russell 1000	9.30%	13.52%	10.63%	16.05%	13.34%
Morningstar Ranking	50	12	29	8	

The Large Cap Long Short strategy, which adds small cap alpha to a large cap mandate through shorting and leverage, returned 14.22% outperforming the Russell 1000 by 0.22%. Over the two and one half years we have run this strategy, it has added over 6% annually to large cap performance.

Large Cap Long Short as of 3/31/2019



	QTD	1 Yr	2 Yr	Since Inception
Large Cap Long-Short	2.00%	9.51%	17.42%	19.17%
Russell 1000	1.74%	9.30%	11.62%	13.17%

Outlook

Going into 2019, we identified three issues likely to affect equity markets

1) Trade tensions
2) Economic slowdown
3) Interest rates

Trade

The trade war has fallen in significance. It has been a year since the opening rounds, and the effects can now be clearly understood, falling mostly on price levels to the consumer. The activity of trade-sensitive cyclical stocks such as materials and semiconductors says that the market has mostly priced in an agreement between the US and China. Both sides have too much to lose. There is downside if such an agreement does not come to pass, but that aside, the relevance to the market has likely passed.

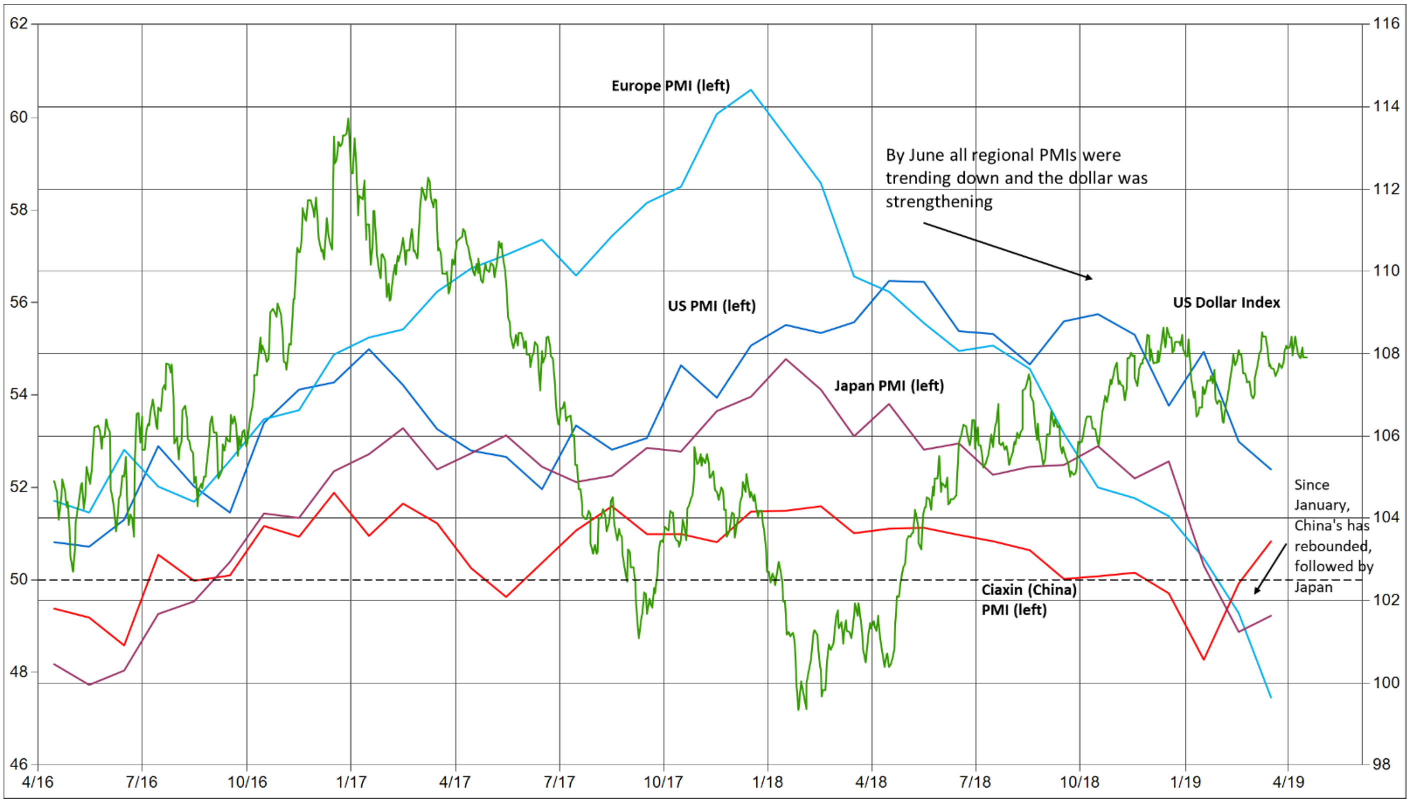
Economic slowdown

Leading economic indicators extended the decline from their mid-summer peaks. Purchasing Manager Indices (PMIs) continued to work lower with Europe and Japan dipping into (sub-50) slowdown levels. There has been one exception: China. Over the past two months, the Caixin PMI index has bounced off a low of 48 to return to reading of just short of 51. Most recent data continue to support this move.

Equity market internals reflect some of this perspective. The relative weakness of small cap stocks and underperformance of value indicate slowing economic growth, while at the same time, weakness in high quality and lower volatility stocks portend higher growth expectations.

The debate that will shape the market going forward is have we found a bottom (and is China going to lead an economic rebound), or are these just spurious data points on the way to a recession.

Regional PMIs and the US Dollar



Interest Rates

Interest rates piled on by bringing forth an old harbinger of doom: the inverted yield curve. Even with the Fed no longer pushing short rates higher, a decline in 10-year yields from 2.68% to 2.50% precipitated the first 10-year/3-month inversion since the financial crisis.

Historically such an inversion has presaged a recession in the next year or two. If this fact was not well known beforehand, it certainly was afterwards as just about every pundit and market commentator weighed in on the topic.

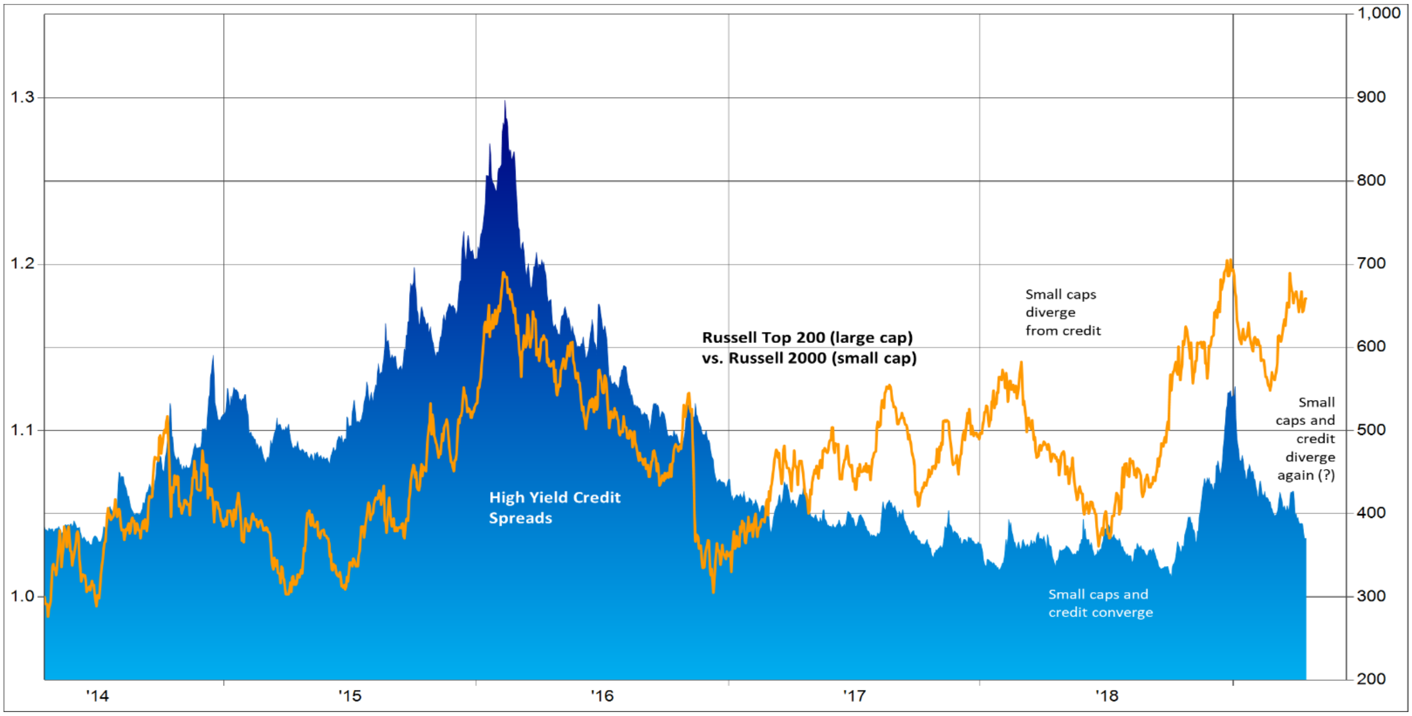
Correlation is not causation however, and while the underlying forces of a curve inversion are not beneficial for the economy (bank margins are put under considerable pressure, and lending could slow), yield curve inversions in other developed nations have not necessarily led to recessions. Also, we have never experienced an inverted curve at such low levels of overall interest rates, or after a decade of extraordinary stimulative behavior by central banks.

A more important question to us is the effect of the shifting yield curve on equity market internals. While the Fed fueled the rally early on, the yield curve took the air out, and as the quarter went on, leadership moved from smaller, more cyclical stocks to larger, more defensive names. The yield curve has historically affected value stocks as well. A flattening curve provides less optimism for value stocks. While this trend has certainly mad life difficult for value investors, one could argue that an inverted curve indicates we are close to a turn in the value versus growth cycle.

Small Cap Stocks

As mentioned earlier, while small cap stocks led large caps during the period, that leadership faded mid-quarter, and reversed in March.

Credit Spreads and the Large vs. Small Cap Stocks



A bellwether for small cap strength is the difference between the yields on high yield corporate debt, and similar treasury bonds, known as the high yield spread. The spread is a measure of the market's view on credit risk. This spread and the relative performance of smaller stocks usually moves in tandem. In the first quarter it did not. The selloff in small cap stocks in March was *not* followed by an increase in the high yield spread. Insomuch as this relationship will continue, something has to give – either the high yield spread has to rise, or small cap stocks rally.

This is the common theme across markets going into the second quarter – disagreement. Whether it is leading indicators, interest rates or market internals, no clear picture emerges. For every indicator that points one direction, another one disagrees, notably ones that usually work in pairs such as quality and low volatility.

When searching for a catalyst to resolve this dispute, many signs point back to China. As the main economy beginning to show signs of rebounding, it may hold the key. If their recovery is real, the trade is resolved as expected, and their economic strength spreads to their trading partners, then growth can continue and even improve. If their recovery falters, then we are that much more likely to follow those negative indicators towards a recession.