Quarterly Letter March 2018

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"Fragility is the quality of things that are vulnerable to volatility."
Nassim Nicholas Taleb

It was a rather dismal first quarter that witnessed an earlier than expected rise in volatility and negative performance in most sectors and asset classes.

The sugar high of the tax reform was spent quickly and the headwinds from a change in monetary policy were realized by the market sooner than anticipated.

On the positive side, a globalized recovery is still intact in spite of a minor slowdown in recent weeks. Earnings are still projected to grow domestically by approximately 25% in 2018 with an inconsequential statistical margin of error. Earnings projections become much less reliable for 2019 where the expected growth is around 9% with a similar margin of error (source: JP Morgan).

Naturally, if a trade war were to materialize all bets would be off. Indeed, the recent volatility is signaling the market's attempt to assign a probability of such an unpredictable outcome. An all-out trade war seems unlikely even in light of the recent spat between the US Administration and China leadership. Nevertheless, it is one possible scenario.

In such an environment, there are few places to hide on a short-term basis as we are losing leadership from momentum sectors such as technology but deep value opportunities such as energy are still being viewed with some skepticism by many investors. Income plays such as REITs are also providing value but increasing interest rates are dumping enthusiasm. One element should be remembered: smoothly higher rates in a relatively mild inflationary environment, are actually not necessarily negative for REITs as validated by performance in similar historical periods.

International markets may provide some opportunities as their valuations, especially in Emerging Markets, are more attractive than domestic equities. The US Dollar position could also eventually help global exposures outperform as the greenback weakness could continue. In the last two years, correlations between US equities and International ones have dramatically decreased creating incentives in diversifying portfolios by geographical

parameters. However, as the weakness in the markets can be traced predominantly to the possibility of a trade war, it is unlikely that global equities, and especially Emerging Markets, may ultimately outperform.

With this macro backdrop and with some attention to the recent flirt of the S&P 500 with its long term 200 day moving average (a general technical parameter defining bull/bear environments), it may be a time for slight caution and continued diversification.

As always, we would like to thank you for the renewed confidence in our work,

Youri Bujko

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