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Quarterly Letter October 2018

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"Good judgment comes from experience, and a lot of that comes from bad judgment."
Will Rogers

The continuation of the spectacular run of our economy and financial markets rests, unsurprisingly, on the good judgment of two major economic players: the Fed and the Administration.

Our central bankers are trying to engineer, as so many of their predecessors before them, a so called "soft landing,' or when restrictive monetary policy is so well fine-tuned that achieves the goal to cool off inflation while keeping the business cycle expanding. It is a tough trick and, more often than not, the process ends with an inverted yield curve and a recession. The latest meeting of the FOMC delivered an additional 25 basis point increase in short term rates and a confirmation that three more hikes are still on the table. This juncture is especially delicate as there is a conflict between the short-term data (juiced by short-term inputs such as the tax cut/reform) and longer-term projections which are pointing to a slow down (trade, structural limitations).

The rate and nature of the coming slowdown is also clouded by the judgment this Administration will exercise in its on-going trade negotiations. While the re-making of NAFTA has ultimately ended up with not much more than a name change (USMCA), negotiations with China have a much higher probability of a policy mistake occurring.

Having first acknowledged the policy risks, one must also recognize that late-cyclical phases can last quite a while and a recession could still be quite some time away.

The developing macro backdrop, which also includes a divergence of policy between different economies (think Emerging Markets versus Developed Markets or US versus Europe) will influence different sectors in a variety of ways.

In our last missive, we indicated energy and midstream along with biotech as favorite bets. Midstream recorded a positive 6.75% return for the third quarter and integrated energy

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produced a positive 0.91%. Good numbers but not as good as the momentum driven S&P500 which clocked a positive 7.65%. Biotech did better as the Ishares Nasdaq Biotechnology returned a positive 11%.

REITS were also slightly positive (0.47%) as they are still held hostage by increases in rates. The value proposition in most subsectors of commercial real estate remains valid as many are trading to a discount to NAV, yields are significantly higher than most fixed income options and growth is expected to accelerate.

Looking forward, US equities still remain a relative better bet; better than bonds and on a short-term basis better than international equities. Emerging markets show value compared to their historical parameters but on an immediate timeframe, uncertainty would seem to linger.

Fixed income should remain under pressure as rates continue to rise which warrant a shorter duration positioning. We also continue to like non-agency mortgages based on valuation and the defensive nature of the credit exposure. We implement such exposure via PIMCO managers.

In commodities, we remain long energy as we think short and long term supply-demand imbalances have not yet been fully accounted for in related equity prices.

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

Youri Bujko

Davide Accomazzo