TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

April 2019

Quarterly Insights

EXECUTIVE SUMMARY

US Stocks Lead All Major Regions In Q1

In the First Quarter, the domestic S&P 500 Index was up 13.65% to lead all major regions in the recovery from 2018. Investor enthusiasm toward a Fed rate pause (which happened in late March) and a China trade resolution (yet to happen) prevailed over fears of a global slowdown and lower company earnings. The Bloomberg Barclay's US Aggregate Bond Index rose 2.94% in Q1 (bond yields fell). We saw a cautious market signal from bonds alongside an optimistic signal from stocks.

Where In The World Should We Invest?

Several managers justify overly high static foreign weightings by stating that global annualized returns converge to the same amount over the long-term. This is faulty logic. There has been considerable performance disparity on an annual basis between domestic (US) and foreign markets. Successful style rotation has led to much higher returns with lower portfolio risk. No region leads forever. Because we advocate style rotation, there will be a time where we increase foreign weighting from our current 15%. That time is close given a decade of US dominance. How much foreign should we add? Where in the world should we invest? When should we make the investment?

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First Quarter 2019

In This Issue

2 Where In The World Should We Invest?

6 Stock Market Spotlight

7 Bond Market Spotlight

8 Financial Planning Spotlight

9 Your Portfolio

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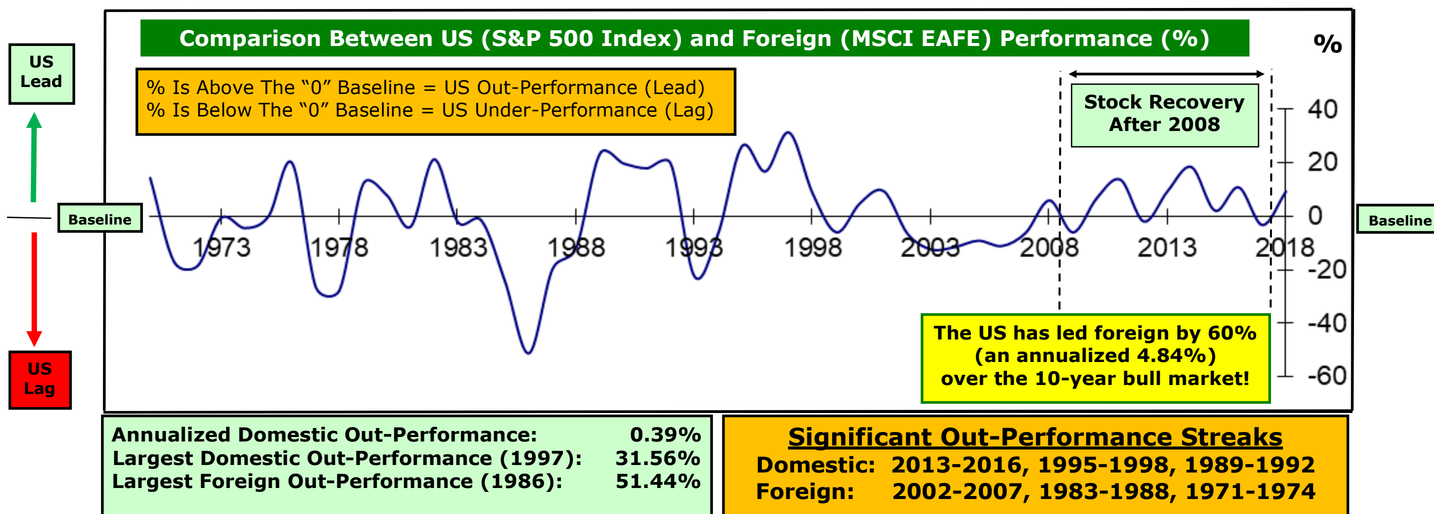
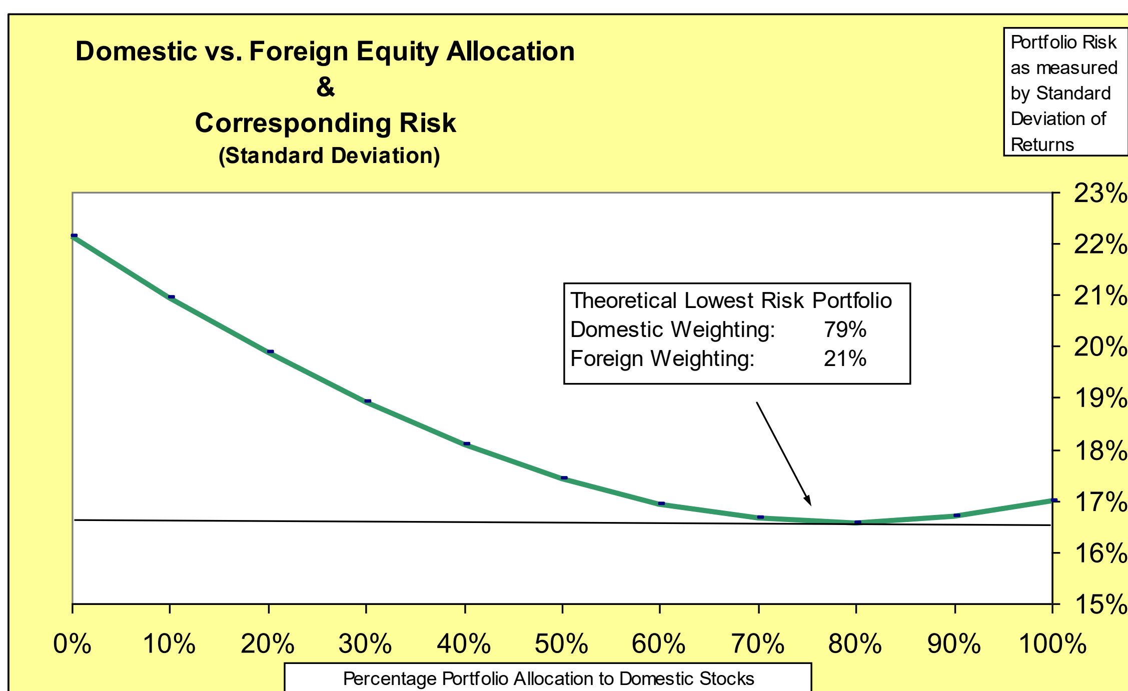
The Two Main Reasons Why We Have Foreign Exposure: Style Rotation & Risk Control

Several managers justify overly high (more than 30%) static foreign stock weightings by stating that global annualized returns converge to the same amount over time. This is faulty logic. While the US slightly out-performed foreign since 1970, there have been stark performance contrasts within those years. Different regions led at different times (often for many years at a time). In most years, there was considerable performance disparity. High static foreign stock weightings triggered significantly lower returns and higher portfolio risk (especially since 2009). Successful style rotation led to much higher returns with lower risk.



The greatest portfolio risk control is reached around an 80% domestic weight. There are additional considerations when we assess desired domestic versus foreign weighting at a given time in the market. We effectively operate within a range of 70% to 90% domestic exposure. For the last decade, we have been between 85% to 90% domestic weighting, and it has worked out very well (foreign stocks have lagged considerably). Because we advocate style rotation, there will be a time where we increase foreign weighting. That time is close given a decade of US dominance. How much foreign should we add? Where in the world should we invest? When should we make the investment?



How Much Foreign Exposure Should We Add Given A Decade Of US Dominance?

We currently have 15% foreign stocks (11% developed markets, 4% emerging) and operate in a 10%-30% range. Our range rationale includes portfolio risk control, foreign currency risk and US economic prosperity.

1. Portfolio Risk Control

Globalization has increased the positive correlation between domestic (US) stocks and foreign stocks. Having said this, US and foreign stocks are not perfectly correlated (perfect positive correlation is a measure of +1). This is why portfolio risk (as measured by standard deviation of returns) will vary according to the mix of US and foreign stocks (see page 2). We get the best portfolio risk control in a range of 10% to 30% foreign stocks. One of the reasons why US and foreign stocks are not perfectly correlated is foreign currency risk.

2. Foreign Currency Risk

More foreign exposure in a portfolio increases currency risk. If foreign currencies depreciate versus the US Dollar, the foreign component of the portfolio will suffer. If foreign currencies appreciate, the foreign component will benefit. Let us illustrate. One reason the US stocks dominated foreign stocks over the last year is that all foreign currencies significantly depreciated versus the US Dollar - the value of the foreign stocks lost considerable value when converted to US Dollars. Interest rates can provide currency stability. Right now, the 10-Year US Treasury Rate is 2.4%. The 10-Year Euro bond is minus 0.1%. Investors are much more motivated to invest in US Dollars versus the Euro. This adds relative strength to the US Dollar.

Region	Currency Depreciation vs US Dollar Over The Last Year	10-Year Treasury Rate
United States	-	2.4%
Euro Area	-10.1%	(0.1%)
Britain	-7.9%	1.0%
Japan	-4.9%	(0.1%)
China	-6.3%	3.0% (5-Year Yield)
India	-5.8%	7.3%

As of March 30; Source: The Economist

From a foreign currency risk standpoint, we are comfortable with a foreign weighting that can range from 10% to 30% based on market conditions. We are very uncomfortable with a foreign weighting above 30%. US investors spend, for the most part, US Dollars - even more-so when they are retired. Why take on significant foreign currency risk, especially to meet income needs in retirement? This is why our equity benchmark is the S&P 500 Index (a 100% US stock market index). We have seen some managers choose a global benchmark such as the MSCI ACWI, an index weighted 55% US and 45% foreign. In our opinion, this is excessive risk.

3. US Economic Prosperity

Make no mistake - the US is still “King of the Castle”! It is 25% of the global GDP (see page 4). Taking all factors (portfolio risk control, foreign currency risk and US economic prosperity) into consideration, we always want at least 70% US exposure.

We Plan To Move From 15% to 20% Foreign Exposure

Consideration	Why We Plan To Move From 15% To 20% Foreign Exposure
Portfolio Risk Control	The market rose more than we foresaw in Q1 ; 20% is the lowest risk point.
Foreign Currency Risk	In a target range of 10% to 30% foreign exposure, 20% is the mid-point.
US Economic Prosperity	In a target range of 10% to 30% foreign exposure, 20% is the mid-point.
Performance Trends (Momentum)	The US has led foreign for the last decade. Trends like these usually reverse.

When We Move To A Higher Foreign Weight, Where In The World Should We Invest?

The world is a big place. When we ask ourselves the question "where in the world to invest?", we approach it as a process of elimination. We "rule out" the areas we don't want to consider and see what areas remain for consideration. The table below acts as our screen framework to filter out the areas we want and don't want.

TriVant Screen Framework: Where In The World Should We Invest?

Factor	Considerations
Global Impact	Does the country/region have meaningful impact on the global economy? Does the country/region have attractive economic growth?
Economic Stability	Is the economy stable or unstable? Are there adverse external factors?
Political Stability	Is the political environment stable or unstable?
Currency Stability	Is the local currency stable versus the US Dollar or not? If not, why not?
Regulatory Stability	Has the local government shown a propensity to deal fairly and be trusted? Are local accounting standards trustworthy from an investment standpoint?
Market Access/Valuation	Are we able to purchase public companies? If so, are valuations attractive?

While we believe the MSCI ACWI World Index is an inappropriate equity benchmark for a US-based investor (too much foreign exposure, see page 3), its composition is useful in defining the "global playing field".

MSCI ACWI INDEX

MSCI WORLD INDEX: DEVELOPED MARKETS

Americas	Europe & Middle East	Pacific
Canada **US**	Austria, Belgium, Denmark, Finland **France** **Germany** **Ireland** Israel, Italy Netherlands, Norway Portugal, Spain, Sweden, Switzerland **United Kingdom**	Australia Hong Kong **Japan** New Zealand Singapore

MSCI EMERGING MARKETS INDEX: EMERGING MARKETS

Americas	Europe, Middle East & Africa	Asia
Brazil Chile Columbia **Mexico** Peru	Czech Republic Egypt Greece Hungary Poland Qatar Russia South Africa Turkey United Arab Emirates	**China** **India** Indonesia Korea Malaysia Pakistan Phillippines Taiwan Thailand

COMPOSITION

US	55%
Developed Foreign	36%
Emerging Markets	9%

At this time, the bolded countries are where we (TriVant) have or are considering investments.

Let's consider our first screen factor - Global Impact. Here are the areas that have 3% or more global GDP:

Region	Percentage of Global GDP (Source: World Bank)	GDP Growth
United States	25%	2.6%
Euro Area	21% (Germany + France = 8%)	1.1%
United Kingdom	4%	1.3%
Japan	6%	0.3%
China	15%	6.4%
India	3%	6.6%

We can screen out most areas under 3% global GDP (see un-bolded countries above). A turbulent political environment (unsolved BREXIT) rules out higher U.K. and Europe exposure. A flat economy rules out higher exposure to Europe and Japan. A high local interest rate (7.3%) could inhibit business in India. The fact that we want to avoid so much of the MSCI ACWI Index (representing over 40% of global GDP) further illustrates why we hate it as a benchmark. Mexico is worth consideration because it is the current 2019 laggard in global stock performance (attractive valuation) and its new government is stable. China is by far the most attractive area to increase exposure because it passes all but one of our screen filters (Regulatory Stability, see page 5).

CONCLUSION: Increase China (Also Consider A New Position In Mexico)

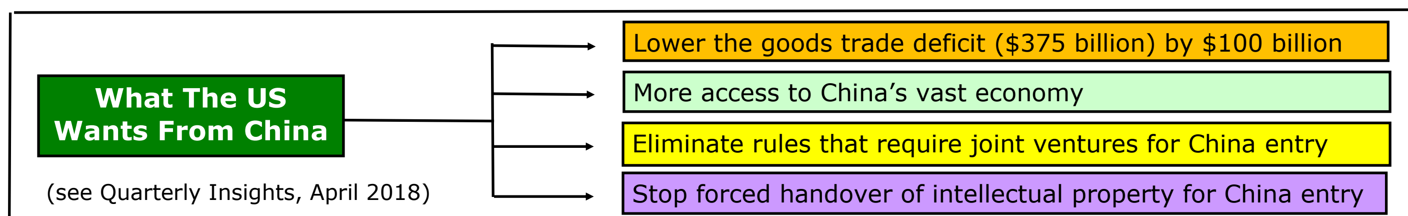
When Should We Increase Exposure In China?

China passes five of six factors in our TriVant screen. It is not a question of wanting to increase our exposure to China - we do - it is a question of when.

TriVant Screen Framework: China		
Factor	**Comments**	**PASS / FAIL**
Global Impact	China represents 15% of the global economy China has attractive economic growth: 6.4% GDP	**PASS**
Economic Stability	While GDP growth has slowed, we consider it stable The government is actively stimulating the economy	**PASS**
Political Stability	President Xi Jinping took office in 2013 No term limits - Xi Jinping may be "president for life"	**PASS**
Currency Stability	The Yuan has been pegged to the USD to aid exports	**PASS**
Regulatory Stability	The government is involved with various companies Some companies receive unfair business advantages Technology theft is huge issue (basis for Trade War)	**FAIL (Wait For Resolution Of US-China Trade War)**
Market Access/Valuation	We can buy companies such as Alibaba and Baidu	**PASS**

We Reached The One-Year Anniversary Of The US-China Trade War In March

On March 1, 2018, the US-China Trade War started with President Trump imposing tariffs on Chinese imports due to intellectual property theft. Chinese products were (allegedly) developed using trade secrets (intellectual property) from US companies that China either stole or forced US companies to give up in exchange for Chinese market access. It is estimated that Chinese theft of American intellectual property annually costs between $180 billion to $540 billion (source: Commission On The Theft Of American Intellectual Property). The US wanted (and continues to want) specific concessions from China.



Where Are We Now With The US-China Trade War?

The goods trade deficit has increased from $375 billion (2017) to $419 billion (2018). Negotiations continue as there have been numerous moratoriums/grace periods of tariff increases. China has renewed promises to open its state-controlled financial services sector to foreign competition and ensure equal treatment. The Chinese government has also pushed ahead legal changes to deal with foreign complaints about an uneven domestic playing field as well as widespread theft of intellectual property. Premier Li Keqiang has promised that China will not discriminate between state-owned and private companies. Our lingering concern is the issue of intellectual property. Even if China makes concessions in this area, how will the laws be enforced?

We Plan To Increase Exposure In China Once We See A Trade Resolution Is Imminent

Trade tensions in 2018 hurt China stocks more than US stocks. This could happen again if talks stall. Until a resolution is imminent, we will likely wait to increase China.

The US-China Trade War - US "Flight To Safety" In 2018				
Index	**Q2 2018**	**Q3 2018**	**2018 Total**	**Q1 2019**
S&P 500 (US)	3.43%	7.71%	(4.38%)	13.65%
China	(3.50%)	(7.42%)	(18.88%)	17.69%
US Outperform:	**+6.93%**	**+15.13%**	**+14.50%**	**(4.04%)**

US Stocks Lead All Major Regions In Q1

In the First Quarter, the domestic S&P 500 Index was up 13.65% to lead all major regions in the recovery from 2018. Investor enthusiasm towards a Fed rate pause (which happened in late March) and a China trade resolution (yet to happen) prevailed over fears of a global slowdown and lower company earnings.

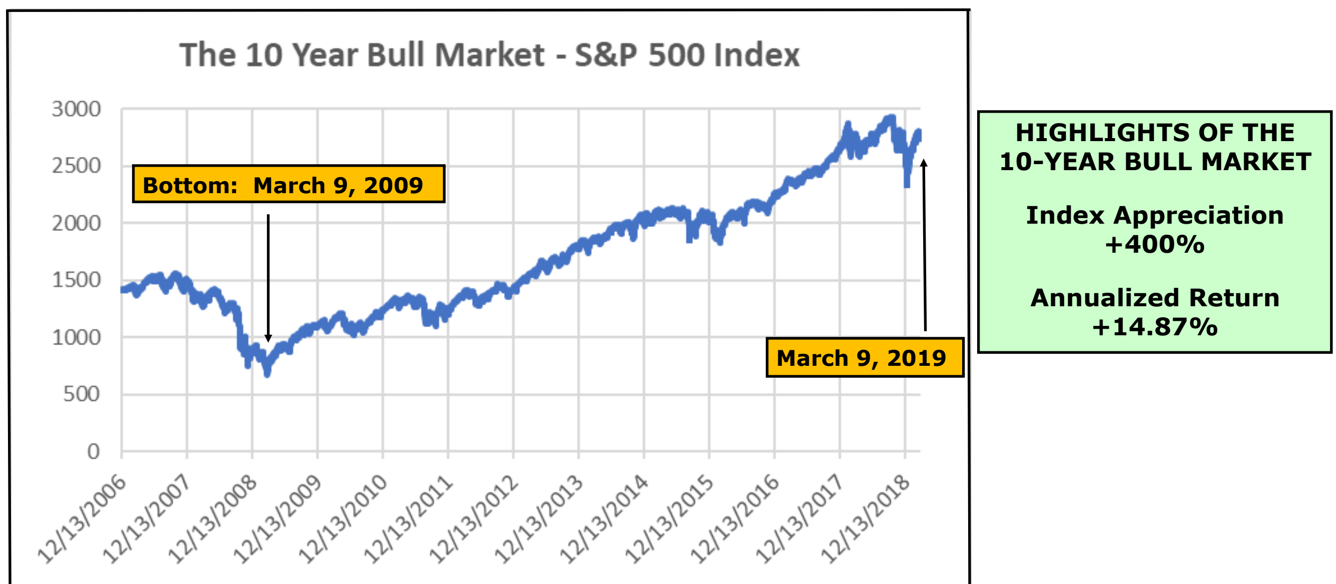
Equity Index Performance

Index	Q1 2019	2018
S&P 500 (Domestic)	**13.65%**	**(4.38%)**
MSCI EAFE (Foreign) *	**9.98%**	**(13.79%)**
MSCI Emerging Markets	**9.92%**	**(14.58%)**
MSCI EMU (European Monetary Union)	**9.94%**	**(16.90%)**
MSCI Japan	**6.66%**	**(12.88%)**

* Europe, Australia and the Far East

We Reached The 10-Year Anniversary Of The Bull Market

We reached the 10-year anniversary of the bull market in early March. Everyone has horrible memories of 2008. It may surprise you to know how well the US market has done in the 10-year time frame since it bottomed. The S&P 500 Index is up 400%, which translates to an annualized return of +14.87%.



Lessons Learned

1. The Market Converges To Historical Averages Over Time

The stock market has averaged a 10% rate of return over the long term - including the ugly years.

2. Patience Is A Virtue

The investors who took a long term market view and didn't get rattled in 2008 were significantly rewarded.

3. Don't Try To Time The Market

There are always temptations to try and time the market. Don't try! The most recent example of poorly-executed market timing was last year. A combination of volatile market conditions and bad timing caused the average US investor to lose twice as much as the S&P 500 Index in 2018 (source: DALBAR). Imagine how much investors likely lost over the 10-year bull market with multiple attempts to time the market.

Bonds Rise In Q1

The Barclay's Capital US Aggregate Bond Index, a broad-based representation of bond performance, rose 2.94% in the First Quarter, following a mere 0.01% rise in 2018. On March 20, the Federal Reserve paused rate hikes, signaling no rate hikes this year and only one increase in 2020. The yield curve briefly inverted on March 22 - an inversion is when short-term rates exceed longer-term rates.

Key US Interest Rates	December 31, 2018	March 31, 2019	Change
Federal Reserve Board Funds Target Rate	2.50%	2.50%	0 basis points
2-Year Treasury (Constant Maturity)	2.48%	2.27%	- 21 basis points
5-Year Treasury (Constant Maturity)	2.52%	2.24%	- 28 basis points
10-Year Treasury (Constant Maturity)	2.69%	2.41%	- 28 basis points

Bonds And Stocks Are Saying Two Different Things - Which Signal Do We Follow?

Stock prices and bond yields have been moving in different directions for months, sending conflicting signals to investors watching for warning signs about slowing global growth. The S&P 500 Index rose 13.65% in Q1 while the 10-Year Treasury yield fell 0.28% (the bond index rose 2.94%). Bear in mind the inverse relationship between bond prices and bond yields - as bond prices rise, bond yields fall.

Cautious Signal From The Bond Market

Investors typically view falling bond yields as a sign of economic pessimism because it points to higher demand for a safe haven asset. The Fed pivoted rapidly from its hawkish stance in 2018 (four rate hikes in 2018 and two anticipated rate hikes in 2019) to a more dovish outlook (no rate hikes anticipated in 2019 and the outside possibility of lowering key rates by year-end). This signals that the Fed sees slowing growth in economic activity and the possibility of a recession. The greater recession risk is reflected with a flattening yield curve and the brief inversion in late March. While instances of inversion can be an indication of a slowing economy, history shows that only sustained periods of inversion have proven to be better predictors of recession within the following 9-18 months.

Optimistic Signal From The Stock Market

Given what the Fed telegraphed, it is ironic that stocks did very well in Q1 versus pulling back. We have a theory as to why this happened. The Fed Funds Rate has been hiked nine times (0.25% per hike) since the rate went to zero at the end of 2008. As the Fed rate goes higher, so does the Fed's capacity to maneuver. If the economy slows and the stock market falters, the Fed could conceivably lower the Fed rate and invigorate the economy. This downside protection (called a "Fed Put") likely gave investors confidence.

We Will Follow The Cautious Signal From The Bond Market

BOND MARKET STRATEGY
(flat yield curve and concern for economic weakness)

- Shorter maturities (average duration = 3 years)
- Focus on quality bonds
- Minimal riskier bond exposure (such as corporates)

STOCK MARKET STRATEGY
(follow the cautious signal from the bond market)

- Move towards lowest risk portfolio (see page 2)
- Increase China (see page 5)
- Delay move to small cap value (see January report)

The 10-Year Bull Market Has Created A Welcome Problem: Unrealized Capital Gains

The S&P 500 Index has appreciated 400% over the 10-year bull market, which translates to an annualized return of +14.87%. For taxable accounts, this has created a welcome problem: high unrealized capital gains. Our long-standing clients are holding highly-appreciated stocks. To illustrate, here is a small cross-section of the highest gainers in a client's portfolio (asset values as of April 3, 2019):

Symbol	Name	Acquisition Date	% Unrealized Gain
AAPL	Apple	11/05/2008	1193%
V	Visa	05/20/2011	708%
SBUX	Starbucks	01/16/2008	666%
MSFT	Microsoft	10/10/2008	467%
NVO	Novo Nordisk	10/14/2008	408%

There are two main reasons why we need to occasionally sell individual securities in a taxable account:

a) The client needs funds

b) We want to make portfolio adjustments due to style rotation and/or firm-specific reasons

Tax implications are important. We realize capital gains when we sell appreciated stocks in a taxable account. Short-term capital gains (asset acquired up to one year ago) are taxed at your ordinary income tax rate. Long-term capital gains (asset held for more than a year) are taxed at a federal rate of 15%-20% (depending on your taxable income and filing status) and a state rate (depending on state of residence).

We try our utmost to be sensitive to realized gains, especially with highly-appreciated stocks. There is a saying that says "Don't Let The Tax Tail Wag The Investment Dog". Its literal meaning is "don't make investment decisions solely based on tax considerations". There are three considerations we bear in mind in an effort to minimize your taxes:

1. Keep Investments For At Least One Year

Except for unusual circumstances, we want to hold securities for at least one year in a taxable account. The reason is that we want to graduate from short-term unrealized gains to long-term unrealized gains in the event we sell the security. In most instances, long-term realized gains are cheaper in terms of taxes.

2. Tax-Loss Selling

In a well-diversified portfolio of 40 to 50 stocks, there are inevitably stocks that are up and down. Near year-end (if feasible), we try to mitigate realized gains with realized losses (sell "down" stocks).

3. Legacy Considerations

We become increasingly sensitive toward holding highly-appreciated stocks in taxable accounts as our clients age. First, we try our best to minimize taxes. Second, clients often mandate legacy objectives. When a stock is worth more than its purchase price on the date of a single owner's death, the cost basis is "stepped up" to the value of the stock as of the date of death. This is a huge tax benefit to the deceased owner's heir(s).

We made a few portfolio adjustments in Q1. The rationale for these moves included a desire to remain cautious, especially until we see a trade resolution is imminent with China. These adjustments were defensive in nature, buying one large cap stock and selling two small cap stocks.

We bought Colgate-Palmolive (symbol: CL; $57 billion market cap), one of the world's largest consumer products companies. Its products include oral care, shampoos, shower gels, deodorants, home care products, and specialty pet food. These products are sold in over 200 countries. Over 75% of CL sales are international (50% of sales are in emerging markets). CL enjoys a 40% worldwide market share in toothpaste (55% in India, 73% in Brazil, and 30% in China). Attributes of CL include solid brand recognition and loyalty, strong management, and consistent revenue / cash flow / profitability.

We sold AerCap Holdings NV (symbol: AER; $7 billion market cap), an international leader in aircraft leasing. We also sold Moelis & Co Class A (symbol: MC; $2 billion market cap), a global independent investment bank.

As already discussed, we anticipate future portfolio adjustments when we move to a more aggressive stance. The exact timing of these actions is yet to be determined, but we know they are on the horizon. Whenever we make the moves, there is one thing of which we are reasonably sure - you will feel quite uncomfortable about them! This is the nature of style rotation.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

TRIVANT

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Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.