TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

October 2019

Quarterly Insights

Third Quarter 2019

In This Issue

EXECUTIVE SUMMARY

US Stocks Lead Major Regions In Q3

In the Third Quarter, the domestic S&P 500 Index was up 1.70% to further extend its 2019 lead over all major regions. Investor enthusiasm towards two quarter-point Fed rate cuts (July 31 and September 18) was somewhat "washed out" by lingering concerns regarding a China trade resolution (yet to happen). The Bloomberg Barclay's US Aggregate Bond Index rose 2.27% in Q3, following a 3.09% rise in Q2. We saw a cautious market signal from both stocks and bonds in Q3.

"Down Stocks" Should Be A Welcome Sight In Your Portfolio

We primarily use individual securities versus mutual funds and ETFs when building your stock portfolio. It is easy to see, on a stock-by-stock basis, which holdings are up, down, and by how much. When a stock is down a lot, we often get asked why we are holding a "loser" instead of a "better choice". Don't dismiss "down stocks" so easily!

"Down stocks" are an absolute necessity if your portfolio is well-constructed to control risk. Our objective is not to avoid holding "down stocks". Our objective is to have your portfolio perform well relative to its benchmark over the long-term.

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“Down Stocks” Stand Out Like a Sore Thumb - But Don’t Dismiss Them So Easily

We primarily utilize individual securities versus mutual funds and ETFs when building a diversified stock portfolio. Consequently, you can see, on a stock-by-stock basis, which holdings are up, down, and by how much. Behavioral Science tells us that investors hate losses two-and-a-half times as much as they like gains. It is human nature to “pick on the down stocks”.

When a stock is down a lot, we often have clients contact us to ask why are we holding a “loser” instead of a “better choice”. In our recent client survey (thank you for your participation), many of you repeated the same question. In the considerable “up market” we have experienced over the last 10 years, a “down stock” stands out like a sore thumb. Try to remind yourself that it is the sum of the parts that is important, not the individual parts. Put another way, consider how your overall portfolio is performing versus its benchmark.

Successful Money Management And Winning Chess Have A Lot In Common

On both the chess and money management battlefields, the object is to protect the King.

In chess, the casualties can include any chessboard piece except the King. The winning chess player is the one who successfully protects his King from being attacked in such a way that the King cannot escape.

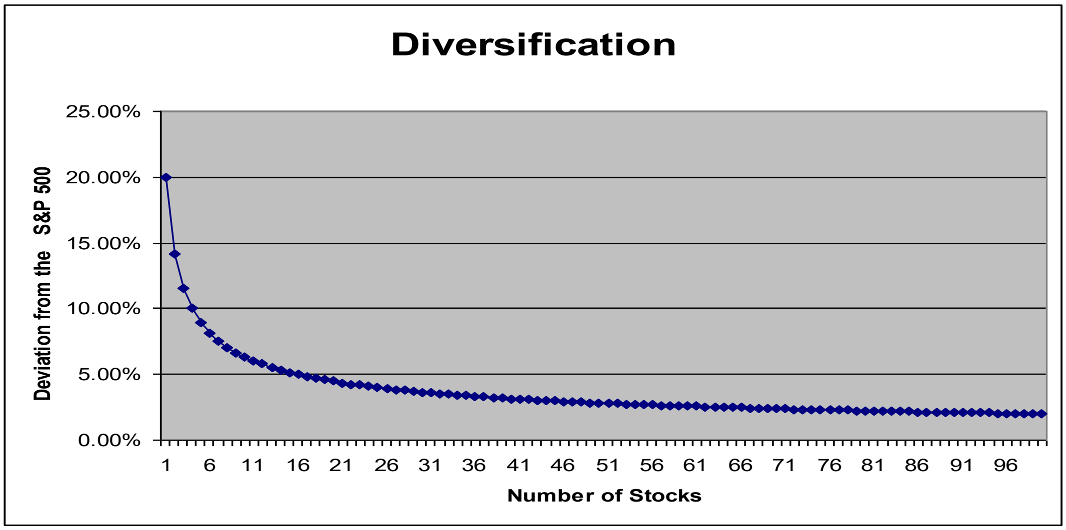
In a well-diversified stock portfolio that beats a performance benchmark for the long-term, the casualties are the “down stocks” - but never the King. The winning money manager is the one who successfully protects his King (you) from being irreparably damaged by the market.

Casualties Must Be Incurred To Protect The King

If there are no casualties in a chess game, this would imply that neither player is willing to move the chess pieces. There would be an effective "stalemate" - no winner, no loser and no game.

If there are no casualties in a diversified stock portfolio, this would necessitate that every stock in that portfolio is a winner. If every stock is a winner, it can be concluded that the stock portfolio is not diversified and is subject to very high levels of risk.

It is not only advantageous to have "down stocks" in a diversified portfolio, it is an absolute necessity if the portfolio is well-constructed. An optimal portfolio must contain negatively-correlated stocks to minimize risk. We believe a properly-diversified portfolio should have 40+ individual stocks - so some stocks will be down.



Winning The War Is The Only Thing That Matters

The winning chess player is the one who anticipates his opponent's moves and, through effective offensive and defensive strategies, is able to corner his opponent's King. As a chess game progresses, the captured pieces are removed from the chessboard. On the sidelines, the winning chess player has pieces he has won, lost, traded and sacrificed in order to protect his King. But most importantly, he has won the war. The pieces on the sidelines are just as important, and sometimes more important, than the pieces remaining on the chess board.

The winning money manager is the one who correctly anticipates market conditions and, through effective offensive and defensive strategies, constructs a stock portfolio to protect his King from getting badly hurt in the market. He protects his King by building an optimally diversified portfolio that beats a performance benchmark for the long-term. In the portfolio, the winning money manager has stocks he has won, lost, traded and sacrificed to gain position. But most importantly, the money manager has won the war. The "down stocks" are just as important, and sometimes more important, than the winners.

In A Well-Executed Strategy, Casualties Are Planned And Deliberate, Not Accidental

When we execute a portfolio strategy, we always ask ourselves what could happen if we are wrong. Hence we intentionally hold "counter-strategy" positions that will be down if our anticipated market conditions prove correct. We may also hold a "down stock" when we believe the company's prospects are favorable.

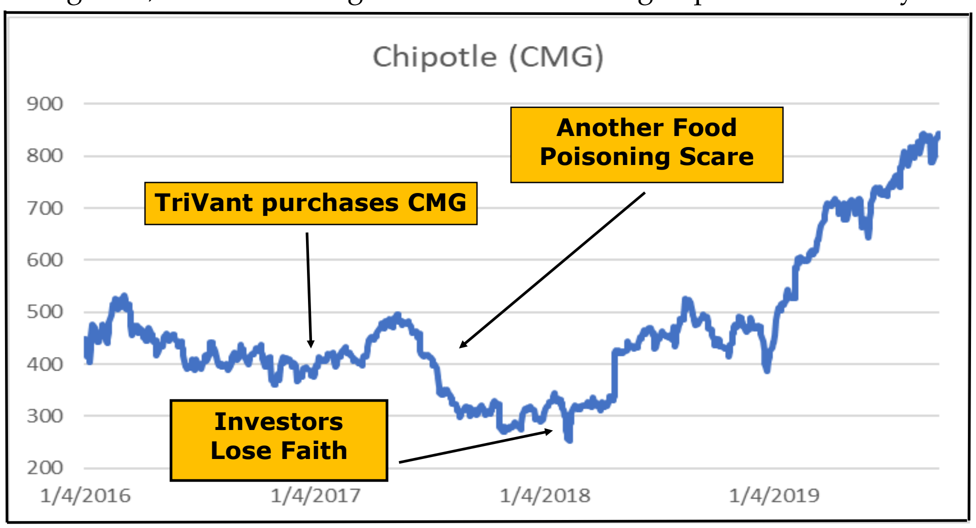
Chipotle: A Big Loser One Year Out Of The Gate - And A Subsequent Huge Winner

Chipotle (symbol: CMG), the largest player in the fast-casual Mexican restaurant category, reached a share price of $742 on July 31, 2015. Then during October, 2015, there were several reports of food poisoning at multiple store locations in Washington and Oregon. By January 13, 2016, the share price had fallen to $428. The price remained stagnant for another year. We bought Chipotle on January 13, 2017 for $411 per share. At that time, our rationale for buying Chipotle was that it represented tremendous future growth potential:

1. We believed the food poisoning scare had passed and was over-blown as compared to Jack In The Box
2. It cost $800,000 to open a store and each store had annual net income of $400,000 (great metrics)
3. There was tremendous cash and negligible debt on the balance sheet

In July 2017, there were further reports of food poisoning in a Virginia restaurant. A little over a year into our CMG purchase (February 13, 2018), the stock had fallen to $251 (down 39%). Peak ($496 on May 16, 2017) to trough ($251 on February 13, 2018), CMG was cut in half. Still, we believed in CMG and held on to the stock. CMG subsequently more-than-tripled (now at $840) and has been the best stock in the S&P 500 Index in each of the last two years.

During 2017, CMG was a big "down stock" in a big "up market". Many bailed at the price bottom. We didn't.



Chipotle (CMG)	
2017	- 23.4%
2018	+ 49.4%
2019 YTD	+ 96.5%

S&P 500 Index	
2017	+ 21.8%
2018	- 4.4%
2019 YTD	+ 20.6%

CONCLUSION: Maintain Your Hypothesis If It Still Makes Sense - Patience Is A Virtue

US Stocks Lead Major Regions In Q3

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Equity Index Performance

Index	Q3 2019	2019
S&P 500 (Domestic)	**1.70%**	**20.66%**
MSCI EAFE (Foreign) *	**(1.07%)**	**12.80%**
China	**(4.73%)**	**7.62%**
MSCI EMU (European Monetary Union)	**(1.79%)**	**13.90%**
MSCI Japan	**3.13%**	**11.12%**

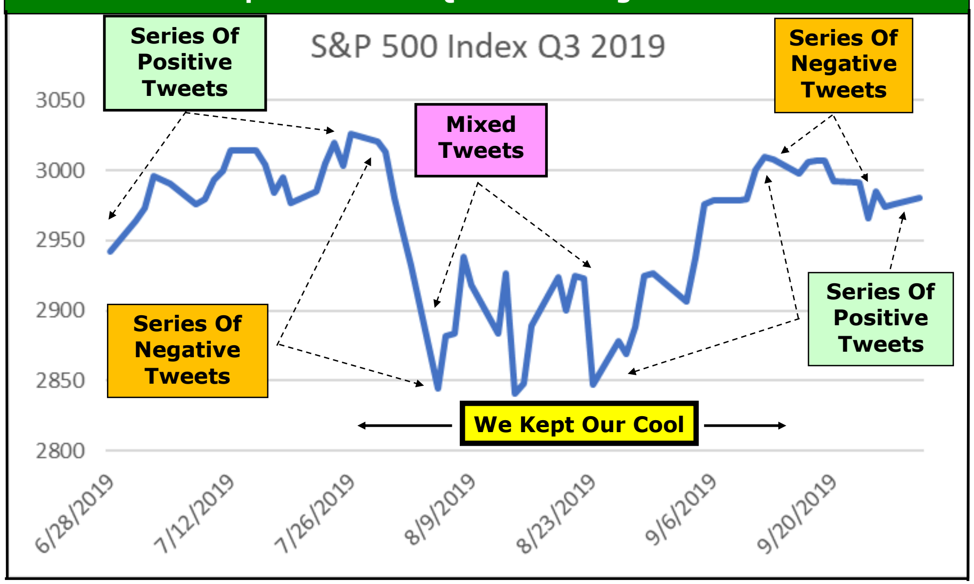
* Europe, Australia and the Far East

The Biggest Market Driver In Q3: Trump Tweets Regarding Trade War With China

There is another type of chess game going on: the US/China Trade War. We believe the US has more to gain by settling soon and more to lose by waiting it out - hence the volume of Q3 Trump tweets.

Trade War Chess Game: US vs. China	WAIT IT OUT GAIN	WAIT IT OUT LOSS	SETTLE SOON GAIN	SETTLE SOON LOSS
US	Nothing	Economy Politics Pride	Economy Politics Pride	Leverage (Make A Bad Deal)
China	Leverage (Potentially Deal With A New Administration)	Economy	Economy	Leverage (Make A Bad Deal)

President Trump's Tweets In Q3 Concerning Trade War With China



The positive or negative tone of President Trump's tweets drove the ups and downs of the market in Q3. This is a phenomenon we have never seen. We cannot anticipate the timing and nature of Trump's tweets. During Q3, the end result was roughly a zero-sum gain amidst all the volatility, so we feel we did the right thing by tuning out Twitter.

Stock Portfolio Strategy: Ignore The Noise And Maintain Conservative Position

We "kept our cool" during the market's "V-shape Fall And Recovery" between late July and mid September. The portfolio continues to have a large emphasis towards large cap ("conservative") US stocks. Until we see a concrete resolution to the trade war (versus Twitter comments), we will continue to err on the side of caution.

Bonds Rise In Q3

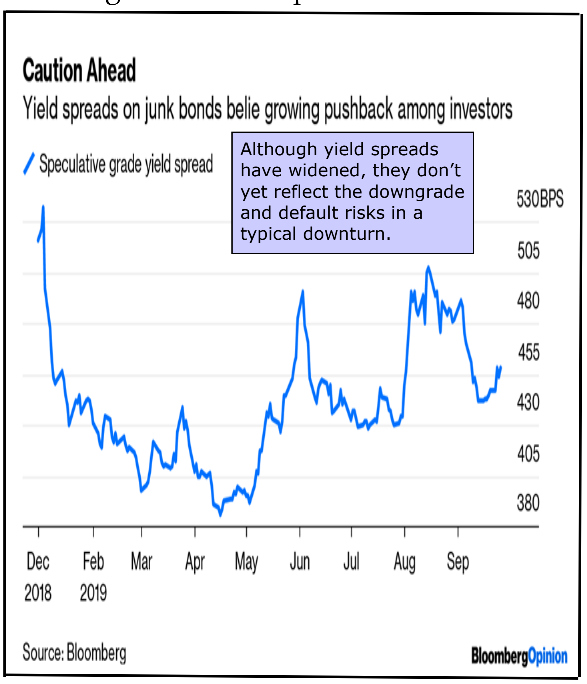
The Bloomberg Barclay's US Aggregate Bond Index, a broad-based representation of bond performance, rose 2.27% in Q3, following a 3.09% rise in Q2. On July 31 and September 18, the Federal Reserve cut its target rate by 0.25%, with another cut possible before year-end. The yield curve inverted on August 29: an inversion is when short-term rates (2-year) exceed longer-term rates (10-year).

Key US Interest Rates	June 30, 2019	Sept. 30, 2019	Change
Federal Reserve Board Funds Target Rate	2.50%	2.00%	- 50 basis points
2-Year Treasury (Constant Maturity)	1.75%	1.63%	- 12 basis points
5-Year Treasury (Constant Maturity)	1.76%	1.55%	- 21 basis points
10-Year Treasury (Constant Maturity)	2.00%	1.68%	- 32 basis points

Corporate Bonds Are Becoming More Risky

Investment-grade bonds are rated from AAA through BBB. With interest rates historically low, BBB debt issuance has risen over 200% since 2008 and now represents about 50% of the investment-grade corporate market's debt. Much of the BBB debt raised did not end up being used for capital expenditures which typically foster long-term company growth - instead, a disproportionate amount of funds have been used for mergers and acquisitions, dividends, and share repurchases. With slow global economic expansion and uncertainty, the prospects of achieving adequate growth and profitability to cover the additional bond interest costs have been diminished, despite a large amount of refinancings.

Many investment-grade companies have leveraged their balance sheets to levels consistent with mid-to-low BBB ratings. Some of those companies have retained their high ratings from the bond rating agencies in part by targeting free cash flow to reduce leverage in upcoming years. But this may not happen in a slow growth business environment. Investors demand a higher risk premium to compensate for potential credit spread widening and downgrades, resulting in higher volatility of corporate bond prices. High leverage is assigned greater credit risk. Yield spreads on junk bonds (lower than investment-grade bonds) are rising because companies must boost interest rates to compensate investors for additional credit risk.



We Have Minimal Exposure To Corporate Bonds

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)

We Maintain Our Conservative Stock Stance

In Q3, companies with fragile balance sheets (small cap value stocks) out-performed their sturdier peers (large cap growth stocks) and the broad market for the first time since 2016 (source: Goldman Sachs). This may be a sign that the Fed's rate cuts are propping investor confidence in heavily-indebted companies. We believe this is a short-term phenomenon and we don't want to "chase the heat". In the event of an economic downturn, we want companies that will best "weather the storm" with strong financials.

Roth IRA Conversions: A Potentially Worthwhile Maneuver

One of the primary benefits of a Roth IRA is that you don't pay income tax when you withdraw funds (subject to a few rules). With a Regular IRA, you pay income tax when you withdraw funds. Because it is the best tax-advantaged account, the US government doesn't make it easy - you cannot contribute to a Roth IRA if your income is too high. However, a Roth Conversion is a legal way to sidestep income limits by converting traditional IRA assets into Roth IRA assets. This is not a tax dodge - you have to pay taxes on the money you convert to a Roth IRA. But it may make sense to consider.

1. A Roth Conversion May Make Sense In Terms Of Tax-Efficiency

You want to pay as little income tax as possible. A Roth Conversion may allow you to make smart tax moves that will save money in the long term.

If you anticipate significantly-lower income in a certain year (and increasing in subsequent years), you could plan a conversion for the low-income year. You may be in a lower tax bracket the year you convert.

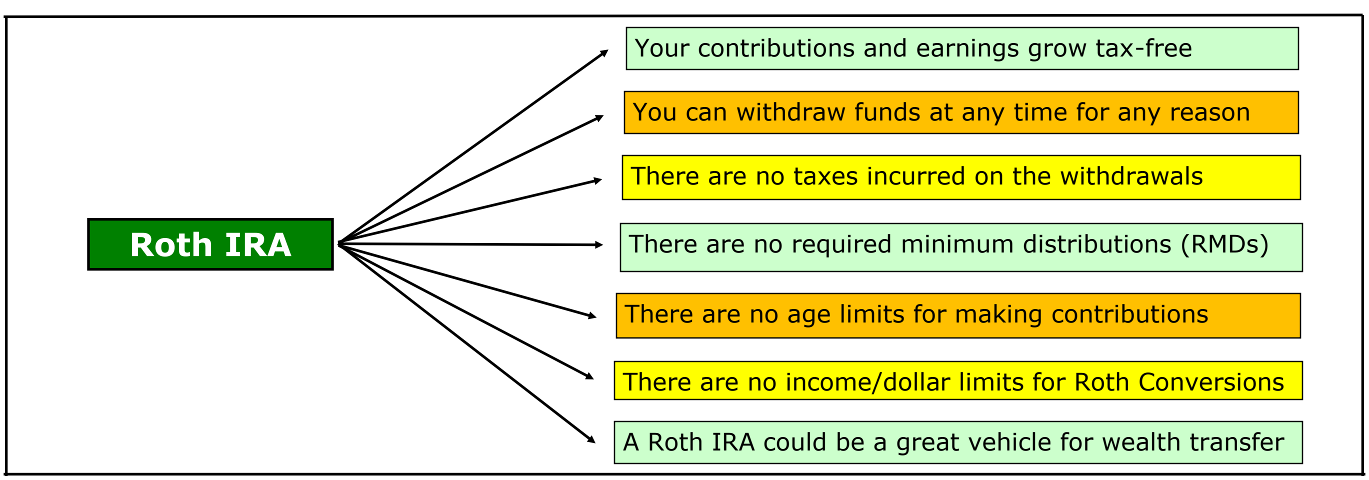
If the IRS announces a tax rate increase(s) to go into effect for the following year(s), a conversion in the current year would save income tax.

Converting to a Roth IRA will guarantee that you will owe no additional income tax on the converted funds - and any money those funds will earn before you withdraw them - during retirement. The balance in your Roth IRA will be what you can access in retirement without having to consider taxes. The added flexibility of a Roth IRA income source may help smooth out your taxes in retirement.

2. A Roth Conversion Has No Caps On Income Or Conversion

There is no cap on your level of personal income in determining your eligibility to do a Roth Conversion. You can convert as long as you pay the appropriate tax on the conversion. Also, there is no cap on the dollar amount you can convert - but bear in mind what we call "tax bracket creep". Your taxable income increases when you withdraw funds from your Regular IRA account. Watch out if you get pushed into a higher tax bracket (see IRS schedule and/or consult your tax professional).

3. Maximizing Your Roth IRA Is Excellent Financial Planning



Please contact us for further information and assistance.

Effective October 7, Schwab is eliminating trading commissions for US-listed stocks, exchange-traded funds (ETFs) and options. Trading costs will be reduced from $4.95 per trade to $0.00 per trade.

We made several portfolio adjustments in Q3. The rationale for these moves included a desire to increase our under-weight to Financials and Energy, increase our exposure to Discretionary (low cost consumables) in a slowing economy, reduce high-debt companies, and reduce our exposure to politically-sensitive Health Care.

We bought US Bancorp (symbol: USB; $87B market cap), the nation's fifth-largest bank with branches in over 20 states. We also bought Dollar General (symbol: DG; $40B market cap), which has over 15,000 stores in 44 states: 80% of its items are priced at $5 or less. We sold Novo Nordisk ADR (symbol: NVO; $115B market cap), the leading provider of diabetes-care products in the world with almost a 50% market share (by volume) of insulin. We anticipate heated election rhetoric regarding the high cost of drugs. We also sold AT&T (symbol: T, $258B market cap) due to its high level of debt. Finally, we sold Continental Resources (symbol: CLR, $10 billion market cap) to take a realized loss and replaced it with ConocoPhillips (symbol: COP).

We started to "tax-loss sell" for 2019 in select taxable accounts. Tax-loss selling is when we try to mitigate/ reduce realized capital gains by realizing losses with stocks whose price is (currently) below acquisition cost. We will continue to tax-loss sell when feasible as we approach year-end in an effort to be as tax-efficient as possible. As we are not tax professionals, we are happy to work with you and/or your tax advisor as needed.

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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