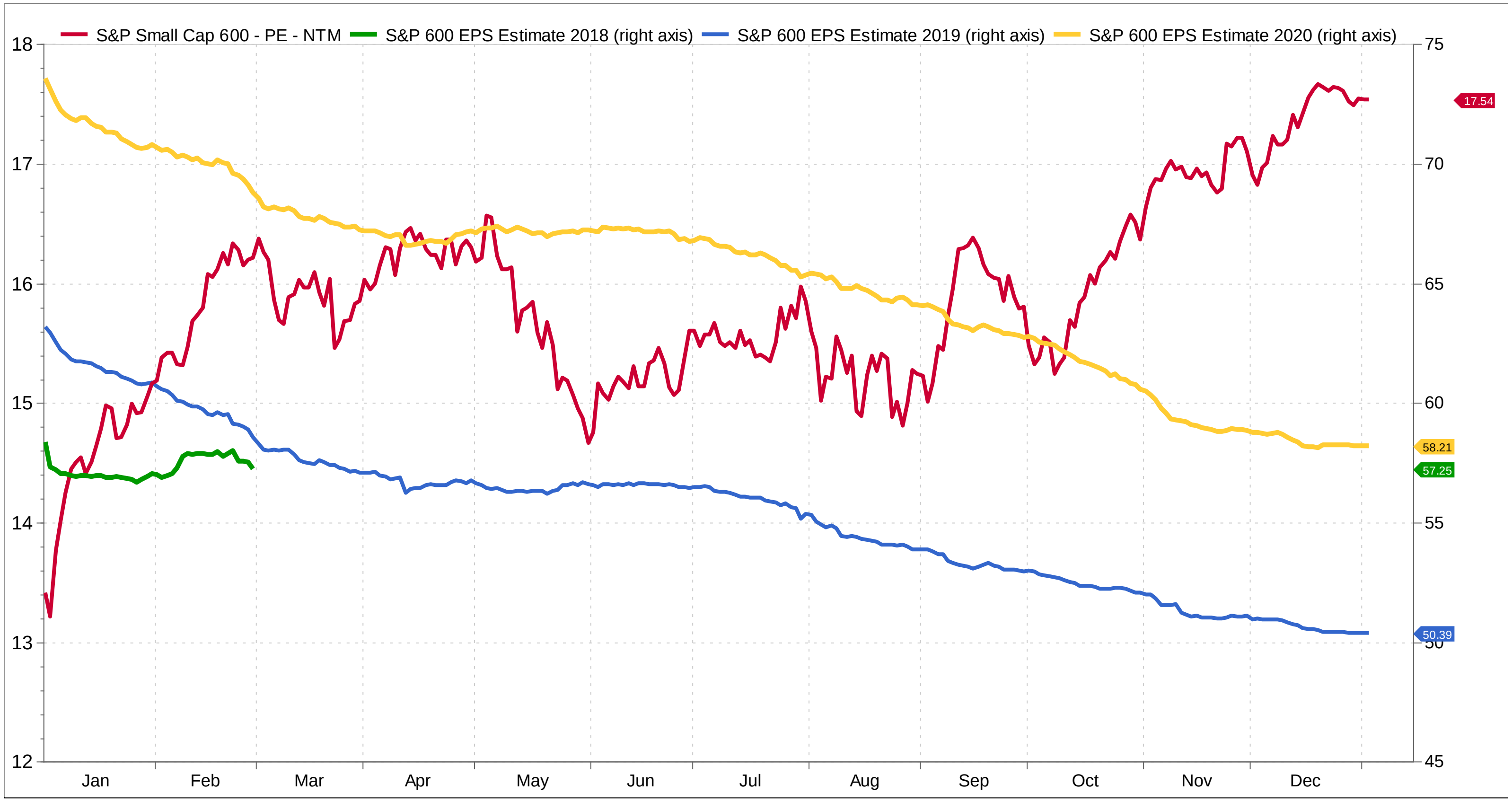
The 2019 market gains for small cap indices were driven completely by higher valuations or multiple expansion, while expected earnings declined 12%. The multiple expansion was largely the result of two policy shifts. The first from Fed Chairman Powell, the second from President Trump. One way of looking at the shift in monetary policy is to track the forward rate guidance provided by the FOMC. In December 2017, the median of the projections of FOMC participants pointed to three ¼ point interest rate increases in 2018. A year later, after four rate increases, the Fed Funds rate was 2.5% and projections indicated two more hikes would occur in 2019. That proved to be the high watermark for rates as they were lowered three times during 2019, as the "crosscurrents"[1] that Chairman Powell pointed to in his December 2018 press conference apparently became too strong for the Fed's liking. Today, the published projections from the December 2019 FOMC meeting call for what sounds like a hopeful ¼ point increase in 2020. Powell's tone has shifted as he said that he would like to see a significant and persistent move up in inflation before raising rates, and later adding that, "you've had quite a significant move in the direction of higher accommodation."[2]

While the current expansion is now the longest in history, it continues to be the slowest. While the duration of this expansion is noteworthy, growth did decelerate in 2019, specifically in the manufacturing or goods-producing side of our economy. In November, Industrial Production declined year-over-year for a third consecutive month. Similarly, non-defense capital goods orders rolled into negative territory in the second half of the year after growing roughly 10% in late 2017 and 5% in late 2018. Additionally, shipping activity in our West Coast ports fell in 2019 after several years of mid-single digit growth. It is easy to attribute most of this weakness to the worries caused by the trade negotiations with both Mexico and China. We have been of the view that there was no easy solution for the trade negotiations with China. In our opinion, this is Trump's highest conviction policy and the only initiative that had general support from both sides of the aisle. While China had nothing to gain from escalating the issue, substantive changes to their economic policy was unlikely. It appears that earlier this fall, both sides, but specifically the US, decided that reducing the collective pressure was in everyone's best interest, at least in the short term, hence a phase one trade deal or truce has been agreed to.

So, here we are at the beginning of a new calendar year and decade. Policy moves have alleviated a lot of the tensions that resulted in a down stock market in 2018 and triggered a substantial rally in 2019. Given the dramatic shifts in policy over the past year, an extra dose of humility for any market or economic forecaster looks appropriate. With that said, basic economic dynamics remain in place, so the lower inflationary and interest rate pressures have created a more conducive backdrop for rising confidence and activity in 2020, assuming future policy moves do not counteract these positives.

In terms of our strategic positioning, we had maintained a defensive posture for most of 2019, overweight sectors such as Utilities and REITs, and we also bought our first gold stock in years. This positioning has generally proved beneficial as interest rates fell and growth expectations were lowered over the course of the year. We did hold more cash than usual since we were uncomfortable owning the more cyclical stocks in the face of the slowing pace of growth. We have also shied away from the tech and healthcare sectors, which was a drag for most of the year and especially in the fourth quarter, as these were the two strongest performing sectors. During the fourth quarter, we exited several of our defensive positions in favor of stocks within the more cyclical sectors such as Financials, Energy, Industrials and Materials. These are areas of the market that we have either avoided or held low exposure to over the past year. We sold all three of our utilities and the REIT, Community Healthcare Trust (CHCT). Collectively, these positions were more than 10% of the portfolio at the time of their sales. The healthcare facility owner CHCT was a homerun for the portfolio, but its valuation had become very stretched with its cash flow multiple climbing from 16x to 23x in a little more than a year's time.

We will introduce two of the newest positions, Chart industries (GTLS) and Brightsphere Investment Group (BSIG), but we would be happy to share with you our thoughts on each and every holding in the portfolio. Chart Industries makes equipment for the gas storage and processing industry, with a large offering for LNG terminals and storage. After years of growth, LNG demand and exports from US ports have slowed, a victim of the US/China trade dispute. GTLS' multiple has fallen to 8x vs the 10 to 15x range it traded in since mid-2016. We like its breadth of product and end markets served, and believe that the stock could rebound if trade tensions ease or if energy infrastructure spending perks up. Brightsphere is the former asset management arm of Old Mutual. A number of developments have taken place at the company in the past few years. John Paulson has replaced a Chinese conglomerate as the company's largest shareholder, they have changed their name, they have a new leadership team, and they decided in July to re-domicile to the US. The asset management business has been challenging for several years, especially for the more value and equity-oriented managers, which best describes BSIG. We are of the view that 2020 could be a tactically better year for BSIG and its peers in general. While most traditional asset managers are trading at historically low valuations, BSIG has seen a large gap open up between its multiple and that of its peers.



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[1] Transcript of Chairman Powell's Press Conference December 19, 2018

[2] Transcript of Chair Powell's Press Conference December 11, 2019