PARITAS CAPITAL MANAGEMENT

SECOND QUARTER | 2019

INVESTMENT COMMENTARY

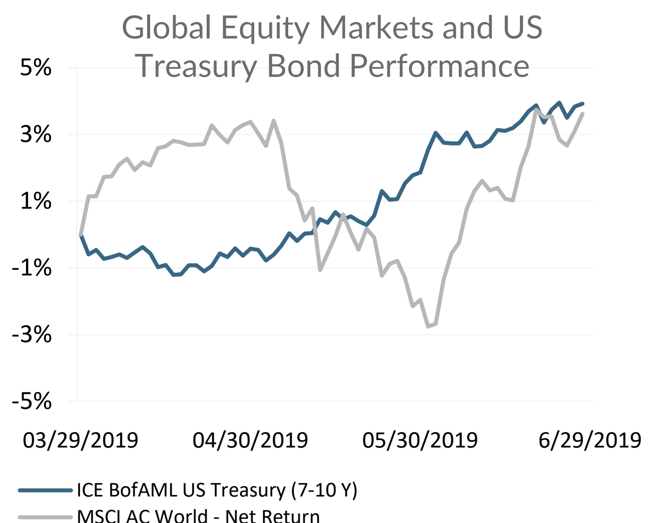
At a Glance

During the second quarter of 2019, the Global Wealth Strategy portfolio produced a net return of 3.02%. We believe the combination of first quarter earnings surprises and potential rate cuts by the US Federal Reserve and other Central Banks helped all asset segments in the portfolio to produce positive returns for the quarter.

Market Recap

It was a volatile quarter for global equity markets with gains in April, followed by large losses in May, finishing with a strong month in June.

Driving the increase in volatility was a changing storyline for each month. In April, the market reacted favorably to the positive surprises in earnings. The market then reversed course in May when it was announced the US was going forward with tariff increases with China. This triggered a sell-off in global equities as investors flocked to US Treasury Bonds, producing their third best monthly gain over the past seven years. In June, the expectation that the US Federal Reserve and other Central Banks would cut interest rates in response to low inflation and a slowing economy, benefited both global equities and US Treasury Bonds.



The chart to the right shows that despite the big moves in global markets in April and June, the steady growth and protection provided by US Treasury Bonds over the quarter was enough to achieve greater overall return than equity markets without the big bump in the road.

What Helped and What Hurt

All asset segments benefited from the broad-based equity and fixed income rally and made positive contributions to the portfolio's return for the second quarter.

Our Fixed Income allocation reacted favorably to the indication of a potential rate cut from the US Federal Reserve and other Central Banks. This helped the Fixed Income asset class be the largest contributor to performance for the quarter. Fixed Income was led by Investment Grade Corporate Bonds and US Treasuries with the iBoxx USD Liquid Investment Grade Index up 5.39% and the ICE BofAML US Treasury (7-10 Y) Index up 3.92%.

The move to more defensive, lower risk equities during the sell-off in May helped the Defensive Equities segment to minimize losses which was the key driver behind Inflation Hedges ending the quarter as the second largest asset class contributor.

Internationally, the Developed Equities segment was a solid contributor with the MSCI EAFE Index up 3.68% for the quarter. Emerging markets were weighed down by the uncertainty over trade tariffs with China, limiting the return for the MSCI Emerging Markets Index to just a modest 0.61% for the

quarter. The unwavering strength of the US Dollar and trade talks we believe will be in focus for emerging markets as the year progresses.

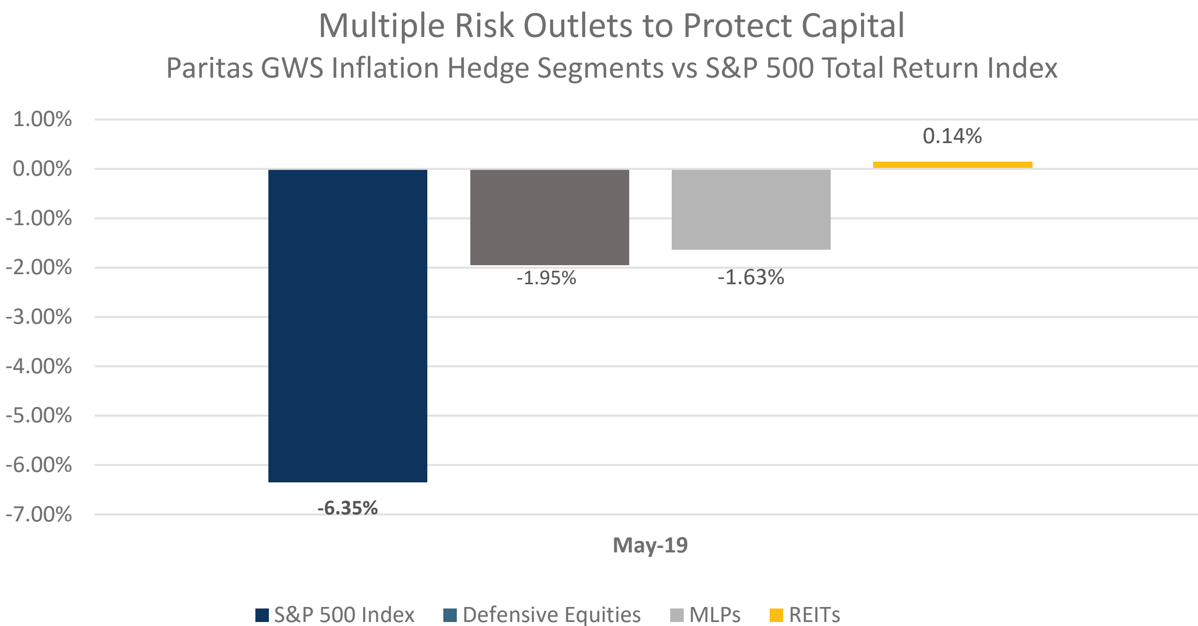
The US Large Cap segment was a bright spot in the US Equities class with a return of 4.80% while Small Cap lagged them by over 2% for the quarter.

Final Thoughts

The second quarter highlighted the importance of having an investment process that can adapt to changes in risk and minimize the impact of large losses.

Although the S&P 500 Total Return Index produced large gains in April (+4.05%) and June (+7.05%), the large loss in May (-6.35%) limited the return for the quarter to 4.30% while exposing investors to a heightened level of volatility.

The chart below shows the performance the segments that make up our Inflation Hedges asset class vs the S&P 500 Index.



In addition to Fixed Income, the Inflation Hedge segments were instrumental to the portfolio only capturing 44% of the negative return in May. By allocating capital based upon risk, the portfolio was able to identify effective risk outlets to protect capital.

The key takeaway from the second quarter is that the GWS portfolio met its objective of protecting capital in down periods while participating in up periods. This combination of protection and participation results in less volatility with an attractive long-term total return.

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