# A VIEW FROM THE SUMMIT

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## SGI Equity Strategies 4th Quarter & 2019 Summary

The fourth quarter of 2019 was a difficult period of performance for the firm that negatively affected full year performance. All three of the equity strategies posted strong positive returns, but underperformed their respective benchmarks. Here are some highlights:

- The U.S. Large Cap equity strategy returned 28.23% for the year and 3.57% for the quarter, underperforming the S&P 500 Index on a gross basis by 3.24% for the year and 5.28% for the quarter, while maintaining significantly lower overall portfolio risk.
- The U.S. Small Cap equity strategy returned 22.29% for the year and 4.59% for the quarter, while underperforming the Russell 2000 Index on a gross basis 3.20% for the year and 5.34% for the quarter, while maintaining lower overall portfolio risk.
- The Global equity strategy returned 25.21% for the year and 3.86% for the quarter, underperforming the MSCI ACWI Index on a gross basis by 2.08% for the year and 5.19% for the quarter, while maintaining lower overall portfolio risk.

| SGI Performance | 4Q19 | 1 Yr | 3 Yrs | 5 Yrs |
|---|---|---|---|---|
| US Large Cap Gross | 3.78% | 28.23% | 15.12% | 11.91% |
| US Large Cap Net | 3.57% | 27.20% | 14.28% | 11.06% |
| S&P 500 Total Return | 9.06% | 31.47% | 15.26% | 11.69% |
| US Small Cap Gross | 4.59% | 22.29% | 7.05% | 10.71% |
| US Small Cap Net | 4.38% | 21.37% | 6.32% | 10.19% |
| Russell 2000 Total Return | 9.93% | 25.49% | 8.57% | 8.21% |
| Global Large Cap Gross | 3.86% | 25.21% | 14.19% | 10.45% |
| Global Large Cap Net | 3.66% | 24.44% | 13.46% | 10.03% |
| MSCI ACWI Total Return | 9.05% | 27.29% | 13.06% | 9.02% |

Please review our separate one-page commentaries covering each strategy for additional details about portfolio positioning and attribution.

All SGI equity strategies implement a managed risk approach to equity investing. This managed risk focus has historically allowed investors to enjoy **competitive equity returns** while taking **meaningfully less overall portfolio risk**. For example, historically, our large cap strategy averaged 10-20% less return volatility than the S&P 500 Index (5 years monthly as of 12/31/2019).

## MARKET COMMENTARY

### Politics

During December the House of Representatives impeached President Trump with a vote divided along party lines. Then the Speaker of the House, using political maneuvering, decided to indefinitely delay sending the two articles to the Senate for a trail. Most pundits estimate the likelihood of the President being removed from office in a Senate trial is very remote. However, a contentious election season is expected during the next ten months with policy rhetoric creating additional volatility for the financial markets.

### Trade

The U.S. and China agreed to a “phase one” trade deal. Few details have emerged however both countries agreed to halt additional tariffs. The deal is expected to be signed by both countries during January. A China visit during 2020 by President Trump is expected to commence the second phase of a more comprehensive trade agreement. Uncertainty regarding this next phase will likely create additional volatility for the global financial markets.

### Economy

The most recent quarterly growth rate of U.S. GDP was 2.1%. Construction spending in the U.S. has been recovering during the past six months but remains below its February 2018 peak. Year-over-year industrial production diminished to below zero for past three months. In fact, the December 2019 Manufacturing PMI is 47.2%, whereas a reading below 50 means contraction. The non-manufacturing NMI for December accelerated to 55.0 from 52.6 in September. While auto sales have been slowing worldwide, heavy truck sales are also down for the past three months. Unprofitable companies such as Uber and Lyft had initial public offerings this year that are down significantly since then. In fact, 2019 has had the highest percentage of unprofitable IPO companies since the 2000 dotcom bubble.

# A VIEW FROM THE SUMMIT

Initial jobless claims and unemployment remain very low. The housing market remains robust in many parts of the country. While the economy exhibits signs of slow to modest growth, the S&P 500 Index hit new all-time highs during the quarter. Interestingly, although small cap stocks performed well, they did not reach new heights and have failed to surpass their 2018 peak.

| Levels | 3Q19 | 4Q19 | Change |
|---|---|---|---|
| Russell 1000 Index | 9500.64 | 10359.42 | 9.04% |
| Russell 2000 Index | 7675.09 | 8437.98 | 9.94% |
| MSCI EAFE | 7988.98 | 8644.84 | 8.21% |
| MSCI Emerging Markets | 2297.20 | 2571.14 | 11.92% |
| U.S. Aggregate* | 2.26% | 2.31% | 2.02% |
| US High Yield 2% Cap* | 5.65% | 5.19% | -8.06% |
| U.S. Federal Funds Rate** | 1.90% | 1.55% | -18.42% |
| U.S. 10 Year Treasury** | 1.67% | 1.92% | 15.19% |
| U.S. Dollar Index | 99.38 | 96.39 | -3.01% |
| WTI Crude Oil Spot | 54.07 | 61.06 | 12.93% |

* Yield to Worst    **Interest Rate

## The Federal Reserve

Investors watching the financial news may know that the overnight bank lending system in the U.S. suddenly broke down in mid-September. Cash was in short supply between banks, and the overnight lending rate spiked to levels not seen since 2008. The Federal Reserve (the "Fed") responded by injecting cash into the banking system in exchange for collateral. Initially the overnight bank funding rate operations were thought to be short term however the Fed continues to support the repo market by injecting liquidity and expanding its balance sheet.

2019 opened with the effective Fed Funds rate at 2.40%, after multiple rate cuts during the year the effective Fed Funds rate has dropped to 1.55%. In fact, the futures market currently prices in a 96.3% probability of at least another 25 basis points interest rate cut during 2020. The yield curve, measured by the 10-year treasury yield minus the 3-month yield, is low but no longer remains inverted.

Many of the highlighted factors are causes for concern, however, our outlook remains cautiously optimistic because major portions of the economy, labor markets, and stock markets remain strong.

## SGI Outlook

- The U.S. economy will continue its longest economic expansion in history through the first half of 2020.
- Globally, highly indebted major economies will force governments to attempt to keep interest rates lower for a longer time period. Globally, negative yielding debt is here for the foreseeable future, especially in Europe and Japan.
- The Federal Reserve will likely respond aggressively to weakening economic conditions in the U.S. by lowering short term rates and resuming some form of quantitative easing (monetizing debt).
- A limited "phase one" trade deal will get signed but financial markets will focus on impacts of protracted "second phase" negotiations during 2020.
- Election based rhetoric from President Trump and Democratic candidates will become increasingly sensational and vitriolic, potentially affecting specific sectors such as Technology and Healthcare.
- Impeachment trial by the Senate will make headlines but unlikely impact the term of the President.

We continue to adhere to our disciplined, managed-risk, multi-factor investment process. Over a full market cycle, this approach has historically limited downside risks and allowed for participation in market rallies. We are grateful for the opportunity to help steward your investments.



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