



BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, July 2018

The equity markets in June had mixed results with the Dow Jones Industrial Average finishing down 0.49%, the S&P 500 Index up 0.62% and the technology-heavy NASDAQ leading the way up 0.92%. Year-to-date, the returns are -0.73%, 2.65% and 8.79% respectively. Again, the outsized returns for top technology companies—Amazon, Google, Facebook, Microsoft and Netflix—comprise the lion's share of the year's return for both the S&P and the NASDAQ. The market leadership for growth stocks, including the aforementioned has been spectacular over the past several years. Growth has outperformed value by more than 50% during this period, in addition to growth outperforming value this year 7.28% versus a loss of 2.22% for value stocks.

The impetus for this detail is to point out that nothing goes up forever and market leadership changes and other industry sectors do rotate back into favor. Despite the big disparity in returns, Blue Granite's particular value strategy has kept pace with our respective benchmark returns. Market history proves that a wide disparity in performance as we are witnessing now with growth and value stocks will consistently reverse course over time. As a contrarian investor, the more we hear about how great Amazon and Netflix have performed, the more positive we are that a significant change in the leading stocks and the dominance of technology is taking place in favor of value.

Our client's own several of the above stocks but our portfolios are filled with great companies with very compelling stories and strong fundamentals in a variety of other industries. The analysis that we do, to identify companies with competitive advantages, compelling valuations, catalysts for growth and free cash flow generation will ultimately lead to very appealing stock performance. Technology and growth comprise only a portion of the leading companies and industries worldwide. That's why we adhere to an asset allocation strategy that blends stocks and bonds and broadly diversifies the assets in the portfolios. This portfolio diversification also provides another measure of safety, but the true benefit is exposure to a group of stocks from assorted industry groups with very compelling valuations that possess the sound fundamentals to generate a long-term stream of profits.

Our views for the remainder of the year force us to look at a number of potential issues and market scenarios. Economic growth continues at a moderate pace in the 2-2.5% range. This growth rate is still well below normal post-recession levels. With more than a 300% gain in the stock market since 2009 and the correlated consumer wealth that has been created, it's still confusing to see such low-level growth. Corporate earnings growth rates are also at multi-year highs, yet combined with consumer wealth, the economy just chugs along at a modest pace. The cautionary note here is that with a 9 year bull market combined with moderate economic growth does guarantee stock market gains even with the catalyst of strong corporate earnings.

Despite inflation running just over 2% (not an alarming level), the Fed is stoking fears with the prospect of higher interest rates. The negative impact of higher rates is real and will ultimately impact stock markets, hurt spending for housing and related home related goods and services, and reduce consumer buying power as well.

At the top of our list for second half concerns has to be the trade and tariff issues that have turned into an ugly global war of sorts. World leaders are digging their heels in and currently showing very little flexibility in their negotiations. The outcome of these disputes is very unclear and the ultimate impact to specific countries, companies and stock markets is still very uncertain. Tariff wars are a very serious matter and have already left their imprint on global stocks markets as investors attempt to handicap the potential outcomes. In light of these issues, we feel comfortable with our conservative asset allocation - being positioned to weather any significant trade issues with the broad diversification we have built into our clients' portfolios.

I hope you had a peaceful Independence Day and wish you a very enjoyable summer. Thank you for your trust and support and please call me if there is anything you wish to discuss.

Best regards,

Scott