q2 report

July 2018

Despite all of the market noise, the quarter did see global growth, good corporate earnings reports, strong consumer confidence and positive Purchasing Managers' Index (PMI) data.

The trade war noise became louder and louder as the second quarter progressed. While the equity markets have been resilient for the most part, they have not been able to completely avoid some drawdowns – only to be followed by recoveries.

During the Trump presidency, you tend to take the good with the bad. The good is a strong economy and lengthening of the expansionary phase of the current business cycle, aided by tax reform and fiscal stimulus. The bad is the threat of the unknown weighing on asset values, along with spates of volatility. Given that trade was a prominent campaign issue, it should not be surprising if the war of words persists for more than just a few months.

For Barometer clients, we remain invested in the strongest themes supported by a backdrop of positive macro fundamentals. But even these themes have felt the market pullbacks as the news flow can (for short periods) override the real data. Our investment process will continue to provide guidance as the market adjusts to a changing environment.

As through previous quarters, investment themes remained concentrated in U.S. companies that exhibited one or more of the following qualities:

- are in the technology sector,
- are driven by innovation,
- are within the healthcare sector,
- are driven by secular demand, or
- are within the energy sector, which has become an emerging theme as the price of oil is finally appreciating after years of oversupply.

Financials have been trimmed as the rise in rates and steepness of the yield curve have not yet met optimistic estimations.

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Despite all of the market noise, the quarter did see global growth, good corporate earnings reports, strong consumer confidence and positive Purchasing Managers' Index (PMI) data. At the same time, however, markets continued to test key technical levels. Although this may have caused investor discomfort, the market continued to hold at key technical support levels, illustrating that underlying confidence in the markets remains positive.

Market Highlights

The base case for Barometer is that despite the sensationalized threats, the Trump administration tends to settle for small, non-paradigm-shifting concessions.

Portfolio Updates

The **Barometer Tactical Income Strategy** added to its energy positions, making it the largest weight along with financials and technology.

In financials, we sold down some bank weightings (which were laggards) and instead added positions in MSCI Inc., Standard & Poor's Financial Services LLC, Visa Inc. and Mastercard Inc. All of these companies proved themselves to be strong businesses with defendable competitive positions and secular growth. In addition to buying back shares, these companies also have growing dividends.

Over the course of the quarter, energy companies like Hess Corp. and Suncor Energy also contributed to performance.

The Tactical Income Strategy has remained concentrated in U.S. companies that remain well positioned to benefit from the strong U.S. economy.

Within the **Barometer Tactical Balanced Strategy**, the bond portfolio was a positive contributor to returns in the second quarter, benefiting from the higher yields of preferred shares. Strong performance from technology, consumer discretionary and medical devices stocks were positive contributors. Sample companies in this space include Edward Lifesciences Inc. and Amazon.com Inc.

United HealthGroup Inc. and Microsoft Corp. are examples of dividend-paying stocks in the strategy that are leaders participating in secular growth themes. The Tactical Balanced Strategy remains diversified, with sector concentrations in technology and industrials. Financials were decreased in Q2 to allow for an increasing allocation to energy.

The **Barometer Equity Strategy** remained invested primarily in the U.S. markets. Technology has been the largest theme. Although technology did drive earlier performance in the quarter, it too has also been affected by the recent market volatility. Silicon Valley Bank is an example of a company in this sector that is both driven by technology, and benefits from the strong California economy.

Amazon.com Inc. and Centene Corp. contributed positively to returns in Q2. Centene Corp. is showing consistently high growth as demographics drive increased Medicare enrollment in the U.S.

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We reduced weight in financials and significantly increased the position in healthcare, where we identified a number of innovative medical technology leaders with large growth potential.

Within the **Barometer Long Short Strategy**, energy and small capitalization technology stocks (primarily software) have been strong contributors to performance. Software companies, such as Okta and New Relic, continue to see widespread adoption across their customer base and increased revenue growth. The energy companies, such as Hess Corp., Whiting Petroleum Corp. and Parex Resources Inc., are benefiting from a rise in oil prices. As in our other strategies, financials were sold down.

Throughout the quarter, the **Barometer Global Macro Strategy** remained heavily exposed to the U.S., and benefitted accordingly from U.S. market outperformance relative to many other markets globally. The strategy saw positive contributions-to-return over the quarter by holding a net short position in the volatility index. Over the course of the quarter, the strategy increased its short positions in U.S. government fixed-income securities and in emerging market fixed-income products. These fixed-income short positions contributed positively to performance as this asset class has proven to be a reliable underperformer.

Some notable increases in exposure included the Global Macro Strategy taking a larger position in U.S. small caps, and consumer discretionary, information technology and health care; along with building a position in oil. Some notable decreases in exposure included a reduction in exposure to the industrials sector, and to various Asian emerging markets – once the positions began to underperform.

Looking Forward

As July begins, all eyes continue to be on whether the U.S. can bring China to the negotiating table. The base case for Barometer is that despite the sensationalized threats, the Trump administration tends to settle for small, non-paradigm-shifting concessions.

We have a similar view on NAFTA.

We continue to prudently manage risk utilizing our unique disciplined process within this context. The tailwinds of tax reform, fiscal stimulus and robust economic data continue to reinforce our view that the U.S. is the best place to find market leading stocks. When earnings begin to come out in mid-July, these positives will likely become tangible again. We expect the market rally to resume given the magnitude and persistence of these tailwinds.

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