

# 2Q19 SIERRA NEWSLETTER



## MARKET REVIEW

IN THE FIRST QUARTER OF 2019, THE U.S. ECONOMY GREW AT A ROBUST PACE OF 3.1%, AIDED BY A BOOST FROM NET EXPORTS AND INVENTORY BUILDING. THE INCREASE IN NET EXPORTS AND INVENTORIES WAS DUE TO TRADE-WAR RELATED DISTORTIONS AS MERCHANTS STOCKED UP ON INVENTORIES AHEAD OF TARIFFS. IF WE LOOK THROUGH THE NOISE FROM TEMPORARY DISRUPTIONS, THE UNDERLYING TREND IN ECONOMIC ACTIVITY, INCLUDING PERSONAL CONSUMPTION, WAS WEAKENING. IN THE SECOND QUARTER, THERE WERE SOME SIGNS OF STABILIZATION. CONSUMER SPENDING REBOUNDED AND NEW HOME CONSTRUCTION ACTIVITY PICKED UP. ON THE FLIPSIDE, THERE WERE PLENTY OF CAUSES FOR CONCERN. DESPITE THE IMPROVEMENT IN NEW HOME BUILDING, CONSTRUCTION SPENDING STILL DECLINED ON A YEAR-OVER-YEAR BASIS FOR FOUR MONTHS IN A ROW. IN ADDITION, MANUFACTURING AND PRIVATE INVESTMENT CONTINUED TO REMAIN TEPID AS THE IMPACT OF THE PROTRACTED TRADE WAR RIPPLED ACROSS THE GLOBE. THE OVERALL PACE OF GROWTH DURING THE SECOND QUARTER IS EXPECTED TO HAVE SLOWED TO AN ANNUALIZED RATE OF 1.5 – 2.0%.

## DOMESTIC EQUITY

OUR **LARGE CAP INTRINSIC VALUE EQUITY** STRATEGY RETURNED 2.91% (GROSS) COMPARED TO THE 3.84% RETURN OF THE BENCHMARK RUSSELL 1000 VALUE. STOCK SELECTION DROVE MUCH OF OUR UNDERPERFORMANCE FOR THE QUARTER. FOR THE THREE-YEARS TRAILING, OUR LARGE CAP INTRINSIC VALUE EQUITY STRATEGY HAS OUTPERFORMED, RETURNING 13.75% (GROSS) COMPARED TO THE 10.19% RETURN OF THE BENCHMARK RUSSELL 1000 VALUE.

OUR **U.S. CONCENTRATED GROWTH** STRATEGY PERFORMED AS WE EXPECTED IN THE SECOND QUARTER OF 2019, GIVEN ITS DEFENSIVE POSITIONING IN A VOLATILE MARKET. FOR THE SECOND QUARTER OF 2019, OUR U.S. CONCENTRATED GROWTH STRATEGY (COMPOSITE) RETURNED 4.88% (GROSS) VERSUS THE 4.64% RETURN FOR THE RUSSELL 1000 GROWTH INDEX. YEAR-TO-DATE, OUR PORTFOLIO HAS RETURNED 20.25% (GROSS), SLIGHTLY UNDERPERFORMING THE 21.49% RETURN FOR THE RUSSELL 1000 GROWTH INDEX. SINCE INCEPTION (JANUARY 1, 1994), OUR U.S. CONCENTRATED GROWTH STRATEGY (COMPOSITE) HAS COMPOUNDED AT 11.74% (GROSS) COMPARED TO

THE 9.54% COMPOUNDED RETURN OF THE BENCHMARK RUSSELL 1000 GROWTH INDEX.

OUR **SMALL VALUE EQUITY** PORTFOLIO RETURNED 1.33% (GROSS) FOR THE QUARTER, PERFORMING IN LINE WITH THE BENCHMARK RUSSELL 2000 VALUE RETURN OF 1.38%. DESPITE A CHALLENGING PERIOD FOR VALUE INVESTORS, THE PORTFOLIO RETURNED -5.93% (GROSS) VERSUS -6.24% FOR THE BENCHMARK OVER THE TRAILING 12 MONTHS, AND 5.02% (GROSS) ANNUALIZED VERSUS 2.98% OVER THE TRAILING 2 YEARS. FURTHER, SINCE INCEPTION (MARCH 2005), THE PORTFOLIO HAS RETURNED 8.64% (GROSS) VERSUS 6.84% FOR THE BENCHMARK RUSSELL 2000 VALUE.

## INTERNATIONAL EQUITY

IN **GLOBAL AND NON-U.S. VALUE EQUITY**, INTERNATIONAL EQUITIES ADVANCED MODESTLY DURING THE SECOND QUARTER OF 2019, AS OPTIMISM OVER RENEWED CENTRAL BANK EASING ULTIMATELY OVERCAME CONCERNS ABOUT SOFTENING ECONOMIC GROWTH AND ONGOING INTERNATIONAL TRADE DISPUTES. WE CAN THINK OF THE PORTFOLIOS IN TERMS OF A BARBELL, WITH ONE GROUP OF SECURITIES CHARACTERIZED BY RESILIENT BUSINESSES AND THE OTHER BY HIGH-CONVICTION BARGAINS. THE FORMER IS COMPRISED OF CHEAP COMPANIES WITH SOUND BALANCE SHEETS, GOOD COMPETITIVE POSITIONS, HIGH DIVIDEND YIELDS, HEALTHY PROFIT MARGINS AND COUNTER-CYCLICAL DEMAND PROFILES. THE LATTER GROUP IS CHARACTERIZED BY LOW VALUATIONS, NEGATIVE SENTIMENT AND CYCLICALLY DEPRESSED ECONOMIC FUNDAMENTALS. WE BELIEVE WE ARE TAKING THE NECESSARY STEPS TO IMPROVE INVESTMENT OUTCOMES IN A DIFFICULT ENVIRONMENT.

IN **INTERNATIONAL AND GLOBAL PLUS EQUITY**, GLOBAL EQUITY MARKETS MANAGED TO DRIFT HIGHER IN SOMEWHAT DIRECTIONLESS TRADE DURING THE SECOND QUARTER. WE VIEW THE RISE AS PRIMARILY A CONSOLIDATION MOVE AFTER THE MORE DRAMATIC SWINGS IN THE PRIOR TWO QUARTERS, WITH MARKETS TUMBLING IN THE FOURTH QUARTER ONLY TO RALLY DURING THE FIRST THREE MONTHS OF 2019. FOR THE SECOND QUARTER OF 2019, OUR EAFE PLUS EQUITY COMPOSITE RETURNED 4.23% (GROSS), VERSUS THE 3.97% RETURN OF THE MSCI EAFE INDEX, AND THE 5.73% FOR THE MSCI EAFE GROWTH (NET

DIVIDENDS) INDEX. FOR THE TRAILING TEN YEARS, OUR EAFE PLUS EQUITY COMPOSITE HAS OUTPERFORMED, RETURNING 10.46% (GROSS) VERSUS THE 7.40% RETURN OF THE MSCI EAFE INDEX, AND THE 8.23% RETURN OF THE MSCI EAFE GROWTH (NET DIVIDENDS) INDEX.

### FIXED INCOME

IN THE **FIXED INCOME** MARKET ARENA, INVESTMENT GRADE CREDIT SPREADS WERE RELATIVELY FLAT FOR THE SECOND QUARTER, TIGHTENING JUST TWO BPS; HOWEVER, DEMAND FOR CORPORATE BONDS REMAINED STRONG. EXPECTATIONS FOR LOWER RATES SUPPORTED A CONTINUED HUNT FOR YIELD AND TRUMPED CONCERNS OF RECESSION AND TRADE TENSIONS. INVESTMENT GRADE CREDIT DEFAULT SWAPS WERE TIGHTER THAN THEY HAD BEEN IN MORE THAN A YEAR AS THE QUARTER ENDED. INVESTMENT GRADE OUTPERFORMED HIGH YIELD CORPORATE BONDS, UNDERSCORING THE CONTINUED PREFERENCE FOR HIGHER QUALITY. ALTHOUGH ISSUANCE THIS YEAR HAS BEEN PLENTIFUL, IT REMAINS 12% BELOW LAST YEAR'S PACE YEAR-TO-DATE, FURTHER SUPPORTING NARROWER YIELD SPREADS.

OUR **HIGH YIELD** STRATEGY EXCEEDED THE BENCHMARK, WITH SECTOR ALLOCATION BEING NEUTRAL AND SECURITY SELECTION BEING SIGNIFICANTLY POSITIVE. OUR PORTFOLIO RETURNED 3.01% (GROSS), OUTPERFORMING THE BLOOMBERG BARCLAYS U.S. CORPORATE HIGH YIELD INDEX BENCHMARK RETURN OF 2.50%. A MULTITUDE OF FACTORS LED SECURITY SELECTION TO BE THE PRIMARY DRIVER OF THIS OUTPERFORMANCE. THESE INCLUDED DISTINCTIVE NEWS UPDATES WHICH POSITIVELY AFFECTED MULTIPLE HOLDINGS, LONG DURATION EXPOSURES, AND THE AVOIDANCE OF DISTRESSED COMMODITY-FOCUSED ISSUERS

(PARTICULARLY ENERGY). OVERWEIGHT ALLOCATIONS TO BB/B-RATED SECURITIES ALSO SIGNIFICANTLY BENEFITTED PERFORMANCE IN THE QUARTER AS CCC-RATED SECURITIES MATERIALLY LAGGED.

### EMERGING MARKETS

EMERGING MARKET EQUITIES CONTINUED TO MAKE PROGRESS IN ANTICIPATION OF LOWER INTEREST RATES IN THE USA IN THE SECOND QUARTER OF 2019. INVESTORS ASSUMED THAT THE POSITIVE REAL INTEREST RATES PREVAILING IN MOST EMERGING MARKETS GIVE GREATER POLICY FLEXIBILITY IN THE EVENT OF AN ECONOMIC SLOWDOWN THAN IS AVAILABLE IN THE NEGATIVE YIELD ENVIRONMENT DOMINATING MANY DEVELOPED MARKETS. AT THE SAME TIME HOWEVER, CONCERNS ABOUT A POTENTIAL SLOWDOWN INCREASED AS A RESULT OF WEAKER ECONOMIC DATA IN ASIA AND INCREASING TENSION OVER TRADE BETWEEN THE USA AND CHINA. FOR THE SECOND QUARTER OF 2019, OUR **EMERGING MARKETS EQUITY** PORTFOLIO UNDERPERFORMED COMPARED TO ITS BENCHMARK, THE MSCI EMERGING MARKETS EQUITY INDEX, RETURNING -0.18% (GROSS), VERSUS 0.74%. FOR ONE YEAR TRAILING, OUR EMERGING MARKETS EQUITY PORTFOLIO HAS RETURNED 1.90% COMPARED TO ITS BENCHMARK RETURN OF 1.61%. SINCE INCEPTION (JULY 1, 2012), OUR EMERGING MARKETS EQUITY PORTFOLIO HAS RETURNED 5.28% (GROSS) COMPARED TO THE 4.53% RETURN OF THE MSCI EMERGING MARKETS EQUITY INDEX.

### THANK YOU

WE WOULD LIKE TO THANK THE **SAN DIEGO ELECTRICAL PENSION TRUST** FOR ADDITIONAL CONTRIBUTIONS TO SIERRA'S FIXED INCOME PRODUCT. WE AT SIERRA INVESTMENT PARTNERS, INC., VALUE EACH OF OUR CLIENTS AND ARE GRATEFUL FOR THE OPPORTUNITY TO MANAGE A PORTION OF YOUR ASSETS.

## DISCLOSURE

SIERRA INVESTMENT PARTNERS, INC. (SIERRA) IS A MANAGER OF MANAGERS AND USES EXCLUSIVE SUB-ADVISORY AND MARKETING RELATIONSHIPS TO MANAGE PLAN ASSETS. SIERRA'S SUB-ADVISORS ARE: AMUNDI PIONEER INSTITUTIONAL ASSET MANAGEMENT, INC. FOR CONCENTRATED GROWTH EQUITY; TODD ASSET MANAGEMENT LLC FOR LARGE CAP INTRINSIC VALUE EQUITY & INTRINSIC VALUE OPPORTUNITY; FRANKLIN TEMPLETON INSTITUTIONAL, LLC FOR FRANKLIN EAFE PLUS EQUITY & GLOBAL PLUS EQUITY; TEMPLETON INSTITUTIONAL ASSET MANAGEMENT, LLC FOR NON-U.S. EQUITY & GLOBAL EQUITY; STONERIDGE PMG ADVISORS, LLC FOR FIXED INCOME; ROBERT W. BAIRD & CO. INCORPORATED FOR SMALL VALUE EQUITY; FORT WASHINGTON INVESTMENT ADVISORS, INC. FOR HIGH YIELD FIXED INCOME; AND EDINBURGH PARTNERS LIMITED FOR EMERGING MARKETS EQUITY. PERFORMANCE REFLECTS THAT OF OUR SUB-ADVISOR FOR EACH RESPECTIVE PRODUCT. RETURNS ARE CALCULATED AND PRESENTED GROSS OF FEES. GROSS OF FEES PERFORMANCE IS CALCULATED AFTER THE DEDUCTION OF TRADING COSTS, BUT BEFORE THE DEDUCTION OF MANAGEMENT FEES, CUSTODIAL FEES OR OTHER FEES. FEE SCHEDULES ARE DESCRIBED IN PART II OF SIERRA'S FORM ADV. SIERRA CLIENT RETURNS WOULD BE REDUCED BY INVESTMENT MANAGEMENT FEES. FOR EXAMPLE, A FIVE-YEAR GROSS ANNUALIZED RETURN OF 20.10% WOULD BE REDUCED TO 18.96% AFTER THE DEDUCTION OF ANNUALIZED FEES OF 1%. THE INFORMATION PROVIDED IS HISTORIC IN NATURE AND SHOULD NOT BE TAKEN AS ANY INDICATION OF FUTURE PERFORMANCE AS FUTURE INVESTMENTS WILL BE MADE UNDER DIFFERENT ECONOMIC CONDITIONS AND MAY UTILIZE DIFFERENT SECURITIES. THE RUSSELL 1000 VALUE INDEX IS A WIDELY RECOGNIZED INDEX OF MARKET ACTIVITY BASED ON THE AGGREGATE PERFORMANCE OF COMMON STOCKS FROM THE RUSSELL 1000 INDEX, WITH LOWER PRICE-TO-BOOK RATIOS AND LOWER FORECASTED GROWTH VALUES. THE PERFORMANCE DATA WAS SUPPLIED BY FRANK RUSSELL TRUST COMPANY. THE RUSSELL 1000 GROWTH INDEX MEASURES THE PERFORMANCE OF THE RUSSELL 1000'S GROWTH SEGMENT, WHICH IS DEFINED TO INCLUDE THE FIRMS WHOSE SHARE PRICES HAVE HIGHER PRICE-TO-BOOK RATIOS AND HIGHER EXPECTED EARNINGS GROWTH RATES. THE RUSSELL 2000 VALUE INDEX MEASURES THE PERFORMANCE OF THE SMALL-CAP VALUE SEGMENT OF THE U.S. EQUITY UNIVERSE. IT INCLUDES THOSE RUSSELL 2000 INDEX COMPANIES WITH LOWER PRICE-TO-BOOK RATIOS AND LOWER FORECASTED GROWTH VALUES. THE RUSSELL INDICES ARE A TRADEMARK OF THE FRANK RUSSELL COMPANY. INDICES ARE UNMANAGED AND ARE NOT AVAILABLE FOR DIRECT INVESTMENT. THE MSCI EAFE INDEX IS AN EQUITY INDEX CALCULATED BY MSCI. THE INDEX MEASURES THE TOTAL RETURNS (GROSS DIVIDENDS ARE REINVESTED) OF EQUITY SECURITIES IN THE DEVELOPED MARKETS IN EUROPE, AUSTRALASIA AND THE FAR EAST. SECURITIES INCLUDED IN THE INDEX ARE WEIGHTED ACCORDING TO THEIR FREE FLOAT ADJUSTED MARKET CAPITALIZATION (PRICE X SHARES OUTSTANDING X FOREIGN INCLUSION FACTOR). THE MSCI EAFE GROWTH (NET DIVIDENDS) INDEX IS A FREE FLOAT-ADJUSTED MARKET CAPITALIZATION WEIGHTED EQUITY INDEX COMPRISED OF SECURITIES IN MSCI'S DEVELOPED MARKET COUNTRY SPECIFIC-INDEXES, EXCLUDING THE U.S. AND CANADA, THAT HAVE MORE GROWTH-ORIENTED INVESTMENT STYLE CHARACTERISTICS. THE INDEXES ARE NET OF FOREIGN WITHHOLDING TAXES ON DIVIDENDS. THE BLOOMBERG BARCLAYS U.S. CORPORATE HIGH YIELD BOND INDEX MEASURES THE USD-DENOMINATED, HIGH YIELD, FIXED-RATE CORPORATE BOND MARKET. SECURITIES ARE CLASSIFIED AS HIGH YIELD IF THE MIDDLE RATING OF MOODY'S, FITCH AND S&P IS BA1/BB+/BB+ OR BELOW. THE MSCI EMERGING MARKETS INDEX CAPTURES LARGE AND MID-CAP REPRESENTATION ACROSS 24 EMERGING MARKETS (EM) COUNTRIES, INCLUDING BRAZIL, CHILE, CHINA, COLOMBIA, CZECH REPUBLIC, EGYPT, GREECE, HUNGARY, INDIA, INDONESIA, KOREA, MALAYSIA, MEXICO, PAKISTAN, PERU, PHILIPPINES, POLAND, RUSSIA, QATAR, SOUTH AFRICA, TAIWAN, THAILAND, TURKEY AND UNITED ARAB EMIRATES. WITH 846 CONSTITUENTS, THE INDEX COVERS APPROXIMATELY 85% OF THE FREE FLOAT-ADJUSTED MARKET CAPITALIZATION IN EACH COUNTRY. THE INDEXES CHOSEN TO COMPARE PERFORMANCE ARE NOT IDENTICAL IN STRUCTURE TO THE COMPOSITES AND ARE PROVIDED TO REPRESENT THE INVESTMENT ENVIRONMENT EXISTING DURING THE TIME PERIODS SHOWN. INDEXES ARE UNMANAGED, FULLY INVESTED AND DO NOT INCLUDE DEDUCTION OF FEES OR EXPENSES. THIS INFORMATION IS ONLY AN EXPLANATION OF INVESTMENT PHILOSOPHY AND HISTORIC PERFORMANCE AND IS NOT MEANT TO BE AN INVESTMENT RECOMMENDATION. FOR A DISCLOSURE PREPARED IN COMPLIANCE WITH THE GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) AND A LIST OF COMPOSITES AND PERFORMANCE RESULTS, PLEASE CALL OUR CORPORATE HEADQUARTERS AT (925) 941-6300. GIPS HAS NOT BEEN INVOLVED WITH THE PREPARATION OR REVIEW OF THIS REPORT. PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.