

3Q19 SIERRA NEWSLETTER



MARKET REVIEW

RECESSION WORRIES HAVE DOMINATED CONVERSATION FOR THE PAST FEW MONTHS. CONCERNS AROUND TRADE AND GEOPOLITICAL EVENTS CONTINUED TO MOUNT AND WERE FURTHER VALIDATED DURING THE QUARTER BY WEAKENING LEADING INDICATORS AND MANUFACTURING INDICES. U.S. GDP GROWTH IS SLOWING, PARTIALLY DUE TO TRADE WAR IMPACTS, LEADING TO AN EXPECTATION FOR WEAK 3Q19 FUNDAMENTALS AND TEPID GUIDANCE. HOWEVER, FINANCIAL CONDITIONS REMAIN ACCOMMODATIVE, NUMEROUS CENTRAL BANKS INCLUDING THE FEDERAL RESERVE HAVE CUT RATES AND CHINA IS UTILIZING FISCAL STIMULUS; THEREFORE, WE HAVE PLUSES AND MINUSES THAT NEED TO PLAY OUT.

DOMESTIC EQUITY

OUR **LARGE CAP INTRINSIC VALUE EQUITY** STRATEGY UNDERPERFORMED ITS BENCHMARK, THE RUSSELL 1000 VALUE, FOR THE QUARTER, RETURNING 0.63% COMPARED TO THE BENCHMARK RETURN OF 1.36%. HOWEVER, FOR THE THREE YEARS TRAILING, OUR LARGE CAP INTRINSIC VALUE STRATEGY HAS OUTPERFORMED, RETURNING 11.74% COMPARED TO THE RUSSELL 1000 VALUE RETURN OF 9.43%.

OUR **U.S. CONCENTRATED GROWTH** STRATEGY (COMPOSITE) RETURNED 1.13% VERSUS THE 0.01% RETURN OF THE RUSSELL 1000 GROWTH INDEX FOR THE MONTH OF SEPTEMBER, 2019. FOR THE THIRD QUARTER OF 2019, THE PORTFOLIO RETURNED 3.22% VERSUS 1.49% FOR THE RUSSELL 1000 GROWTH INDEX. YEAR-TO-DATE, THE PORTFOLIO RETURNED 24.14% VERSUS 23.30% FOR THE INDEX. IN THE RUSSELL 1000 GROWTH INDEX, WITH ECONOMIC GROWTH SLOWING AND INTEREST RATES DECLINING, CONSUMER STAPLES AND REAL ESTATE WERE AMONG THE BEST PERFORMING SECTORS IN THE THIRD QUARTER OF 2019 DUE TO THEIR DEFENSIVE QUALITIES, SUCH AS HIGH DIVIDEND YIELDS AND RESILIENT EARNINGS.

FOR THE QUARTER, OUR **SMALL VALUE EQUITY** PORTFOLIO OUTPERFORMED THE BENCHMARK RUSSELL 2000 VALUE WITH A GROSS RETURN OF -0.27% VERSUS -0.57% FOR THE BENCHMARK. IN ADDITION TO LONG-TERM OUTPERFORMANCE SINCE INCEPTION (MARCH-2005), THE PORTFOLIO HAS ALSO OUTPERFORMED THE BENCHMARK OVER THE TRAILING

1-YR, 2-YR, AND 3-YR TIME PERIODS GROSS OF FEES.

INTERNATIONAL EQUITY

IN **GLOBAL AND NON-U.S. VALUE EQUITY**, DESPITE A SHARP REVERSAL IN SEPTEMBER THAT DELIVERED THE BEST WEEK FOR GLOBAL VALUE STOCKS RELATIVE TO GROWTH SINCE THE GLOBAL FINANCIAL CRISIS, VALUE ULTIMATELY LAGGED GROWTH FOR THE NINTH QUARTER OUT OF THE PAST 10, EXTENDING ONE OF THE LONGEST AND DEEPEST SLUMPS ON RECORD. YET, UNDER THE SURFACE, WE IDENTIFIED TWO ENCOURAGING SIGNS: THE DRAMATIC STYLE REVERSAL IN EARLY SEPTEMBER—A SIX SIGMA EVENT—HIGHLIGHTED THE VULNERABILITY OF EXTENDED POSITIONING IN GROWTH STOCKS AND BOND PROXIES LATE IN THE CYCLE, AND OUR EVOLUTION TOWARD MORE FOCUSED PORTFOLIOS WITH HIGHER-CONVICTION HOLDINGS BEGAN TO BEAR FRUIT. ALTHOUGH OUR GLOBAL EQUITY COMPOSITE AND OUR TAX EXEMPT NON-U.S. EQUITY COMPOSITE BOTH UNDERPERFORMED THEIR RESPECTIVE BENCHMARKS, THE MSCI ALL COUNTRY WORLD INDEX AND THE MSCI ALL COUNTRY WORLD ex-U.S. INDEX, FOR THE QUARTER OVERALL, THE MARKET AND PORTFOLIO TRENDS WITNESSED LEFT US OPTIMISTIC ABOUT THE VARIABLES THAT ARE BOTH WITHIN OUR CONTROL (ENHANCED STRUCTURE AND PROCESS) AND OUTSIDE OF IT (AN EVENTUAL CYCLE INFLECTION).

IN **INTERNATIONAL AND GLOBAL PLUS EQUITY**, GLOBAL EQUITY MARKETS CONTINUED TO TREAD WATER DURING THE THIRD QUARTER OF 2019 AND HAVE NOT MADE MUCH OVERALL PROGRESS SINCE THE BEGINNING OF 2018. WE PREDICT MORE OF THE SAME FOR EQUITY MARKETS OVER THE COMING MONTHS AS WE AWAIT GREATER CLARITY ON THE ECONOMIC OUTLOOK AND ON SOME UNRESOLVED GEOPOLITICAL ISSUES LIKE TRADE. ALTHOUGH STOCK MARKET RETURNS WERE LARGELY FLAT DURING THE THIRD QUARTER, WE SAW MORE SIGNIFICANT SWINGS FROM A SECTOR AND STYLE PERSPECTIVE. FOR THE THIRD QUARTER OF 2019, OUR EAFE PLUS EQUITY COMPOSITE RETURNED 0.56% (GROSS), VERSUS THE -1.00% RETURN OF THE MSCI EAFE INDEX AND THE -0.45% FOR THE MSCI EAFE GROWTH (NET DIVIDENDS) INDEX. FOR THE TRAILING FIVE YEARS OUR EAFE PLUS EQUITY COMPOSITE HAS OUTPERFORMED, RETURNING 8.30% (GROSS) VERSUS THE 3.77% RETURN OF THE MSCI EAFE INDEX AND THE 5.49% RETURN OF THE MSCI

EAFE GROWTH (NET DIVIDENDS) INDEX.

FIXED INCOME

IN THE **FIXED INCOME** MARKET ARENA, THE NEGATIVE SPREAD BETWEEN THE THREE-MONTH TREASURY BILL AND 10-YEAR TREASURY NOTE FURTHER INVERTED TO -15 BASIS POINTS, SEVEN BASIS POINTS WIDER THAN THE JUNE LEVEL. TEN-YEAR TREASURIES DECLINED 35 BPS DURING THE QUARTER TO 1.66%, WHILE THE TWO-YEAR TREASURY FELL 13 BPS TO YIELD 1.62%. BY FAR, THE BIGGEST DETERMINANT OF TOTAL RETURN IN THE THIRD QUARTER WAS THE MOVE IN U.S. TREASURY YIELDS.

FOR THE THIRD QUARTER OF 2019, OUR **HIGH YIELD** STRATEGY OUTPERFORMED, DRIVEN ENTIRELY BY SECURITY SELECTION AS SECTOR ALLOCATION HINDERED PERFORMANCE. THE PORTFOLIO RETURNED 1.45% (GROSS) OR +12BPS TO THE BLOOMBERG BARCLAYS U.S. CORPORATE HIGH YIELD INDEX BENCHMARK RETURN OF 1.33%. THE FACTORS WHICH CONTRIBUTED TO MATERIALLY POSITIVE SECURITY SELECTION WERE VARIED. THE AVOIDANCE OF AN INCREASINGLY DISTRESSED WIRELINE PROVIDER AND OF MULTIPLE CREDIT CHALLENGED ENERGY ISSUERS PROVIDED THE PRIMARY BENEFITS TO SELECTION. NEWS ON OPIOID-RELATED LAWSUITS CAUSED AN OVERWEIGHT TO THE PHARMACEUTICALS SECTOR TO LIMIT RESULTS. OVERWEIGHT POSITIONING TO BB/B-RATED SECURITIES CONTINUES TO BENEFIT PERFORMANCE AS CCC-RATED SECURITIES REMAIN LAGGARDS.

EMERGING MARKETS

EMERGING MARKET EQUITIES EVIDENCE OF SLOWING ECONOMIC GROWTH IN MANY PARTS OF THE WORLD AND A BACKDROP OF CONTINUING TRADE TENSION

DISCLOSURE

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BETWEEN THE U.S. AND CHINA DOMINATED INVESTORS' THOUGHTS IN THE THIRD QUARTER. THE MSCI EMERGING MARKETS INDEX RETURNED -4.11%, AND OUR PORTFOLIO RETURNED -4.48%. THE AGGREGATE VALUATION OF THE PORTFOLIO HAS PULLED BACK SLIGHTLY TO 9 TIMES FY5 EARNINGS, REFLECTING A SUBDUED OUTLOOK FOR CORPORATE EARNINGS. WE WILL CONTINUE TO FOCUS ON COMPANIES WHICH CAN PROSPER IN A LOWER GROWTH ENVIRONMENT.

PUNCH BOWL SOCIAL

WE WANT TO EXTEND A SINCERE THANK YOU TO ALL OF YOU WHO HONORED US WITH YOUR PRESENCE AT OUR ANNUAL COCKTAIL PARTY DURING THE INTERNATIONAL FOUNDATION OF EMPLOYEE BENEFIT PLANS CONFERENCE IN SAN DIEGO, CALIFORNIA. CONGRATULATIONS TO ALL OF OUR BINGO WINNERS!



THANK YOU

WE WOULD LIKE TO THANK THE **SAN MATEO ELECTRICAL WORKERS HEALTH PLAN** FOR ADDITIONAL CONTRIBUTIONS TO SIERRA'S FIXED INCOME PRODUCT, AND THE **NORTHWEST IRONWORKERS RETIREMENT 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.