Portfolio Manager Commentary

First Quarter 2019

Dear Client,

During the fourth quarter of 2018, domestic equity markets suffered their worst quarterly performance in seven years as investor concerns regarding slowing global growth, the future direction of Fed policy, and a ratcheting up of trade tensions between the US and China led to a sharp contraction in the earnings multiple afforded the broader market. In the first quarter of 2019, slowing global growth became a reality, uncertainty over the direction of Fed policy remained but the terms of the debate shifted from the number of impending rate hikes to whether the next rate move would be higher or lower, and trade tensions between the US and China seemed to stabilize if not move closer to a long-term resolution. This resulted in the best quarterly performance for domestic equities in over a decade with the US equity market effectively recapturing the ground that was lost in the fourth quarter of 2018. In our view, the volatility in equity returns over the past six months, first to the downside and then to the upside, is attributable to a shift in investor perception of a macro environment that really hasn't changed that dramatically.

This is a good time to provide a reminder that the constituents of the Focused Growth portfolio are not driven by our views and predictions of the global economic environment, but rather by a company by company analysis of the unique growth prospects and other attributes of the 20 or so stocks that we hold in the portfolio. Along those lines, our portfolio companies have reported weighted average revenue and earnings growth of 13% and 18% respectively over the last two quarters and the outlook for continued above-market growth remains strong. We are not in the business of making discrete economic forecasts on growth rates, interest rates, or the timing of the next recession but rather, our focus is on building a portfolio of companies that have the ability to perform in a variety of economic environments. That said, we acknowledge that the macro environment does impact equity returns, particularly in the near-term. As such, we offer the following commentary on the macro questions facing the market:

The least controversial macro issue facing investors at this time is the slowdown in global economic growth. The overwhelming consensus among economists is that global growth is slowing. The OECD forecasts global GDP growth of 3.3% in 2019 and 3.4% in 2020. This represents a reduction of roughly 0.4% per year from as recently as last October and makes sense when viewed in the context of a slowdown in the US and Chinese economies, heightened trade tensions across the globe, and increased risk in the Eurozone due to uncertainties surrounding Brexit. From our perspective, the pace of global growth, whether 3.3% or 3.7%, remains in a range that won't pose an undue obstacle for the continued growth of our portfolio companies. In fact, during times of slower growth, companies with unique growth characteristics are typically rewarded with higher valuations by investors.

As it relates to the future direction of Fed policy, investor expectations have shifted from a projection of at least 3 rate hikes for 2019 as of last October to 0-1 rate hikes for the year presently, with some forecasters believing the next move in rates will be lower. Investor perception around Fed Chairman Powell has seemingly shifted from a view that he was blindly hawkish and determined to raise rates no matter what warning signs to growth were flashing around him, to one where he and his Fed colleagues are prudently data dependent. As we noted in our fourth quarter investor letter, our view is that the Fed is always data dependent and generally pretty rational. So, just as we were not unduly alarmed by Chairman Powell's comments regarding rate hikes in early October, we do not believe that he underwent some sort of major epiphany in December that suddenly caused him to think it was a good idea to consult the economic data before deciding on a path forward for rates. What we would highlight as important is the fact that the current debate over the direction of the next Fed rate action is one that could not have taken place as recently as a couple of years ago when the Fed was stuck at 0% rates and had a $4 trillion balance sheet. From this standpoint, we are relieved that after almost a decade of 0% rates, the central bank now has some traditional tools in its kit should the economy face an unexpected shock to growth.

The final macro issue that has occupied a large portion of investor mindshare is the issue of US/Chinese trade. This is an issue that we have monitored closely as we have been forced to analyze the specific company exposure of each of our portfolio companies to a trade conflict that spins out of control. Happily, the first quarter of 2019 saw a ratcheting down of trade tensions as compared to the fourth quarter of 2018. Across the board tariff increases that were supposed to take place at the beginning of the year were put on hold and critical issues like forced technology transfers and intellectual property theft that had previously never been up for discussion now seem to be on the table as negotiations continue. While we won't know for sure until a deal is announced, trade talks with China seem to be moving in a positive direction and it is certainly in the interests of both parties to reach a deal.

In summary, we think the macro economic environment is stable enough to allow companies with structural competitive tailwinds to growth to continue to prosper. While we pull for a strong global economy for a number of reasons, we are careful to construct a portfolio of companies that are not overly dependent on macro issues beyond their control. In 2019, the general consensus is that corporate earnings are going to be choppy and that investors are going to have to drill down to the company level to find areas of growth. Basically, the thinking is that we have moved into a stock pickers market. As a fundamental research driven firm, this is an environment that we welcome.

First Quarter Portfolio Results:

Table 1 below shows the results of the Focused Growth Strategy in the first quarter and since inception (Q4-18) as compared to the S&P 500 and Russell 1000 Growth.

Table 1:

Portfolio / Index	1Q19 Return	Since Inception
Focused Growth Portfolio	18.2%	2.2%
S&P 500 Total Return Index	13.7%	-1.7%
Russell 1000 Growth Index	16.1%	-2.3%

We are pleased with the strong absolute and relative performance of our portfolio during the first quarter and note that the relative outperformance versus the S&P 500 index was driven almost entirely by selection effect rather than allocation effect. This means that our outperformance was due to owning the right companies within each sector rather than simply having an outsized exposure to a sector that outperformed the market during the quarter. This is consistent with our focus on identifying great businesses first and foremost rather than simply trying to pick the right sectors. Of course, we look for opportunities in attractive sectors with a focus on sectors that are less capital intensive, labor intensive, and commodity intensive than the broader market, but the lion share of our analysis takes place at the company level.

Tables 2 & 3 show the top performing stocks on an absolute basis and the top contributors to portfolio performance (% increase x weighting) during the first quarter.

Table 2:

Holding	1Q19 Top Performers
JD.com	37.1%
Alibaba	33.1%
Phillip Morris	32.4%

Table 3:

Holding	1Q19 Top Contributors
Phillip Morris	1.9%
Alibaba	1.7%
Electronic Arts	1.4%

JD.com, Alibaba, and Philip Morris International were the top three performing stocks during the quarter and Electronic Arts, due to a slightly higher weighting than JD.com, took the bronze medal for portfolio contribution in Q1. JD.com, a new addition to the portfolio (more on that later), and Alibaba both benefited from improving investor sentiment surrounding the prospects of a trade deal with China as well as both companies reporting better than expected Q4 sales. While a favorable trade resolution is a macro issue beyond the control of either company, the strong sales performance is validation for the thesis behind owning these stocks- namely that e-commerce in China is going to grow substantially over the next several years and we want exposure to this massive trend. JD's revenues grew 16% in fourth quarter of 2018 on top of 46% growth in fourth quarter of 2017 and the company issued growth guidance for the first quarter for 18%-20% growth. This indicates that the recent deceleration in sales growth has been arrested. Alibaba reported 34% revenue growth in the quarter consisting of 27% growth in its core Chinese retail business and 74% growth in its cloud business. Like JD, Alibaba's performance demonstrated that exposure to a secular growth sector like Chinese e-commerce is enough to overcome a slowdown in the broader Chinese economy.

Philip Morris International's stock was up 32% in the first quarter in part due to a rebound from an unwarranted collapse in December and in part due to encouraging developments in iQOS, PM's heat not burn reduced risk product. Between December 17th and December 31st, PM's stock fell from $81 to $67 on no news. While this was part of a collapse in the broader market, PM's share of the pain was disproportionate. As such, a rebound was in order and did in fact occur. The second half of PM's first quarter rally was driven by a favorable response to a strong fourth quarter earnings release. Although PM is the global leader in combustible cigarette sales, an important part of the company's future performance is going to be driven by the growth of its reduced risk product portfolio. Chief among these products is the iQOS heat not burn system. iQOS has had tremendous success in Japan, where it boasts a 15% share of the market, but questions remained about the ability of the product to thrive outside of Asia. Fourth quarter results showed strong acceleration for iQOS in key European markets and in the critical Russian market where share reached 8% in the seven cities in which iQOS is present. Global cigarette sales remain in decline and while strong pricing in the category is enough to drive profit growth in combustible cigarettes in the face of volume declines, tremendous opportunity exists in the reduced risk space and PM is far and away the global leader in that area of the market.

Electronic Arts is the final positive contributor to results that warrants special mention. In our last investor letter, we discussed EA's opportunity to transition towards more of a subscription model as the reason behind our decision to increase the weighting in this stock. We continue to believe that the major video game companies have extremely valuable libraries of content that can best be monetized via a subscription model. Further, we view recent announcements by Alphabet and Microsoft regarding plans to offer streaming games as an accelerant to this process. As such, we remain positive on the space. That said, EA's strong first quarter stock performance wasn't driven by investor recognition of this long-term thesis nor was it driven by fourth quarter results, which were disappointing across the board. EA's near-term stock was driven by the unexpected launch of APEX Legends, which is a shooter game that has emerged as the primary challenger to Fortnite for the ways that our children waste time. Longer term, we believe that tremendous value lies in the content libraries owned by the gaming companies and that the natural way to unlock this value is via a stable subscription model for content that is streamed into the home from the Microsoft or Alphabet clouds. Near-term, we are more than happy to catch a break from the gaming Gods which we think will buy EA some time to execute its long-term vision.

Tables 4 & 5 show the bottom performers both from an absolute standpoint and from a contribution standpoint during the first quarter.

Table 4:

Holding	1Q19 Bottom Performers
CME Group Inc	-12.5%
United Health	-0.7%
Intercontinental Exchange	1.1%

Table 5:

Holding	1Q19 Bottom Contributors
CME Group Inc	-0.4%
United Health	-0.1%
Intercontinental Exchange	0.1%

That both exchanges (Intercontinental Exchange and CME Group) are on the list of detractors to performance during a quarter in which the S&P rose 13.7% makes perfect sense to us. By their very nature, these companies have some counter-cyclical characteristics in that trading volume across their platforms tends to spike during periods of heightened market volatility. We saw this play out to our benefit during the fourth quarter and to our detriment during the first quarter. What hasn't changed is that the fundamentals of both businesses remain solid and the competitive landscape remains benign. We like the exchange businesses for their high incremental margins and the limited price competition across the different verticals and this has not changed. As such, we will take the counter-cyclical ups and downs of these stocks in stride while keeping an eye on the longer-term dynamics of the space.

While the weak first quarter performance of ICE and CME was understandable to us, the weakness in United Healthcare was not, particularly given the strong Q4 results that UNH released in January. United Healthcare's fourth quarter revenue increased 12%, profit grew 13% and EPS was up 27%. Further, the company's Optum division grew revenues 17% and operating profit 22% during the period. Optum is central to our thesis for owning UNH as this is the area of the business where UNH is mining the vast patient data at its disposal and applying technology to offer solutions that drive better health outcomes at a lower cost to the system. Finally, the company issued guidance for continued mid-teens EPS growth. In short, UNH delivered one of the top fourth quarter earnings reports of all of our portfolio companies.

Despite this, the stock was pressured due to a perceived increase in political risk as aspiring candidates for the Democratic party's Presidential nomination announced a fairly radical set of healthcare plans, some of which called for the complete abolition of the private insurance market and the implementation of a full single-payer government sponsored healthcare system. These plans strike us as political posturing designed to curry favor with the Democratic party base rather than realistic plans that one would expect to be passed into law should the Democrats win the 2020 Presidential election. Political risk is a fact of life for companies like United Healthcare as insurance companies make a fairly attractive target for politicians. We accept this volatility as part of the cost for owning what we view to be a great business. That said, we are surprised that the drumbeat of negative headlines about policies that we think have next to no chance of being implemented was enough to overshadow what we viewed to be an outstanding fourth quarter earnings release and an outlook for continued strength in this business.

First Quarter Portfolio Activity:

Table 6 shows the changes made to the portfolio during the first quarter and as could be expected during a quarter in which our portfolio companies delivered fairly strong results across the board, minimal changes were made during the quarter.

Table 6:

New Purchases / Additions		
Company	**Beginning Weight**	**Ending Weight**
JD.com	0.0%	3.0%

Eliminations / Reductions		
Company	**Beginning Weight**	**Ending Weight**
Constellation Brands	3.0%	0.0%

During the first quarter of 2019, we sold Constellation Brands and bought JD.com. We owned Constellation Brands because we liked the Mexican imported beer business and we still like this business. That said, the Constellation story became more complicated in recent months following the company's large investment in Canopy Growth Corp- a cannabis company with global aspirations. While this investment may turn out to be successful, the cannabis market is in its infancy from a regulatory and branding standpoint and is not an area where we feel like we have a strong sense of who the ultimate winners will be. This coupled with the fact that the Canopy investment is going to claim the bulk of Constellation's free cash flow over the next several years led us to question our investment. Another factor in our decision to sell this position was a slight deceleration in beer volumes coupled with plans to sell a material stake in the wine business, which we believe will be dilutive to earnings. The confluence of these issues served to reduce our long-term return expectations for Constellation and as such, we believed there were better opportunities elsewhere.

JD.com was the opportunity we had in mind when we made the decision to sell Constellation. As discussed above, we like the long-term opportunity in the Chinese e-commerce market and believe that this market is large enough to support two long-term winners- Alibaba and JD.com. Like Alibaba, shares of JD.com were under pressure due to rising trade tensions with China and a slowdown in the Chinese economy. Unlike Alibaba, shares of JD.com faced additional pressure when CEO Richard Liu was accused of sexual assault in Minneapolis. Ultimately, prosecutors declined to press charges and Mr. Liu was cleared of the assault allegations. The overhang of the slowdown in the Chinese economy and the accusations against Mr. Liu created a favorable long-term risk reward opportunity for the stock once the charges were dropped. We took advantage of this opportunity and initiated JD.com with a 3% position.

The two quarters since we launched the Focused Growth portfolio have been nothing if not eventful. Throughout the painful declines of the fourth quarter and the ensuing strong rebound during the first quarter, our focus has been on the performance of the businesses we own and to date, we are pleased with that performance. We thank you for the trust you have placed in us, and as always, please feel free to reach out if you have any questions.

Sincerely,

Ken Burke
Chief Investment Officer

Disclosure

The Burke Wealth Management Focused Growth Composite, created on October 1, 2018, contains fully discretionary large cap equity accounts that is measured against the S&P 500 Total Return Index and the Russell 1000 Growth indices. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The Burke Wealth Management Focused Growth Strategy invests exclusively in a portfolio of high-quality companies.

The S&P 500® Total Return Index is a widely recognized, unmanaged index of 500 common stocks which are generally representative of the U.S. stock market as a whole. Ordinary dividends are reinvested across the index and accounted for in the Total Return index calculations. The Russell 1000® Growth Index is an unmanaged index that measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values.

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