Portfolio Manager Commentary
Second Quarter 2019

Dear Client,

The second quarter of 2019 can be broken into two distinct periods: Pre-Tweet and Post-Tweet. The tweet referenced is President Trump's May 5th tweet announcing a breakdown in US-Chinese trade negotiations. Prior to the May 5th trade tweet, Q2 was shaping up as a continuation of Q1 both in terms of strong equity market returns and solid corporate earnings reports. Investors had settled happily into a goldilocks environment in which Fed Policy was on hold, GDP growth, while slowing, remained at a comfortable and sustainable level, and the risks associated with a trade war seemed to be subsiding. The breakdown in trade talks was not the only event that ratcheted up risk to equity investors in the final two months of the second quarter; regulatory risk in the form of government investigations into several large technology companies and geopolitical risk in the form of heightened tensions and outright hostilities in the Strait of Hormuz also contributed to what was a very volatile final two months of the second quarter. As we've made note of in prior editions of this letter, we are not in the business of predicting trade disputes, regulatory actions, and geopolitical events but rather, we own companies whose durable business models and strong balance sheets enable them to adapt to a wide variety of macro environments.

The escalation in US-Chinese trade tensions wasn't the only trade development in the quarter, but it is certainly the most notable. The US-Chinese trade dispute isn't about a trade deficit, but rather it is about a realignment in the economic relationship between the world's two most powerful countries. The key issues in this fight are a Chinese market that remains largely closed to global competition, intellectual property theft, and even the threat that China's largest 5G equipment provider, Huawei, is working with the Chinese military to implant eavesdropping capabilities into its communications equipment. Indeed, as we analyze our portfolio of leading global businesses for direct exposure to the trade dispute with China, it is remarkable how little direct exposure there is. Part of this is by design, but the bigger part is that the Chinese market is either closed or heavily restricted from foreign competition. It is understandable that the type of realignment sought by the US is going to take time and that the path towards a successful resolution to this matter is not going to follow a straight line. That said, we continue to believe that it is in the best interests of both countries to reach a substantive trade agreement and remain hopeful that such an agreement will occur. Where we are less confident is on the precise timing of an agreement and the number of bumps in the road that will occur on the path to a deal.

While the escalation in US-Chinese trade tensions weighed on the equity market during the month of May, we found President Trump's threat of escalating tariffs on Mexico in response to the border crisis to be of just as great a concern. As we analyzed the US-Chinese trade dispute, we noted that just as tensions on that front were rising, the US had delayed auto tariffs on Europe and Japan and was taking steps towards ratifying the USMCA trade agreement with Mexico and Canada. It looked as though the US had assembled a global coalition on the issue of Chinese trade. This is why the May 31st threat to level a series of escalating tariffs on Mexico should it not take steps to stem the flow of illegal immigration was jarring. It was only after Mexico agreed to increase its enforcement efforts and the threat of tariffs was removed that the strong rally in the month of June began. While this episode of brinksmanship was successful, we believe that using tariffs as a negotiating club in disputes that reach beyond trade increases market risk.

Another risk that reared its head during the second quarter was regulatory risk. On June 1st, it was announced that the Department of Justice would investigate Alphabet's business practices while the FTC would be looking into Facebook and Amazon. All three of these companies are owned in our portfolio, so we have been closely following the escalating rhetoric regarding increased regulation in recent months. In our view, the biggest risk to shareholders from the heightened regulatory scrutiny facing these companies is that it can serve as a long-term source of distraction for management. Amazon is a company that is ruthlessly dedicated to driving down consumer prices while increasing consumer convenience and Facebook and Alphabet (via its Google site) are free services to consumers so it is hard to see how the government is going to make a case that their size harms the consumer. Facebook and Alphabet compete against each other in the advertising space. It is important to remember that while the political criticism these companies face is designed to win in the court of public opinion, anti-trust cases will be tried in a court of law. That said, even if the government seeks to break up these companies and is able to successfully make its case, we just don't see the material downside to shareholders from this worst-case scenario. Of the three companies, only Facebook would require a comprehensive re-evaluation of the investment case should Instagram be separated from Facebook and that evaluation would be whether to own both pieces individually or simply pick one of the two. It could even be argued that breaking up Amazon and Alphabet could unlock shareholder value, particularly in the case of Alphabet. We believe that the most likely case is that the government investigations result in some sort of fine along with a series of non-material adjustments to business practices. That said, this is a situation we will be watching closely as events unfold.

In summary, while the second quarter delivered solid equity appreciation, volatility increased as trade and regulatory uncertainties became prominent storylines. The uncertainty surrounding trade will have an adverse impact on a global economy that was already slowing. That said, the halting of hostilities following the G-20 meeting in Japan provides both the US and China some breathing room to assess the situation without the added pressure of continually increasing tariffs. As for our portfolio, we look forward to the upcoming slate of second quarter earnings reports and take comfort in the fact that each company that we own was purchased based on its own set of unique company specific growth drivers that are not entirely dependent on a particular macro-economic environment.

Second Quarter Portfolio Results:

Table 1 below shows the results of the Focused Growth Strategy in the second quarter, year-to-date and since inception (10-1-18) as compared to the S&P 500 and Russell 1000 Growth.

Table 1:

Portfolio / Index	2Q19 Return	2019 YTD	Since Inception
Focused Growth Portfolio	3.9%	22.8%	6.2%
S&P 500 Total Return Index	4.3%	18.5%	2.5%
Russell 1000 Growth Index	4.6%	21.5%	2.2%

As discussed above, equity returns were fairly volatile during the second quarter but the underlying results of our portfolio companies remained strong. The weighted average revenue and adjusted earnings growth of the portfolio for the first quarter results reported in April and May was 12% and 16% respectively. This is the metric we are most closely focused on as it is what will drive the long-term performance of the portfolio. We expect continued strength in operating results across the portfolio when second quarter earnings reports are released.

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

Table 2:

Holding	2Q19 Top Performers
CME Group	17.9%
Facebook	15.8%
Intercontinental Exchange	12.9%

Table 3:

Holding	2Q19 Top Contributors
Facebook	0.79%
Visa	0.78%
Intercontinental Exchange	0.64%

The exchanges (CME and ICE) have been on our list of top or bottom relative performers in each of the three quarters since the inception of the Focused Growth portfolio with leading performances in volatile quarters (Q4-18, Q2-19) and lagging performance in non-volatile quarters (Q1-19). These are good structural businesses and, from a portfolio standpoint, they provide a nice countercyclical balance while still delivering long-term secular growth. Facebook was a case of a company whose results were such that the stock was able to power through the heightened regulatory scrutiny discussed above. Over the past year, Facebook has faced relentless criticism from both the right and left side of the political aisle (one of the only issues that unites Republicans and Democrats) as well as from consumer privacy advocates. Still, user engagement remains strong, revenue per user increased 27% in the second quarter in the US and was up in the mid-teens in the rest of the world, and the company is one quarter away from lapping the step function increase in spending it made to improve the security of the site. This is a case where the strength of the business model can overcome the noise of bad news cycles. Finally, Q2 featured a strong performance from both Visa and Mastercard (both up low double digits). In a world where the biggest risk is the trade dispute with China, these businesses which feature double digit revenue growth and mid-teens earnings growth with no Chinese exposure are quite attractive to investors.

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

Table 4:

Holding	2Q19 Bottom Performers
Philip Morris International	-11.2%
Intuitive Surgical	-8.1%
Alphabet	-7.9%

Table 5:

Holding	2Q19 Bottom Contributors
Alphabet	-0.63%
Philip Morris International	-0.56%
Intuitive Surgical	-0.48%

Philip Morris International, Intuitive Surgical and Alphabet were the biggest detractors to performance in the second quarter. For PM, this looks to be a case of some mean reversion following a first quarter that saw 32% price appreciation as well as a case where the stock fell victim to negative fund flows from tobacco ETFs. For Alphabet and Intuitive Surgical, the poor second quarter stock performance is an instance where our assessment of the Q1 earnings report differs from that of the broader market. According to a recent JP Morgan report, passive investing controls roughly 60% of the market while algorithmic driven quantitative strategies control another 20%. This can lead to higher volatility and situations where business fundamentals divorce from the stock price for a period of time. Over the long-term, this is a great source of competitive advantage for a long-term focused, fundamental based investment strategy. Our favorite quote from legendary investor Ben Graham is that, "in the short-run, the market is a voting machine but in the long-run it is a weighing machine". This is the underpinning of our investment philosophy. That said, in today's world, companies caught on the wrong end of the flow of funds can suffer some unwarranted near-term price declines. This is what we think happened to PM during the second quarter. There were some truly troubling developments in the US tobacco market during the second quarter. The pace of volume declines accelerated, regulatory scrutiny of the vaping market increased dramatically, and indications were given that the long-dreaded FDA rule proposal to limit the amount of nicotine in combustible cigarettes could come as soon as this summer. This onslaught of bad news drove an exodus from the tobacco sector and shares of Altria, British American Tobacco, and Philip Morris International all suffered sharp declines during the quarter. The only problem with this is while Altria and BAT together control over 85% of the US tobacco market, Philip Morris International has no US exposure and the negative developments for the category were truly US centric. PM has a more diversified international business than its fellow large cap tobacco players and is the global leader in the reduced risk product space with its heat-not-burn iQOS device. As such, the company is not impacted by the fundamental issues currently posing a challenge to Altria and BAT. We believe that over time, as the business results of these companies diverge, the stock prices will as well.

The poor second quarter performance in the shares of Alphabet and Intuitive Surgical is a case where our view of the results differs from the initial reaction of the market. Like Facebook, Alphabet faced an increase in regulatory scrutiny during the second quarter with the announcement of the Department of Justice investigation. Unlike Facebook, the strength of the first quarter earnings release was not enough for the stock to overcome this development. Revenue growth of 17% fell below the magical 20% level for the first time in three years and to hear it told on CNBC, this represented the end of growth at Alphabet. When you factor in that currency represented a drag of ~1.5% in the quarter, the $80B drop in market value of the shares the day after the earnings release seems a bit harsh. To be fair, management did not help itself on the earnings call as they refused to provide additional disclosure around the performance of YouTube and Google Cloud which has resulted in an opacity overhang on valuation. That said, our assessment is that the long-term growth of the company will remain robust and that the durability of the search business remains intact. We think it is likely that management will respond to investor's desire for increased disclosure at some point and that this could trigger a favorable re-rating for the shares in much the same way that additional disclosure around AWS led to a re-rating in shares of Amazon. Until that time, we will remain patient with a company that we think can continue to deliver mid-to-high teens revenue growth for the next several years.

Whereas our view of the Alphabet stock in the wake of its earnings release is of a market overreaction, our view of the performance of Intuitive Surgical following its earnings release is that sometimes the market's view of information is going to be different than ours. When you have a long-term investment horizon in a market where holding periods are constantly shrinking, there are going to be instances where your focus is different from that of the broader market. Intuitive Surgical is one of those instances. Our ownership of Intuitive is based on the belief that the total addressable market for robotic surgery is a multiple of its current level and that Intuitive's Da Vinci system will be the dominant player in that market. When you think about the business in that context, Intuitive's announcement that operating expenses were going to far outpace sales growth in 2019 (mid-20% increase in OPEX vs mid-teens % increase in sales) is not a negative, but rather a positive development given that this spending is going to be focused on building out a sales presence in underdeveloped markets and expediting increases in manufacturing capacity. Simply stated, as a long-term business owner, these are exactly the types of investments you want your management team making and the speed at which the investment is made is far more important than the impact that it has on near-term earnings. A shorter-term view on this development would be that Intuitive was an expensive stock and 2019 is going to be an investment year so why not find something else to buy for now and revisit Intuitive at a later date. Given that we hold such a favorable view of Intuitive's long-term opportunity, we will accept the volatility of the stock with the confidence that we will be rewarded over time if we are correct in our outlook rather than attempting to trade in and out of it based on short-term news flow.

Second Quarter Portfolio Activity:

Table 6 shows the changes made to the portfolio during the second quarter. The most notable changes made during the second quarter were the sale of Altria and the purchases of PayPal and Nvidia. The minor reductions in PM, CME Group, and Verisk were made to free up additional funds for the purchase of Nvidia by tactically reducing the weightings in stocks that had delivered very strong near-term returns.

Table 6:

New Purchases / Additions		
Company	**Beginning Weight**	**Ending Weight**
PayPal	0.0%	3.0%
Nvidia	0.0%	4.0%

Eliminations / Reductions		
Company	**Beginning Weight**	**Ending Weight**
Altria	5.0%	0.0%
Philip Morris Int'l	6.0%	5.0%
CME Group	3.0%	2.5%
Verisk	3.0%	2.5%

The decision to sell Altria was driven by three factors: A terrible capital allocation decision, a more challenging regulatory environment, and an increase in the rate of decay of combustible cigarette volumes in the US. The biggest reason for the sale was our view that Altria's decision to pay $12.8B for a non-controlling 35% stake in JUUL, the leading e-vapor company in the US, was ill-advised. The e-vapor category is in its infancy from a regulatory and brand equity standpoint. In our view, Altria had two very reasonable options to counteract JUUL's rapid rise in the vapor category: It could have copied JUUL's design and made its own flavored nicotine cartridges or it could have wrapped itself in the cloak of public health and called for more stringent regulatory oversight of vapor due to the uptick in teen usage rates. Either action would have been enough to blunt JUUL's rise while maintaining balance sheet flexibility. Instead, Altria spent $12.8B for a 35% stake in JUUL, all but $1B of which was immediately passed on to existing JUUL shareholders and employees. Ironically, Altria's presence as an investor has seemingly increased the regulatory crusade against vaping and JUUL in particular. Vaping has been recently outlawed in JUUL's home city of San Francisco and there is a distinct possibility that the JUUL vaping system could be pulled from shelves altogether within the next year, as the company never received regulatory approval for its design in the first place. It is challenging to discuss this transaction in polite terms.

The other issues that factored into the decision to sell Altria, regulatory scrutiny and volume declines, are issues that tobacco investors have had to consider for years- it's just that both areas are getting worse. On the regulatory front, since 2017, the FDA has been considering stricter rules on the levels of nicotine allowed in a combustible cigarette with a stated goal of reducing the amount to non-addictive levels. This was a known risk, but on his way out as the head of the FDA Scott Gottleib indicated that the final rule could be issued as soon as this summer. This will move the discussion away from the regulatory agency and into the courtroom. US tobacco volumes have been declining since 1981, so volume declines are nothing new in the space. The long-term model has been 2%-3% decline in usage, 30%-35% demand elasticity, and 5%-6% pricing. This has allowed the domestic tobacco profit pool to grow mid-single digits for many years. That long-term model is showing signs of cracking and Altria indicated in December that cigarette volume declines would be moving from the 3%-5% range to the 4%-6% range. This puts more long-term pressure on pricing to drive profit growth and the recent reported rates of volume declines have been in the high-single-digit range, not the new 4%-6% target. For an investment like Altria where the return algorithm was predicated on mid-single-digit profit growth, a couple of percent boost from share repurchase, and a 5% dividend yield there isn't a lot of room for error. Given that the margin of safety around the growth rate of the business was under threat and that the company had voluntarily forfeited the balance sheet flexibility that might have allowed it to successfully navigate a more challenging period, we made the decision to eliminate Altria from the portfolio.

As evidenced by our investments in Visa and Mastercard, we love the global payments space. PayPal is another way to participate in this area. We initiated a 3% position in PayPal during the second quarter. Like Visa and Mastercard, PayPal benefits from the shift away from cash and check to alternative forms of payments. Unlike Visa and Mastercard, where transactions that run over their network are typically initiated by a consumer presenting a physical card issued by one of the member bank partners, PayPal is a digital platform. This means that PayPal's business is more heavily tilted towards e-commerce. PayPal has a two-sided network that includes over 20M merchants and 270M consumers and it is able to transmit funds in over 200 countries worldwide so its business is more protected than one might expect a digital application to be. This also makes it a valuable partner in the digital space for Visa and Mastercard. PayPal also provides small businesses with a software solution that allows them to conduct on-line and cross border business. As a leading digital payment platform for both consumers and merchants, we think PayPal can sustain 20%+ earnings growth over the next three years.

We initiated a 4% position in Nvidia during the second quarter. Nvidia is the world's leading producer of graphics processing units (GPUs). These chips are extremely fast and are essential in high performance computing, which requires enormous amounts of data computation. As such, Nvidia is a leading chip provider to the gaming industry and to data center applications that utilize machine learning and artificial intelligence. The chip space is known to be a very economically sensitive sector, but Nvidia's leading position in these large and extremely attractive end markets makes the higher volatility of the stock worth enduring. We have followed Nvidia closely for some period of time and have long thought that the distortion to GPU demand caused by bitcoin mining might provide us with an attractive entry point. Indeed, Nvidia shares fell from $280 last August to current levels (around $160) as the company was forced to work through an inventory glut for its most common GPU chips. Basically, bitcoin miners were buying large quantities of GPUs when bitcoin was around the $20,000 level at the end of 2017 and when the price of bitcoin collapsed, many of these chips were sold on the secondary market as it was no longer profitable to mine bitcoin. This caused a glut of inventory in the supply chain which has taken several quarters to work through. Our view is that the pain caused by this process is nearing an end and that the disruption created an attractive entry point into a leading chip provider to several rapidly growing end markets. Hence, we bought Nvidia.

The second quarter of 2019 was an interesting time in the equity markets as trade and regulatory risks increased. Our patient approach to investing affords us the time to thoughtfully analyze the impact of a potential change in the macro risk profile without making knee jerk reactions to near-term changes in sentiment. As always, we remain focused on the performance of the businesses we own and are confident in their ability to navigate through a changing macro environment. 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

BURKE WEALTH MANAGEMENT

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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