Fourth Quarter 2018 Newsletter

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Spotlight:

Global Growth Sputters, But There Are Many Reasons To Be Positive

Béatrice Philippe
President
FOUR*POINTS* Asset Management

2018 was indeed an "annus horribilis" for financial markets around the world. The year started well in the U.S., with the S&P 500 up 10.6% year-to-date through the third quarter. However, the fourth quarter was especially brutal. The market ceded 13.5 percentage points in the final three months of 2018 to end the year down 4.4%. Europe fared even worse, with the MSCI Europe down 12.7% and 14.3% in the fourth quarter and for the year, respectively.

The Trump administration's trade war with China, slowing global growth, higher interest rates, and diminished liquidity drove down valuations across asset classes. Uncertainty surrounding U.S.-China trade negotiations, the rise of aggressive populist movements worldwide, and a revival of political risk in Europe (Brexit, Italy's budget crisis, "Yellow Vest" protests in France) will likely continue to contribute to market volatility in 2019.

After last November's midterm elections, a politically divided U.S. government is starting the year marred by a partial government shutdown, which threatens to weigh on economic growth further. However, a slowdown is not a recession, and we do not anticipate one in 2019. In fact, there are many reasons to be positive, including:

- a possible trade deal with China;
- the potential for the Fed to pause rate hikes or to lower interest rates; and
- most importantly, valuations are much more reasonable. The S&P 500 is trading below 15x next twelve months P/E, its lowest level since 2013 (13x ex. FAANG[1] stocks).

Given the above, we think there exist attractive opportunities to invest in quality companies for the long-term.

I wish us all a healthy and more prosperous New Year!

Thank you for your continued support,

Béatrice

[1] Facebook, Apple, Amazon, Netflix, and Alphabet's Google

Philippe
Euro Global Leaders

In 2018, European stock markets fell over 14%, most of which occurred in the fourth quarter (the MSCI Europe declined nearly 13%). There were many reasons for this correction, but the most prominent story besides U.S.-China trade tensions seemed to be rising U.S. interest rates (long duration Treasuries surpassed 3% in the quarter) in the context of slowing global growth, which has revived fears of a recession in the U.S. Not only has growth slowed noticeably in China, but also in Europe, where the composite PMI dropped to its lowest level since 2014. The return of political risk (Brexit, Italy's budget crisis, and protests in France) weighed on business sentiment and output. Trade tensions have also penalized exporting countries, most notable Germany. At the start of 2018, Euro area GDP was forecast to grow well above 2%, however, the region will likely end up increasing only 1.9% for the year.

Given heightened uncertainty, defensive stocks held up better, but nevertheless ended the year in negative territory. Utilities (-6%), health care (-8%), and energy (-9%, benefitting from the sharp rise in crude oil prices until October) stocks outperformed. Conversely, given monetary policy tightening by central banks around the world, the financial sector (-26%) was the worst performing, followed by materials (-20%) and consumer discretionary (-20%), which were affected by mounting trade tensions and slowing global growth.

Philippe Euro Global Leaders ended the year down just over 20%. The portfolio performed fairly well through the first nine months of the year, but was penalized by third quarter earnings disappointments for a few portfolio holdings, including **Seb**, **AB InBev**, **Atos**, **Fresenius**, **ConvaTec**, and **Michelin**. In general, the portfolio's cyclical stocks suffered severe de-ratings, in particular capital goods companies and automotive suppliers, which are now trading near 2009 and 2011 valuation lows. We think current valuations, which would indicate a cycle reversal, are overly pessimistic at this stage.

During the quarter, we reinforced holdings we felt were overly penalized (**Elis**, **Atos**, **CTS Eventim**, and **Johnson Matthey**), while we exited **GEA**. After two years and multiple profit warnings, we came to the conclusion that operating costs headwinds, including competitive pressure and a need for significant IT investments, facing **GEA**, the world's leading manufacturer of equipment for the food and beverage industry, were likely to disappoint investors again in 2019. Considering the stock trades at similar valuations as other high quality, but less risky industrial businesses, we decided to sell our position in full.

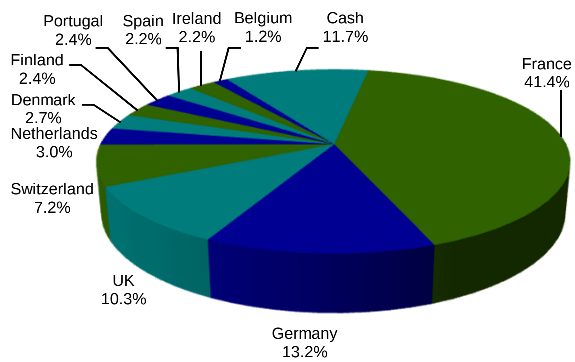
Extreme sectoral rotations, as well as severe downturns for certain portfolio companies have depressed fund performance over the past three months. Nevertheless, in our experience, market hubris creates exceptional investment opportunities. While market timing, like identifying a bottom, is an uncertain, sometimes painful exercise, at some point markets will re-focus on fundamentals rather than trading on sentiment, which could drive as spectacular a reversal for equities as their sudden derating. We feel the portfolio is well-positioned to benefit from this type of reversion to the mean.

Stocks held in the portfolio are bold and underlined. All stock and index performance is in USD.

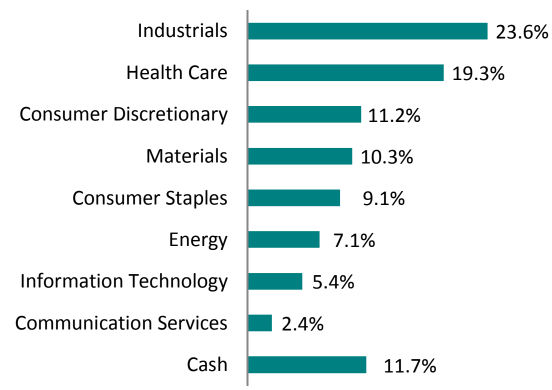
Market Cap Allocation as of 12/31/18

Mega Cap (Greater than $50 billion)	28.8%
Large Cap ($7.5 billion - $50 billion)	36.3%
Mid Cap ($750 million - $7.5 billion)	29.7%
Small Cap (Less than $750 million)	5.3%

Geographic Breakdown as of 12/31/18



Sector Breakdown as of 12/31/18



Top Ten Holdings as of 12/31/18

Airbus	3.1%
Linde	3.0%
Française de l'Energie	3.0%
Danone	3.0%
Philips	3.0%
Roche	2.9%
Elis	2.8%
Michelin	2.8%
Schneider Electric	2.8%
Cap Gemini	2.7%
Total:	**29.1%**

Performance as of 12/31/18 in USD

	Philippe Net	Philippe Gross	MSCI Europe
Quarter	(18.9%)	(18.7%)	(12.7%)
1 Year	(20.3%)	(19.5%)	(14.3%)
Since Inception	1.3%	2.4%	4.0%

Performance greater than 1 year is annualized.
Inception date: January 3, 2017

Sources: Northern Trust, Zephyr Style Advisor

Philippe
U.S. Equities

Although U.S. economic growth remained strong and third quarter earnings were generally better-than-expected, the strength of the U.S. dollar and trade disputes, both of which weighed on global growth, were significant enough to overpower U.S. market strength (+10.6% year-to-date through the end of September). The S&P 500 was down 13.5% in the fourth quarter. Only the utilities sector (+1.4%) finished the quarter in positive territory. Every other sector was in the red, with significant weakness in the energy (-24.4%), industrial (-17.7%), and information technology (-17.7%) sectors. Consistent with the global market sell-off, large cap, defensive, and value stocks outperformed during the quarter.

For the year, the S&P 500 was down 4.4%. Four sectors outperformed the market in 2018: health care (+4.7%), utilities (+0.5%), consumer discretionary (-0.5%) and information technology (-1.6%). The worst performing sectors this year were financials (-14.7%), industrials (-15.0%), communication services (-16.4%), materials (-16.4%), and energy (-20.5%). Following a December rate hike by the Federal Reserve to a federal funds rate range of 2.25% to 2.50%, financials were negatively affected by moderating expectations for higher longer-term interest rates, concerns about the flattening U.S. yield curve, and the general decrease in asset prices. The industrial, energy, and material sectors were pressured by slowing global growth, oversupply, higher raw material costs, tariffs, and large downward fourth quarter EPS estimate revisions. Meanwhile, communication services companies, which are facing intensifying competition for consumers' attention, suffered year-end portfolio rebalancing as well as increasing regulatory pressure with respect to consumer privacy and protection.

Despite strong performance from our consumer staples (**McCormick**, **TreeHouse Foods**) and health care (**Merck**) holdings, the fund was down 15.5% during the fourth quarter as industrial (**Wabtec**, **SiteOne Landscape Supply**, **FedEx**), REIT (**Weyerhaeuser**, **Howard Hughes**), and consumer-related (**Tapestry**, **Apple**, **Amazon**) positions significantly weighed on performance. During the quarter, we sold **SiteOne Landscape Supply** and **FedEx** to harvest tax losses. Despite increased volatility, we remain confident in our portfolio positioning, having reinforced holdings with the most growth potential that appeared oversold during fourth quarter (**Carter's**, **Apple**, **Amazon**, **Ansys**). For the year, the **Philippe U.S.** fund was down 6.4%.

Looking ahead, our outlook for 2019 remains constructive. Despite tighter monetary policies globally and difficult year-over-year earnings growth comparisons at home due to one-time tax cut-related benefits in 2018, we believe that U.S. fundamentals remain solid, with S&P 500 earnings expected to grow 8.3% in 2019. Conference Board's Leading Economic Index remains in positive territory, consumer confidence is still high, and business capital spending plans have only moderated slightly in recent months. We believe the positive effects of minimum wage increases, tax refunds, and lower gas prices (WTI crude lost 38% during fourth quarter on faster U.S. shale production growth) in conjunction with limited headline inflation will continue to support

Continued on page 4

Stocks held in the portfolio are bold and underlined. All stock and index performance is in USD.

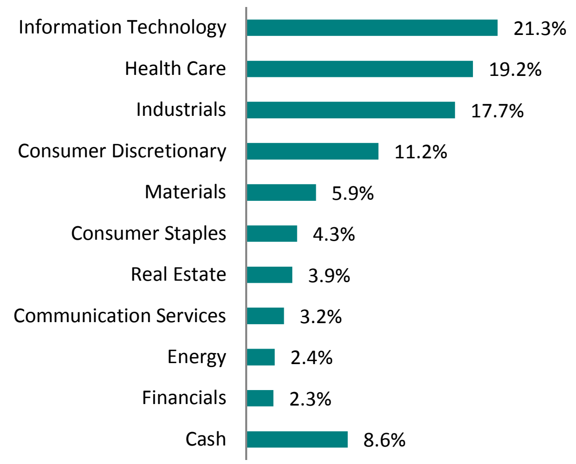
Market Cap Allocation as of 12/31/18

Mega Cap (Greater than $50 billion)	41.7%
Large Cap ($7.5 billion - $50 billion)	33.4%
Mid Cap ($750 million - $7.5 billion)	24.9%
Small Cap (Less than $750 million)	0.0%

Top Ten Holdings as of 12/31/18

Mercury Systems	3.6%
Alphabet	3.2%
Salesforce.com	3.2%
Medtronic	3.2%
Zoetis	3.1%
Thermo Fisher Scientific	3.1%
Ecolab	3.1%
Home Depot	2.9%
Allegion	2.9%
RPM Interational	2.8%
Total:	**31.1%**

Sector Breakdown as of 12/31/18



Performance as of 12/31/18 in USD

	Philippe Net	Philippe Gross	S&P 500
Quarter	(15.5%)	(15.3%)	(13.5%)
1 Year	(6.4%)	(5.5%)	(4.4%)
3 Years	4.8%	5.8%	9.3%
5 Years	2.5%	3.6%	8.5%
10 Years	9.3%	10.5%	13.1%
Since Inception	3.9%	4.8%	5.6%

Performance greater than 1 year is annualized.
Inception date: January 29, 1999

Sources: Northern Trust, Zephyr Style Advisor

Philippe U.S. Equities (*Continued from page 3*)

strong consumer confidence and spending. Meanwhile, stock valuations have become much more reasonable: the S&P 500 is trading at 14.1x forward 12 months earnings compared with 5- and 10-year averages of 16.4x and 14.6x, respectively.

In our opinion, the current economic environment and corporate fundamentals do not signal a U.S. recession in 2019. That said, after such a long period of stability/economic expansion following the global financial crisis, it's not unreasonable for the topic of a recession to come up, especially in the context of slowing growth and an inverting yield curve, which is often seen as a harbinger of a recession. Market volatility could remain high driven by global economic, geopolitical, liquidity, and monetary policy events. After last November's midterm elections, a politically divided U.S. government is starting the year marred by a partial government shutdown, which could impact upcoming infrastructure and health care legislative initiatives. This is further complicated by the ongoing trade dispute with China and debt ceiling (the current suspension expires on March 1) negotiations. In the interim, we expect a lot of noise, but that should also create opportunities to invest and reinvest in great companies that can capitalize on growth trends in the current environment. Our portfolio holdings' seasoned management teams are more than capable of quickly adapting to changes in business cycles and protecting cash flows.

However, it is also important to be cognizant of headwinds on the horizon. Government shutdown-driven delays in the publication of economic data could limit visibility into the health of the U.S. economy, which would only raise uncertainty at a time when corporations are reporting annual results and providing their outlooks for 2019. Indeed, there has already been some cautious commentary so early in earnings season: **Apple** cited the timing of its iPhone launches, a strong U.S. dollar, supply chain constraints, and expected weakness in some emerging markets as reasons for lower sales; **Sherwin-Williams**, a competitor to portfolio holding **RPM International**, noted weaker-than-expected sales in October and November. In addition, uncertainty over tariffs (the next increase from 10% to 25% is planned for March 2) and associated supply chain disruptions could keep pressure on the market in early 2019. Another area of concern is corporate leverage. Any deterioration in credit quality and subsequent downgrades of corporate bonds could lead to tightening in financial conditions, which would limit economic growth potential. Moreover, "covenant lite" leveraged loans exacerbate the risk of default in the high yield market.

The outcome of Brexit negotiations and central bank policy in the context of slowing global growth will be of particular importance to investors in 2019. As of the last Federal Open Market Committee meeting on December 19, the Federal Reserve projected two rate hikes in 2019 and continued balance sheet reduction, while the European Central Bank ended its asset purchase program at the end of 2018. Based on Fed Chair Jerome Powell's late December comments, promising to remain data dependent, the market has priced in an even slower rate path in 2019, to a federal funds range of 2.75% to 3.00% or 1 to 2 hikes. It remains to be seen how these headwinds will affect investor sentiment, but we believe the combination of attractive valuations and continued U.S. economic growth will provide great opportunities for long-term investors in 2019.

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DISCLOSURES

LLC Descriptions

The **Philippe Fund Euro Global Leaders, LLC** is a commingled fund suitable for U.S.-based, high net worth individuals and endowment/foundation clients. The minimum investment in the LLC is $250,000. The minimum time frame recommended for investment in the LLC is two years. The LLC is officially valued at the end of each month. Further information is available in our Confidential Memorandum, which can be obtained from **FOUR***POINTS* Asset Management, Inc. The benchmark is the MSCI Europe Index. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. A fee schedule is available upon request and is described in Part 2 of the firm's Form ADV. The fund is available to qualified investors only. Accounts are included from the first full month under management. Leverage is not used. Past performance is not indicative of future results. The fund's assets under management as of December 31, 2018 were $23.8 million.

The **Philippe Fund U.S. Equities, LLC** is a commingled fund suitable for U.S.-based, high net worth individuals and endowment/foundation clients. The minimum investment in the LLC is $250,000. The minimum time frame recommended for investment in the LLC is two years. The LLC is officially valued at the end of each month. Further information on the LLC is available in our Confidential Memorandum, which can be obtained from **FOUR***POINTS* Asset Management, Inc. The benchmark is the S&P 500 Index. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. A fee schedule is available upon request and is described in Part 2 of the firm's Form ADV. The fund is available to qualified investors only. Accounts are included from the first full month under management. Leverage is not used. Past performance is not indicative of future results. The fund's assets under management as of December 31, 2018 were $24.1 million.

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All returns shown in this publication assume the reinvestment of dividends.

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A complete list and description of FOUR*POINTS* **Asset Management, Inc.'s LLCs is available upon request.**

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