Quarterly Review & Outlook

2Q Review

The U.S. equity market settled down in the second quarter of 2019 after several months of wild swings. In 2018's second half, the S&P 500 benchmark flirted with bear-market territory. Dragged down by big losses in energy and other economically sensitive stocks, it fell 19.4% between Sept. 21 and Dec. 24. Then in the first quarter of 2019, the market snapped back sharply, as the S&P 500 gained 14% and many of the same stocks posted the biggest gains. For the most part things have been much calmer over the past three months albeit still positive. For the quarter, we saw the S&P 500 advance 4.3% with the other market indexes having similarly solid returns.

DCP US All-Cap Review

As the stock market continued to chug higher, we saw the US All-Cap Portfolio continue to participate in the upside. For the quarter the strategy advanced 2.77% and is now up over 15% year-to-date. This is obviously a strong 6-months, however, the strategy has lagged the broader benchmark return which is to be somewhat expected in a hard charging market like this.

The underperformance was driven by our roughly 10% weighting to cash, as well as our underweight to Financial sector which turned in the strongest sector performance for the quarter. Positive contributions were made through our stock selection in the Communication Services and Industrial sectors.

DCP International All-Cap Review

Our International portfolio slightly underperformed the broader MSCI EAFE with a 3.29% return vs. 3.97% for the benchmark. The strategy has also returned over 15% for the year and is outpacing its' benchmark during that time. The underformance was driven primarily by our overweight to Chinese equities. The strategy was helped by strong stock selection in the Industrial sector.

Another Update on the Value Investing Conundrum

There’s never been a worse time in history to be a value investor.

That’s according to an analysis by J.P. Morgan’s chief U.S. equity strategist, Dubravko Lakos-Bujas, who wrote in a note to clients that “value is currently trading at the biggest discount ever, and offers the largest premium over the last 30 years.”

While value investing has historically delivered market beating performance, it’s been a losing strategy since the financial crisis, when stock markets have been driven more by macroeconomic events than company fundamentals, and dominated by fast-growing, technologically innovative companies.

After a decade when such growth stocks have outperformed their cheaper rivals, the median forward price-to-earnings ratio of the cheapest decile of S&P 500 stocks is now trading at 7 times less than the broader S&P 500. “Similarly the relative price-to-book spread of the cheapest vs. the most expensive portfolio is at 9 times,” Lakos-Bujas wrote.

The discrepancy between performance of growth stocks and value stocks has grown so much that even Buffett’s Berkshire Hathaway has been buying up shares of Amazon, a quintessential growth stock, while Buffett regrets not having bought shares himself sooner.

So, is there hope for value as we move forward in the coming quarters?

In our opinion, for Value to make a sustained comeback, the following developments are likely needed:

- regulations that foster competition;
- a stabilization of active manager’s assets under management, relative to passive investing;
- less policy uncertainty;
- Either a reaccelerating of global growth, or a full-blow recession that forces a repricing of growth stocks.

While we are uncertain about the likelihood of these factors, we do believe that reversion to the mean is a powerful force in nature as well as financial markets, and with that being said, it stands to reason that a prudent investor would want at least some exposure to value strategies in the current environment given the state of the current environment.

The team and I at Durand Capital truly appreciate your loyalty and trust. As always, if you have any questions in regard to anything above, or just questions about the strategy in general, please do not hesitate to get in contact.

Sincerely,

Jim Tassoni
President/CIO
Durand Capital Partners