GOLUB GROUP
BUILDING SUSTAINABLE WEALTH
Quarterly Commentary

Q1 2019 Quarterly Commentary – April 1, 2019 A "V-Shaped" Recovery Demonstrates the Value of Investor Discipline

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Global equity markets performed strongly in the first quarter of 2019, a marked turnaround from the prior quarter. Major factors cited for the recovery included "dovish" pronouncements by Fed Chairman Powell, the reopening of the Federal government following a bitter stalemate, and the lack of any further adverse developments in the U.S./China trade negotiations. There is a certain amount of symmetry in the performance of key equity indexes in the most recent two quarters as shown below, the net result of which is that we stand slightly below where we were six months ago in terms of overall market valuations.

Q1-2019 Q4-2018
S&P 500 +13.7% -13.5%
Dow Jones Industrial Average +11.8% -11.3%
NASDAQ Composite +16.8% -17.3%
MSCI EAFE Index (Developed Countries) +10.2% -12.5%
MSCI Emerging Markets Index +9.9% -7.4%

These results offer yet another reminder that markets are inherently volatile, driven in the short term by factors that are hard to anticipate, and for which it is hard to determine if there will be any real, lasting economic impact. They are a reminder that the best course of action in markets that are driven by shifting investor sentiment triggered by temporary events is often to do nothing. Human beings are not wired to sit still when faced with perceived danger, but the errors that investors can make by reacting to news headlines can be substantial and might never be undone. Since 1994, DALBAR, Inc. has published findings of its Quantitative Analysis of Investor Behavior. This study measures the effects of investor decisions to buy and sell in reaction to nine common behavioral impulses, which include loss aversion, herding, regret, media response, anchoring, optimism, narrow framing, mental accounting and diversification. The study concluded that over the 10-year period through 2018, the average equity fund investor trailed the S&P 500 by nearly 3.5 percentage points per year (9.66% vs. 13.12%) due to poorly-timed purchases and sales. In straightforward financial terms, it can be said that impulsive behavior cost the average equity fund investor $916,110 in foregone returns for every $1,000,000 invested over this 10-year period! As overseers of your hard-earned wealth, we keep this lesson top of mind.

Whereas the near-term volatility that we experienced over the past six months is common in the normal functioning of our markets, we know that in the long term, equity markets and individual stock prices are driven principally by the growth of corporate earnings. Higher profits warrant higher valuations, all else constant. Our focus, when thinking about our equity exposures, should therefore be on the growth of profits over time of the companies in which we own shares, and across the economy in general. Most of the rest is noise (We note that the level and direction of change of interest rates is an important factor in equity markets, and while this relationship is somewhat complex, we are also mindful of inflationary pressures in the economy and the dynamics in the bond markets).
On the earnings front, the news was mostly good throughout this recent volatile period. The companies that make up our GGEFX equity portfolio grew their earnings by 21.3% in Q4'18 versus the year-earlier period, and are expected to grow them by 6.9% for the full year 2019 versus 2018. The total market shows similar strength, with S&P 500 earnings up by 14.3% in Q4'18, and earnings for 2019 forecasted to be up by 3.1% over 2018 (Source: Yardeni Research, April 2019). Of this growth we had little doubt, even while stocks were falling during the fourth quarter and the headlines looked bleak. This gave us confidence to stick with our holdings and our strategy, and the price declines provided us with an opportunity to make some productive changes on the margin to the portfolio, which are discussed later in this letter.

We recognize that stock market volatility can be unsettling, and recommend that every client use this experience as an opportunity to test their own appetite for market turmoil. Bond instruments offer an uncorrelated alternative, which as a part of a larger portfolio strategy can make the ride smoother. During the first quarter of 2019, the 10-year Treasury note yield declined by 28 basis points (0.28%) to 2.41%. This decline in rates boosted the bond market. The Barclay's Aggregate Bond Index, a gauge of the domestic market in government and corporate debt markets, rose by 2.94% in the first quarter. Looking back to Q4, bonds demonstrated their importance to accounts with a "balanced" mandate by providing a buffer to volatile equity markets. In that period, the Barclay's Aggregate Bond Index rose by 1.64%. Your Financial Advisor can speak with you further about the risks and benefits of fixed income in a balanced portfolio.

Q1 Portfolio Changes
Please keep in mind, these commentaries should not be construed as a recommendation to buy or sell the securities discussed. Such decisions are made only within the context of the market environment as we perceive it at the time of the decisions and the structure of the diversified portfolio of which the securities are a component.***
During the quarter we initiated new positions in Wells Fargo & Company and Mastercard Incorporated and exited our position in Wabtec Corporation.

Wells Fargo & Company
Wells Fargo is one of the four largest banks in the country and together with its national peers dominates consumer and business banking in the United States.

While the banking business is competitive in nature, we think Well Fargo is protected by an economic moat that stems from its extremely low-cost deposit base, efficient operating structure due to economies of scale, and below average credit costs, which are a result of conservative underwriting practices. We think these unique attributes allow Wells Fargo to earn substantial returns on equity, and consequently return large portion of earnings to shareholders in the form of dividends and share buybacks.

The main overhang on the stock remains the scandals that engulfed Wells Fargo over the past two years. What started with the fake accounts scandal has morphed into a culture and leadership crisis that has already claimed the jobs of two CEOs, several other C-level executives, and many midlevel managers at the bank.

But our research shows that all these issues can be solved over time and that Wells Fargo is committed to addressing them head on. In fact, we have plenty of evidence that Wells Fargo has made considerable progress towards changing its culture and business practices in a meaningful way. Besides replacing most of its leadership, Wells Fargo has changed bankers' compensation, revamped sales processes, refunded customers for unduly collected fees, and settled with plaintiffs and regulators that launched multiple legal actions against the company. While management still has work to do, we expect the company to completely clean house within 1-2 years and turn the page on this unfortunate chapter that has stained an otherwise impeccable track record of superb performance.

We can never be sure when exactly the market will stop worrying about short-term issues and start focusing on long-term fundamentals, but we do know that if investors buy a company at a sufficient discount to its intrinsic value, they are likely to be rewarded over time. We think that for patient investors focused on the long term, Well Fargo offers a terrific opportunity to buy a high quality business that's also becoming more ethical, more customer friendly, with improving corporate culture, at a price that's, in our view, substantially below the intrinsic value of the underlying business.

Mastercard Incorporated
Mastercard is the second largest global payment network and together with Visa, dominates the payments space. Similar to Visa, Mastercard operates a global payment network that connects financial institutions that issue its cards and merchants that accept them as forms of payment. Mastercard charges fees for essentially every transaction from cards with its iconic interlocking red and yellow circle logo.

The company's wide economic moat stems from network effects, efficient scale, high switching costs for network users, and enormous barriers to entry. When it comes to economic moats, Mastercard and Visa are second to none.
But business quality is only part of this fantastic story. Mastercard benefits from a secular shift in the payments world from paper payments such as cash and checks to digital payments such as debit and credit cards. We think this trend will propel revenue and earnings higher over the foreseeable future and will continue to drive shareholder value for many years to come.

After taking a closer look at the company's recent results, we concluded that the stock traded below the intrinsic value of the business, so we decided to establish a new position in this exceptional company.

Wabtec Corporation
Wabtec is a leading provider of systems and parts for locomotives, freight cars, and passenger transit vehicles. General Electric, whose shares we bought in 2018, sold its transportation unit to Wabtec and received a combination of cash and Wabtec shares as consideration in that transaction. General Electric than distributed a portion of these shares to its shareholders and as a result we became shareholders of Wabtec. After taking a close look at Wabtec's business model and future growth prospects to assess its intrinsic value, we concluded that the current stock price isn't attractive enough for us to maintain a position in this name.

Growth in the Team
This investment firm's most important investment is its people, and we are fortunate to welcome five new members to our team. In January, we welcomed Adam Govani to our team of Financial Planning Associates. In February, Sneha Vaidya joined the team as a Client Service Specialist. In March, Alejandra Torres joined our team of Client Operations Specialists. Effective April 1st, we welcome two individuals, Tim Kallas and Brearin Land, to our Business Development team.

Adam Govani joins our team from boutique advisory firm Fountainhead Wealth in Sacramento, where he served as Finance and Operations Associate. He had previously served as a Financial Advisor for Waddell & Reed following his graduation from UC Davis, where he earned a B.S. degree in Psychology. Adam is a native of the San Francisco peninsula, and enjoys spending his free time curled up with a book and his Boston Terrier, Ellie.

Sneha Vaidya joins us from IRA Services in San Carlos, where she served as a primary point of contact with clients and performed a range of back-office tasks. Sneha grew up in Nepal, but came to the U.S. to attend college. She earned a B.A. degree in Business Management from Brigham Young University, and an M.B.A. from International Technological University. Sneha also currently serves in the U.S. Army Reserves as a Chemical, Biological, Radiological and Nuclear ("CBRN") Specialist, and lives in Belmont.

Alejandra Torres comes to us after nearly six years of service with Morgan Stanley, where she was a Client Service Associate. A San Jose native, she graduated from the Leavey School of Business at Santa Clara University with a B.S. degree in Finance and a Minor in Spanish. Away from the office, her passions are competitive dance, physical fitness and travel, and she is a self-described foodie. Alejandra lives in San Jose.

Tim Kallas has spent most of his career in institutional equity sales at firms such as Bear Stearns, JP Morgan, Oppenheimer and Wells Fargo. Previously, Tim served with distinction in the U.S. Army, rising to the rank of Captain in the Infantry. Tim, who resides with his wife Anjie and children in Corte Madera, is an avid fly fisherman and outdoorsman.

Brearin Land comes to us from the Chicago office of TD Ameritrade, where he served as a Senior Financial Consultant. Previously, he founded Irvine Wealth Management and Financial Planning, a firm catering to families in Southern California. Prior to that, he was a Paraplanner for Newport Wealth Advisors. He received a degree in Business Administration from Colorado State University, and is also a first-degree black belt in Jiu-Jitsu. He lives in San Mateo.

Golub Group