GOLUB GROUP
BUILDING SUSTAINABLE WEALTH
Quarterly Commentary

A Challenging Year in Perspective

Quarterly Commentary – January 1, 2019
Golub Group celebrated our 15-year anniversary on December 1, 2018! We are grateful to you, our clients, for helping us turn a vision into a reality by offering us your trust. We are grateful to our team, who have seen in Golub Group and our clients something special, worth the commitment of their time and careers. We are grateful to Michael Golub, who offered his experience and wisdom from the firm's founding to his passing in 2016. What we are today was his vision for the firm, and we know he would be proud.

Other than reaching this milestone, 2018 was a difficult year, to say the least. The markets, as measured by the total return, including dividends of the Dow Jones Industrials, the S&P 500 and Nasdaq Composite, lost -3.5%, -4.4% and -2.8% respectively. The fourth quarter was particularly challenging, with results measured on the same basis of -11.3%, -13.5% and -17.3%. We haven't touched "official" bear market territory, but it feels like it, with 68% of stocks within the S&P 500 down by over 20% from their previous highs at year end. The only thing remotely positive that can be said about the year is that it could have been worse: U.S. markets soundly beat foreign developed and emerging market indexes. The MSCI World Index (developed countries) lost -8.2%, and the MSCI Emerging Markets Index declined by -14.5% for the full year.

Bonds treaded water during the year, as signs of a slowing economy kept a lid on long-term interest rates, even as the Federal Reserve moved to increase rates at the short end of the yield curve. The Barclay's Aggregate Bond Index returned +.01% for the year, and +1.64% in the fourth quarter. We believe the results demonstrate the value of bonds in a portfolio, offering a counterweight to volatile equities for those who need or want one.
Difficult China trade negotiations, a government shutdown over a controversial border wall, the prospect of impeachment proceedings under the new Congress, and similar polarizing issues have put

Wall Street in a sour mood. Further, while most economic indicators are showing continued expansion, the rate of growth has slowed. Markets have taken note of this change and have priced in an increased risk of recession. Recent comments from Fed Chairman Powell and Treasury Secretary Mnuchin did nothing to assuage these concerns. The driver of market weakness was, in its simplest terms, “bad news.”

In a New York Times op-ed published in the depths of the global financial crisis in December 2008, Warren Buffett remarked, “…bad news is an investor’s best friend.” It’s a curious comment, but he explained what he meant later in the piece: “It lets you buy a slice of America’s future at a marked-down price.” What we are going through now is nothing like what we all experienced in 2008, in terms of a threat to the global financial system, but it is the first time since the recovery and economic expansion began that we’ve flirted with a bear market . We are going to take Buffett’s advice and see the current environment as a gift, and use it to our advantage.

Those of you who have been with us for a large part of these past 15 years know that we tend to see the U.S. and world economies through a positive lens, and have nearly always favored a substantial exposure to equities for clients with time horizons of over a few years. We sometimes risked looking like Pollyanna, particularly in times of market stress, but we have had good reason to embrace an optimistic –long-term outlook for stocks. On the day that this firm opened its doors in December 2003, the Dow Jones Industrial Average and S&P 500 stood at 9,899 and 1,070 respectively. Over the succeeding 15 years through 2018—a period that included the worst financial crisis since the Great Depression—these indexes have offered returns of +244% and +219% respectively, including dividends (8.5% and 8.0% annualized). This growth in the markets is not simply happenstance. Equity markets have been driven by fundamental economic factors. Since this firm’s founding, U.S. gross domestic product (GDP) has risen by +75% to $20.7 trillion, global GDP is higher by +108% to roughly $40 trillion, after-tax profit margins among U.S. corporations increased from 6.9% in 2003 to 9.6% in 2018, and S&P 500 earnings per share rose over this period by +171%, from 54 in 2003, to 146 in 2018. We know the economy goes through periods of strength and weakness, and the markets frequently move in unpredictable ways, but we are simply not going to lose faith in our economic system, which is designed to encourage wealth creation and reward owners of productive assets.

We believe equities by their nature offer an attractive means for compounding wealth over time because they represent ownership in productive assets that grow and compound themselves when managed well. Building wealth in stocks is not complicated, but the key to compounding wealth through them is discipline—the discipline to own intrinsically solid companies, the discipline to pay only reasonable prices for them, the discipline to diversify portfolio exposures and make investment decisions that are consistent with an investment policy that is appropriate for one’s true time horizon and risk tolerance, and the discipline to always take emotion out of the equation.

We don’t know if the market volatility we have experienced over the past several months has passed, or if there is more in store. In the New York Times op-ed discussed above, Buffett also admitted that as of December, 2008, he hadn’t “the faintest idea as to whether stocks will be higher or lower a month — or a year — from now.” He warned, however, the markets would recover well before the economy or sentiment did. We suggest that rather than try to predict when the bad news will pass, stick with the discipline to which you have committed and focus on the long term. We’ll be here to talk to you about your goals and put the investing into its proper context.

Q2 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 took advantage of market volatility and shifted our exposures among existing holdings. It was a very active time for our research efforts, and in the process exited a position in Colfax Corporation.

Colfax Corporation

Colfax is an industrial manufacturing company with two business segments: air and gas handling and fabrication technology. While both segments benefit from solid competitive advantages and are leaders in their respective industries, when we first initiated the position, we believed that the air and gas handling was punching below its weight due to tough end market conditions and weak execution by management. Our research showed that these were temporary issues that should correct over time. In addition, we expected the company, which we thought was led by sound capital allocators, to grow the business through accretive acquisitions that would create value for owners over the long run.

Unfortunately, Colfax recently surprised us by announcing a large deal to acquire a healthcare company called DJO Global, proposing to fund this acquisition by selling the air and gas handling segment and issuing new equity. Our research of the proposed acquisition raised several questions about the strategic rationale behind the deal as well as additional risks for Colfax shareholders. We were also disappointed by management's decision to raise equity at the current stock price to fund the purchase. After considering this new information, we concluded that our investment thesis for Colfax was broken and we decided to exit the position.

New to the Team

During the quarter, we were fortunate to have three really exceptional individuals join our firm. Aaron Szager, CFP® has been named Advisor Group Manager. We have grown to the point where the advisory practice would benefit from having additional structure and leadership, and our search led us to Aaron. He comes to us from BlueSky Wealth Advisors, where he managed the firm's Bay Area office. Aaron has expertise in tax planning, stock-based compensation, cross-border strategies, real estate and other key planning areas of great value to our clientele. He graduated with a BS in Business Management and Finance from Salisbury University in Maryland, and is a Certified Financial Planner®. He has hit the ground running, and is already having a great impact on our service offering.

We're also thrilled to welcome Mandy Pham, CFP® as a Financial Advisor for the firm. Mandy comes to us from Houston-based Stavis & Cohen Financial, where she managed relationships with about 30 high-net-worth families, the majority of whom were corporate executives and small business owners. Among her areas of expertise are wealth transfer strategies, family limited partnerships and philanthropic endeavors. Mandy graduated with a BA in Economics from Colorado State University and an MS in Personal Financial Planning from Texas Tech University. She is a Certified Financial Planner® and has passed all three rigorous examinations to qualify for the Chartered Financial Analyst designation. A native of Hanoi, Vietnam, she has a fascinating personal story. Ask her when you have the chance.

Jack Zhao joined our research team during the quarter as an Equity Analyst. We consider ourselves lucky when we add someone like Jack with his deep experience and solid credentials. Jack has a BS in Operations Research & Information Engineering and a BA in Economics from Cornell, where he graduated Magna Cum Laude in 2009. He has MBA from the University of Chicago Booth School of Business (2018), where he concentrated on Accounting, Finance and International Business. Jack's experience in our industry includes research positions with a number of well-regarded institutions, such as Aberdeen Asset Management, Bessemer Trust, Wells Capital and Madison Investments. Bringing new ideas and perspectives to the research effort is always a plus, and we expect Jack will play a major role in broadening out our investment offerings as we grow as an institution.

Thank you again for entrusting our firm with the role of financial advisor to you and those for whom you are responsible. We understand that you need us to come through for you during both good times and difficult times, but particularly during the latter, when uncertainty prevails and it can be harder to maintain one's resolve. We will be reaching out to you, as always, but encourage you to use us as a sounding board on all matters of finance and the markets.

***The securities identified do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable.

Kurt Hoefer, CFA®

Partner