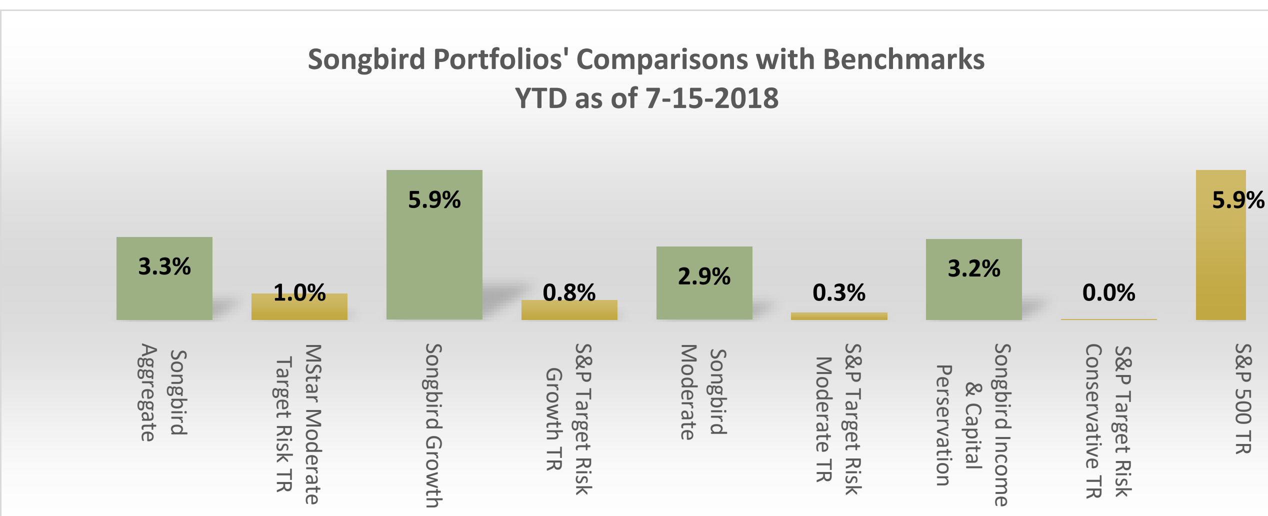
Songbird Capital Research
2018 Midyear Letter and Market Commentary

Songbird Performance Review: Songbird delivered an asset weighted return of ***3.3%*** net of fees in aggregate year-to-date as of July 15th, 2018, outperforming Morningstar Moderate Target Risk return of ***1%*** (gross return). Songbird's Growth Portfolio composite returned ***5.9% net of fees, achieving the same gross return as S&P 500 in the same period.*** Songbird Moderate Composite gained ***2.9%*** and Income & Capital Preservation Composite rose ***3.2% both net of fees.***

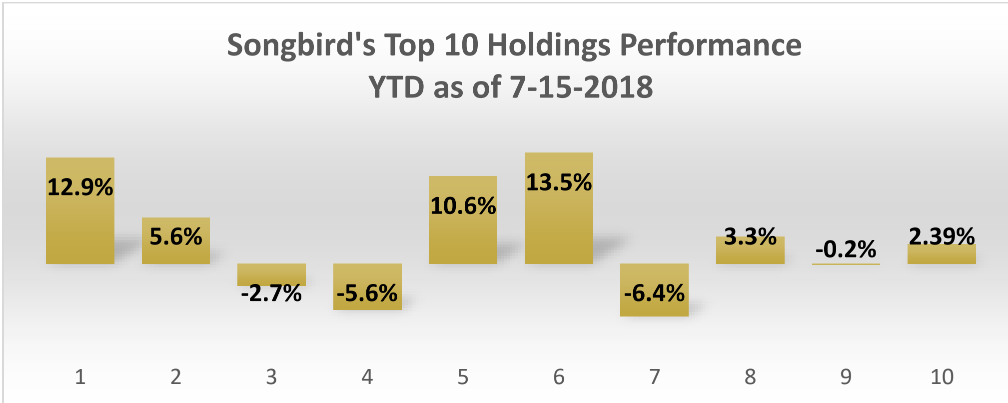
Allocations to growth equities was the major driver of the performance across all portfolios. However, fixed income and international equities allocations detracted from the performance as rising interest rates drove fixed income prices down in two consecutive quarters and international equities, particularly emerging market equities were under pressure in the second quarter due to the rising US Dollar and uncertainties created by US tariffs. Songbird Income & Capital Preservation portfolios slightly outperformed Songbird Moderate portfolios, mainly due to larger allocation to international equities in Moderate portfolios. However, we see more positive outlook for international equities in the second half in 2018 as the strengthening in US Dollar could be temporary and future clarity on trade negotiations and avoiding full blown trade war will provide continued confidence in the international equity investing. (See Chart below for top 10 holdings performance as of 7-15-2018.)

Songbird bought in oversold sectors, such as REITs, after it went down over slightly over 8% in the first quarter. It has gained almost 9% in the second quarter.



Data sources: Charles Schwab, Morningstar Office and Songbird Capital

Notes: Songbird Aggregate composite combined all fee paying discretionarily managed accounts by Songbird. Songbird Growth, Moderate and Income & Capital Preservation (formerly Conservative) composites are sub-composites made up of the managed accounts based on defined risk tolerance and return objectives. All benchmarks are in gross returns.



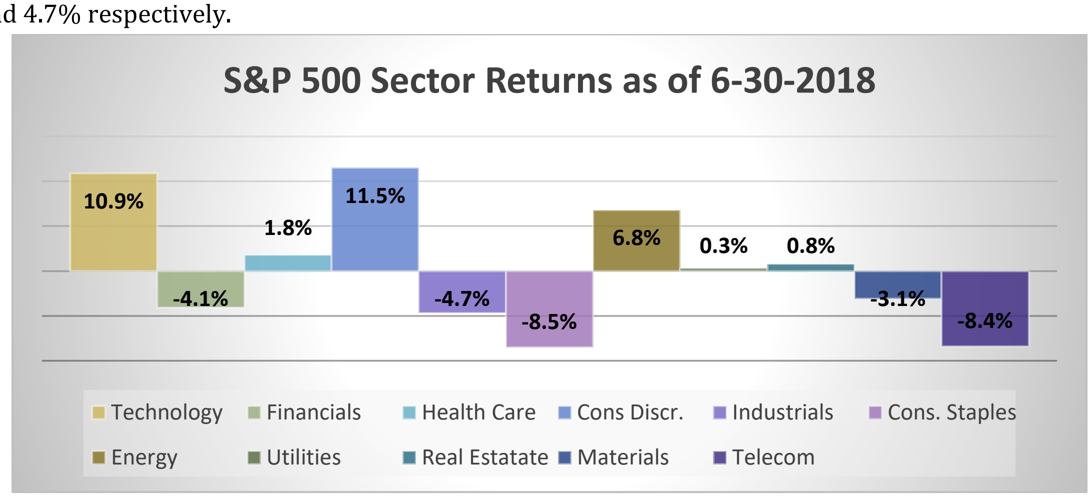
Top 10 Positions from Largest to Smallest

Data sources: Charles Schwab, Morningstar Office and Songbird Capital

2018 Midyear Market Reviews:

- **US Equities – T**he S&P 500 delivered a total return of ***5.9%*** year-to-date as of July 15th, 2018. Growth equities continue outperforming value equities by a large margin. The first half of 2018 also saw a large dispersion in performance among S&P sectors. Technology and Consumer Discretionary led the performance, up 10.9% and 11.5% for the year, contributing almost all S&P 500 returns so far in 2018. Consumer Staples had the worst performance, down 8.5%, followed by Financials and Industrials, both down 4.1% and 4.7% respectively.

- **Growth stocks continue outperforming value stocks** in the first six months in 2018 with nearly 13% difference in performance. Songbird's clients' portfolios benefited from the trend. However, we see small cap growth is trading 26% premium against its 20-year average P/E vs small cap value P/E is at 3% discount to its 20-year average. At this juncture, small growth could be more vulnerable to correction than small value.

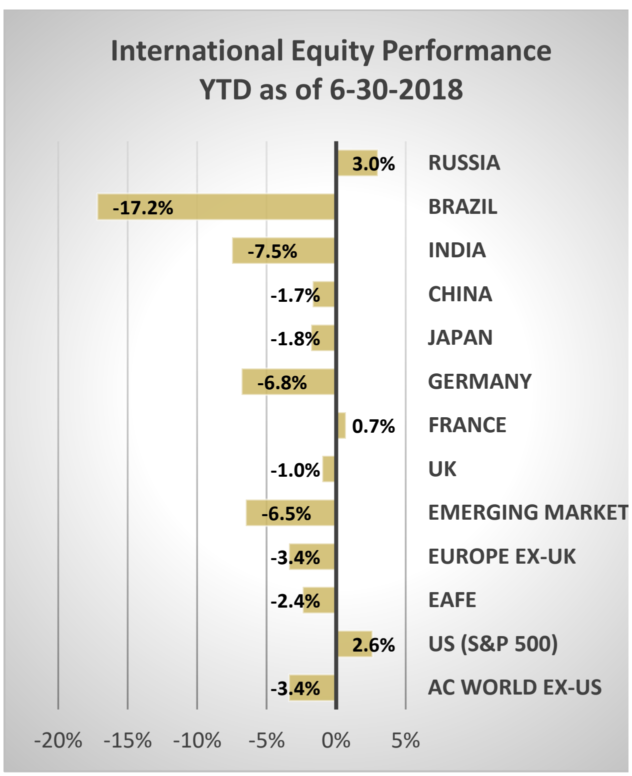


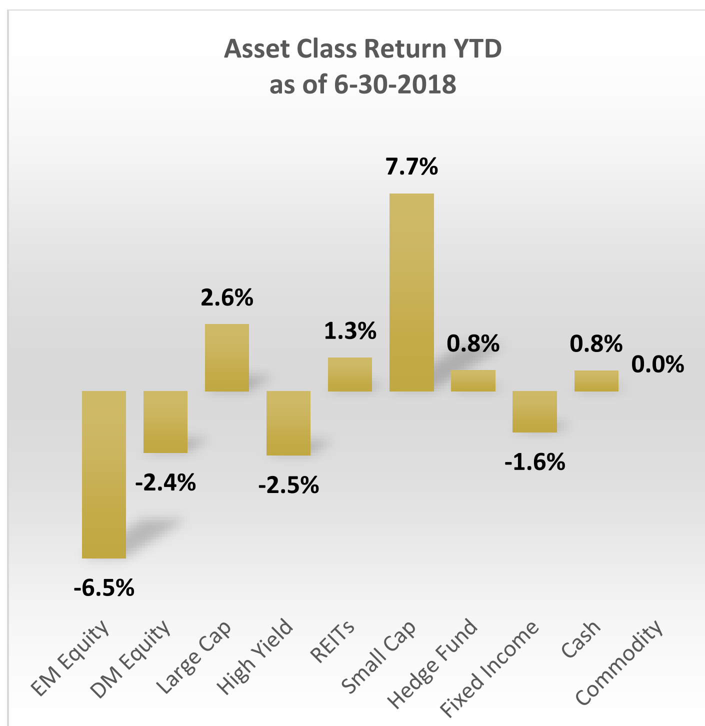
Data sources: Standard & Poor's, JP Morgan AM, Morningstar and Songbird Capital

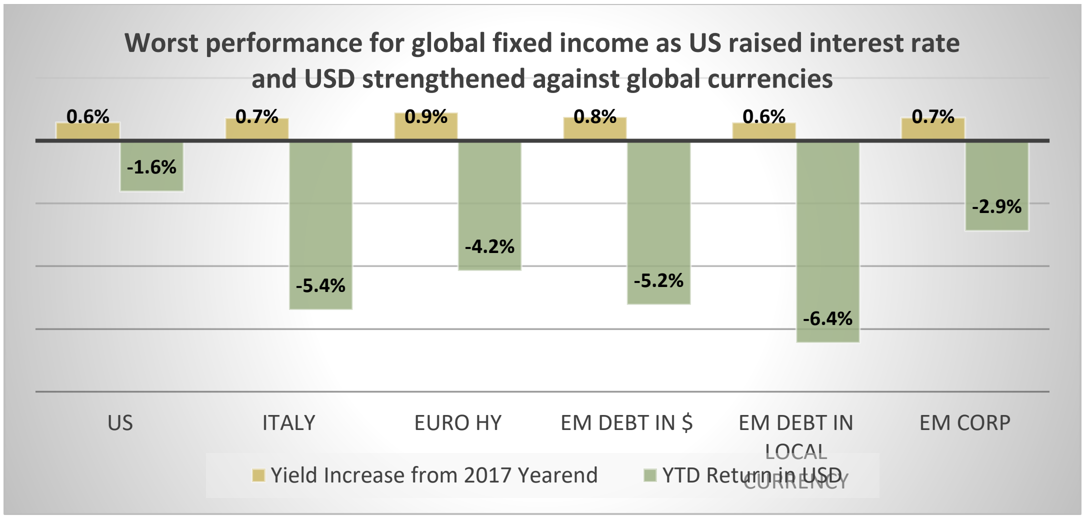
- **International equities** - ***Rising US dollar combined with increasing uncertainties induced by potential trade war caused underperformance among international equity markets.*** On the back of strong performance in 2017, international equities were mostly down, particularly emerging market equities which were under pressure from the rising US dollar and commodity prices. Despite solid fundamentals in global economy, international equities took a pause in face of uncertainties induced by potential trade war. We may see a rebound in international equities in the second half of 2018.

- **Global fixed income** – ***US 10-year Treasury yield ended at 2.85% as of June, up 0.45% from 2017 yearend. Global fixed incomes had worst performance in three years, particularly for emerging market debt as rising interest rate in the US and strengthening US Dollar had large impact on international fixed income performance.*** On the positive note, the fundamentals in EM remain solid and the US dollar is strengthening, which could be temporary. With low yields and increased durations across developed countries, managing duration risk and being selective are key to fixed income investments at the current juncture of the market cycle.

- **Alternative Investments** such as Hedge Funds, REITs and Commodities (except Oil which rallied 20% in the first 6 months) were flat to slightly positive outperformed international equities and fixed income. However, they underperformed against US equities. REITs fell over 8% in the first quarter, we took the opportunity and increased our allocation to REITs as we believe that in current tighter labor market and rising inflation, REITs may benefit from rising rents more than detracting from rising interest rate.







Data sources for 3 charts above: Barclays, Bloomberg, Russell, Standard & Poor's, MSCI, NAREIT, Morningstar, Songbird Capital. EM Equity (MSCI EME), DM Equity (MSCI EAFE), Large Cap (S&P 500), High Yield (Barclays Global HY Index), Small Cap (Russell 2000), Fixed Income (Barclays Aggregate) and Commodity (Bloomberg Commodity Index), Hedge Fund (HFRI Asset Weighted Composite)

Investment Outlook:

At the beginning of 2018, the whole investment community was cheering for global synchronized growth which had been unseen since the great recession, the S&P 500 rallied over 7.5% in January before it gave back all the gains and was down 3% for the year in mid February. The optimistic sentiment was quickly shifted by uncertainties and spike in volatility at the end of January. A lot has happened in the first 6 months this year: Jerome Powell sworn in as the new Fed chair in February, two interest rate hikes in March and June with two more coming by yearend. The recent tariffs proposed by Trump administration on foreign imports created uncertainties for international markets and have negative impact on US products as well as they may potentially raise prices for US consumers as the result of higher costs, creating inflation for an already slow growing economy.

In near term, global equities supported by strong corporate earnings will move higher in the remainder of 2018 if the current trade disputes don't turn into full blown trade war. A few weeks into retaliation tariffs imposed by China, US farmers who have suffered pain from inability to sell their products and are demanding free market not subsidies from US government. There is no sign that China will tolerate further tariffs imposed on Chinese products without retaliatory measures. Trump administration may have to change its tactics on handling the trade issues. Any change in trade stance will bring market relief and rally.

In medium term, US earning's growth is peaking in the third quarter and will start to decelerate, while commodity prices are rising. US economy is entering late cycle in economic growth. The volatility in both equities and bonds is expected to increase while the return expectation will come down particularly relative to the previous 10 years. Historically, bonds have been a very good diversifier to a mixed equity and bond portfolio. In a rising interest rate environment, bonds will increasingly face downside risks. As an asset allocator, I believe that being able to diversify across regions, asset classes and even different segments of the market, a portfolio can not only participate the investment opportunities when they present, but also protect the overall portfolio from risk concentration.

In long term, the US fiscal outlook becomes more troublesome. The rising debt to GDP as the result of the combination of tax cuts and spending will eventually put pressure on interest rate. High debt burden can also impact spending both at private and public sectors and drag down economic growth.

What is the role of cash in investment portfolios? Have we thought about tradeoffs between cash and other investment options?

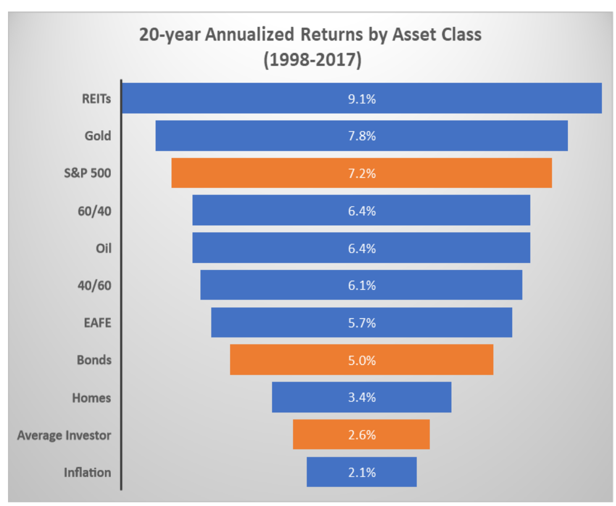
Every time I spot a large quantity of cash in prospective clients' portfolios beyond their one year's cash needs, I always ask their reasons for holding such a large amount of cash. Most often the answers are protecting them from another financial crisis or they are waiting for a good market entry point or just not sure what they should do with it.

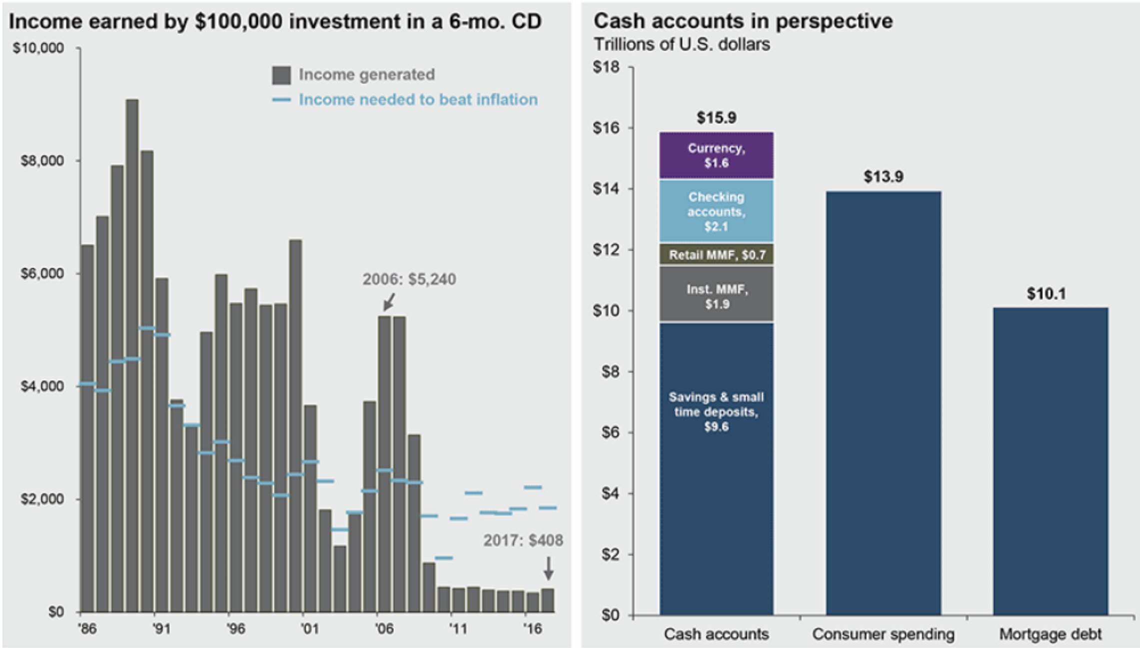
Cash drag is one of the reasons that despite the strong US equity market (S&P 500 returned 302% since March 2009 and 75% since prior peak in October 2007) in the past decade a lot of investors have not been participating.

What is the cost for holding cash? Looking at the chart on the next page shows that the short-term cash yield 0.4% in the past few years and average inflation is 2% for the same period, the investors' net loss in purchasing power is 1.6% by holding cash. Currently, the various cash accounts in the US stands at $16 trillion, while the outstanding mortgage debt is $10 trillion. To put $16 trillion into perspective, it represents over 50% of the total US stock capitalization, which is approaching $30 trillion. Although the cohorts of cash owners and mortgage debtors are different, we can argue that collectively the total available cash is 1.6x larger than outstanding mortgage debt.

According to the research firm DALBAR Inc. (See chart below), in the past 20 years from 1998 to 2017, S&P 500 annualized return has been 7.2% (including the lost decade from 2000 to 2010 when S&P 500 returned merely 0.4% per annum), bonds returned 5%, US Homes 3.4%, while average US investors have only made 2.6% per year, slightly above inflation rate of 2.1%. Clearly this is the result of poor investment decisions, including chasing returns in individual stocks resulting in buy high sell low, or holding a large amount of cash for long term which earns below inflation rate. These decisions can affect long term investment results. For example, a million-dollar portfolio that earns 2.6% per year vs 5% will result in missing almost $1 million earning in 20 years.

The investment choices do have serious consequences that affect our long-term financial well-being.





Source: FactSet, J.P. Morgan Asset Management; (Left) Bankrate.com; (Right) BEA, Federal Reserve System.
Cash accounts and consumer spending are as of 5/31/18 and mortgage debt is as of 3/31/18. M2 includes M1 (currency in circulation and checking accounts) plus savings deposits, small-denomination time deposits and retail money market mutual funds. Institutional money market funds are considered a memorandum item, not included in M2. Annual income is for illustrative purposes and is calculated based on the 6-month CD yield on average during each year and $100,000 invested. Past performance is not indicative of comparable future results.
Guide to the Markets – U.S. Data are as of June 30, 2018.

J.P.Morgan
Asset Management

Songbird Capital has institutional experience in portfolio and risk management and is specialized in asset allocation across multiple asset classes and strategies. We provide valuable services for investors by capturing investment opportunities while navigating risks and staying invested. ***Songbird's competitive fees in the industry always helps our clients to keep more along the way. (See Songbird fees against industry average and "Savings from fees compounded over 20 years" on our website) .***

Sincerely Yours,

Jie Hayes / Principal of Songbird Capital

Disclaimer:

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