Commentary and Looking Forward

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Q2 of 2019 was marked by another tumultuous period with the market suffering through a tough May, only to rebound in June and end the quarter on a positive note. Much if the tumult experienced during the quarter was self-inflicted and tough negotiations with our trading partners, in this case specifically with tariff talk surrounding imports from Mexico. Thankfully cooler heads prevailed and the tariffs on Mexican imports were avoided.

The surge in the first half of the year can be primarily attributed to the bounce back from an oversold market in the 4th quarter of 2018, combined with solid economic numbers. The oversold condition was caused by an irrational fear of tariffs and of the economy rolling over, once good economic numbers revealed themselves, the market coarse corrected higher. But let us be clear, small cap stocks remain approximately 10% below the highs achieved in September of 2018, which means there is room to run on the upside.

In order for the market to make any meaningful growth in the near term, just one thing has to happen, the Fed must lower rates by at least a quarter of a percent. In the longer term the economy mustn't turn negative. We expect to see continued growth in the small cap market segment as small caps begin to close the relative underperformance gap to large cap stocks that has opened during the past nine months.

Regarding all that talk of recession you hear ion financial news sites, we're far more optimistic. We do see the economy taking a small hit from the tariffs but not enough to derail the economy. That said, the portfolio is positioned well to handle the noise as it tends to be less volatile than the small cap market segment. Historically the strategy has captured about 90% of the upside while only capturing about 75% of the downside of market moves, we believe this dynamic will persist and be beneficial to our clients as the market fluctuates.

Portfolio Review

During the quarter the Small Cap strategy gained a respectable 5.58% versus a 2.77% return for the Russell 2000 Growth and 2.11% for the Russell 2000 Index. Much of the positive returns were the result of the portfolio performing exceptionally well during the tumult experience in May. In May the portfolio declined 3.92% significantly outperforming the Russell 2000 Index which declined 7.77% and the Russell 2000 Growth which declined 7.42%.

Technology Services, Commercial Services and Health Technology aided relative performance most, while holdings in the Producer Manufacturing, Electronic Technology, and Retail Trade constrained relative portfolio performance. At the end of the quarter, the portfolio was most overweight in the Consumer Services, Electronic Technology, and Utilities sectors. The Portfolio was most underweight in the Health Technology, Producer Services and Consumer Non-Durables sectors relative to its benchmark.

From an individual holdings perspective, Paycom Software (PAYC), NV5 Global Inc. (NVEE) and Wingstop (WING) contributed most to positive performance, returning 19.88%, 37.13%, and 24.75%, respectively, during the quarter. While World Wrestling Entertainment (WWE), Duluth Holdings (DLTH), and Echo Global Logistics (ECHO) declined the most -16.66%, -37.50%, and -15.98%, respectively, during the quarter.

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There was some notable turnover during the quarter as the portfolio trimmed its position in Paycom again by 3%. This gain was offset by eliminating positions that did not work out to our expectations, namely Duluth Holdings was eliminated as well as Echo Global Logistics. As of the writing of this quarterly summary, the portfolio remains holding loss carry forwards despite the significant gains made in the first half of 2019.

Regards,

Michael J. Borgen

Founder & CIO

Sapphire Star Capital LLC

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