



Commentary

With the 1st half of 2020 in the rearview, the market continued its march higher in July and August with US equities reaching a new record high on September 2nd. Shortly thereafter we saw the return of the “September Swoon” which has historically resulted in a challenging month for stocks. Even with the negative month, the economic recovery remained on track during the third quarter as business and consumer confidence gained momentum and macro data saw continuous improvement. Unemployment numbers continued to fall during the quarter and market returns were overall positive, although a bit less so than the rebound that we saw in the previous quarter. Despite this backdrop of dystopia including COVID-19 uncertainties, looting, riots, protests, election, and economic uncertainties, etc., the optimism of investors seemingly continues to rebound extending the equity markets V shaped recovery. Optimism could also be seen in the form of skyrocketing home prices for all housing types in all regions of the United States which during the month of August were up 11.4% and home sales were up 10.5% from August 2019¹. Actions by the Fed Chair Jerome Powell to lower interest rates has spurred a boom in housing which should help to offset weak recovery in industries that have been challenged due to COVID. Consumer Confidence increased and retail sales and food services for August 2020 were 2.6% above same sales in August 2019². Q3 2020 as measured by the VIX trended down for most of the quarter but spiked at the beginning of September reminding us that volatility especially that of the 2020 varietal should not be ignored as it can rear its ugly head at any time and therefore the proper insurances should remain in place. With COVID-19 and US Election uncertainty still dominating the news headlines as well as the talk at the new normal virtual water cooler we look to navigate the remainder of 2020 with cautious optimism.

Portfolio Review

The Sapphire Star Small Cap Strategy was able to capitalize on the upwardly biased market we saw during the 3rd quarter returning 8.39% versus a return of 7.17% for the Russell 2000 Growth and 4.62% for the Russell 2000 Index. During the quarter, the portfolio benefited from both sector allocation and stock selection effect, with sector allocation aiding the portfolio the most. Holdings such as TechTarget (+46.39%), Lithia Motors (+50.80%), and Meritage Homes Corp (+45.02%) aided the portfolio the most from a holdings perspective while Winnebago (-22.26), LPL Financial Holdings (-1.91%), and Smith Micro Software Inc. (-16.37%) did not live up to our expectations. Since the end of the quarter, we have eliminated Smith Micro Software from the portfolio. By the of the quarter, the portfolio was most heavily weighted in the electronic technology, health technology, and consumer services sectors, while most underweight in the non-energy minerals, industrial services, and energy minerals sectors. Small Caps have continued to trail large caps year to date however, this underperformance will not last forever and small caps will again demonstrate their dominance in producing powerful positive returns. Remember, successful small caps have a much longer runway of performance as they grow from small cap to eventually large cap stocks.

¹ <https://www.nar.realtor/research-and-statistics/housing-statistics>

² United States Census Bureau



Looking Forward

With Q42020 well underway it is certain to be an eventful and volatile ride to close out the year. Uncertainty regarding the US Election, the ongoing process of developing vaccines and therapies for COVID-19, labor market recovery and the small hope of an additional stimulus are and will be the key drivers during Q4 and beyond. As of writing this, we feel that the recent rise in COVID cases or the coming of the second wave should not materially impact the recovery given the optimism that we have seen in the equity markets to date. We continue to believe that the outlook for small cap stocks is very positive with record low rates and a mega cap market that looks to be overvalued especially when compared to that of its small cap brethren. We also see an American economy that is consistently improving which should be very beneficial to small cap stocks, as we have seen to be the case historically. In addition to that the decision by the fed to keep long term rates low seems to suggest that equity prices have the fuel needed to keep climbing higher.

As always, we welcome any questions or concerns you may have and appreciate your continued confidence in our small cap strategy.

Regards,

Michael J. Borgen

Founder & CIO

Sapphire Star Capital LLC

Meghan N. Chicoine

COO & CCO

Sapphire Star Capital LLC

Disclosures:

Sapphire Star Capital LLC is a registered investment adviser and the information contained herein has been prepared by Sapphire Star Capital LLC. Such information is obtained from and based upon sources believed to be reliable, but accuracy cannot be guaranteed. Sapphire Star Capital LLC and its affiliates and representatives disclaim all liability for any inaccuracies and omissions contained in these materials. All opinions and estimates constitute Sapphire Star's judgement as of the date of the creation of these materials and are subject to change without notice. Information presented is not intended to be an offer of solicitation for the sale or purchase of any securities, investments involve risk and are not guaranteed. Any decision to purchase securities mentioned herein must consider existing public information on such security. Projections contained herein are based on a variety of estimates and assumptions and there can be no assurance that the assumptions made in connection with the projections will prove accurate, and actual results may differ materially. Past performance is not indicative of future results.

7826 Leary Way NE
Suite 201
Redmond, WA 98052
Phone: 425.576.4083