Q2 2021

Commentary

The second quarter of 2021 saw the major economies of the world roaring back, resulting in a historic and unprecedented economic turnaround following a global catastrophe of this magnitude. We see a strong U.S. economy with U.S. company earnings YTD among the best ever recorded. Pent-up consumer demand and robust household balance sheets contributed greatly to the cyclical stock rally providing a tailwind for areas of the market that were the hardest hit throughout much of the pandemic. Many companies used the crisis to adapt, innovate and improve operations, technology and analytics. The stark contrast of growth vs. value stocks began to fade during the quarter and U.S. stock market volatility fell to 2019 pre-pandemic levels. With effective vaccines and the easing of restrictions it is our view that we will continue to see robust growth for the remainder of 2021 and well into next year. In fact, in early April, the International Monetary Fund revised its growth estimates significantly higher with the expectation that the US economy will expand 6.4% vs their original forecast of 3.1%.[1]

Portfolio Review

The Sapphire Star Small Cap strategy continued to perform well during the 2nd quarter of 2021 gaining 6.01% net versus 4.54% for the Russell 2000 Index and 3.74% for the Russell 2000 Growth Index. At the end of Q2 electronic technology, retail trade and the health technology sector comprised the top three sectors in the portfolio, while the portfolio was least weighted in utilities, process industries, and the miscellaneous sector. From a holding's perspective Intellia Therapeutics Inc. was again the top performer gaining 101.74%, followed by Wing Stop 24.08%, and Audio Codes 22.65%. Lithia Motors, Inc. (11.83%), Jounce Therapeutics, Inc. (33.79%) and Fabrinet (9.84%) were the three holdings that hindered portfolio performance the most. From an attribution analysis viewpoint, stock selection accounted for 100% of the out-performance as sector allocation slightly hindered portfolio relative performance. Digging down deeper the holdings in the health technology, technology services, and electronic technology sectors aided the portfolio the most. More specifically it was the biotechnology sectors and particularly Intellia Therapeutics that drove the out-performance. Due to the great performance experienced during the quarter, we had to trim Intellia Therapeutics back down to 2.6% of the portfolio for risk management purposes. The three sectors that hindered relative performance the most included retail trade, consumer durables and transportation sectors. Specifically, in the retail trade sector it was in the specialty stores industry with Lithia Motors digesting some of the gains from the first quarter of 2021.

Our benchmark outperformance during Q2 did not come easy as the benchmarks held the fundamentally inferior "meme stocks" such as AMC Entertainment Holdings which gained an astounding 455.14% during the quarter. Despite having a stand-out quarter, and year so far, you will never see "meme" stocks in our portfolio as they simply do not pass the second part of our investment process; fundamentals. In order to make it into our portfolio a stock must possess an attractive reward to risk

[1] International Monetary Fund, World Economic Outlook Database, April 2021.

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profile, have solid quality fundamentals, and finally mix well with the other holdings of the portfolio through our optimization process.

Looking Forward

Looking ahead to the end of the year and taking into account the continued reopening, existing household savings buffers, and likely more stimulus we remain pro-risk on a strategic basis. However, we also feel that rising cost pressures, transitory inflation and market volatility make it very important to diversify among sectors and companies. As you may recall, during the second half of 2020 we began to increase the portfolio's allocation to economically sensitive cyclical "value" stocks. As we look ahead now to the second half of 2021, we do believe that small cap value still has room to run and will continue to benefit from the economic reopening. That being said however, we believe a careful balance between value and growth is necessary as long-term growth trends are alive and well. With a market midcycle on the horizon we will look to quality stocks as they tend to perform well during these periods. Finally, August is generally a weak month for the markets due to many on Wall Street taking extended summer vacations. In my experience August has been a catalyst in creating highly attractive buying opportunities within the markets which we look forward to participating in.

As always, we welcome any questions or concerns that you may have and appreciate your continued confidence in Sapphire Star.

Regards,

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