SEIZERT CAPITAL PARTNERS

DIRECTIONS

A PERIODIC PUBLICATION OF STOCK MARKET INSIGHTS AND OBSERVATIONS

Investment opportunities tend to arrive during times of controversy, when parts of the market fall out of favor, or in periods of panic and fear. One of these may be occurring right now, with growth indices outperforming the value indices by the widest margin in almost two decades.

	Year to Date Return	1 Year Return
Russell 1000 Growth Index	7.3%	22.5%
Russell 1000 Value Index	-1.7%	6.8%
Russell Midcap Growth Index	5.4%	18.5%
Russell Midcap Value Index	-0.2%	7.6%
Russell 2000 Growth Index	9.7%	21.9%
Russell 2000 Value Index	5.4%	13.1%

Source: Factset; Data as of June 30, 2018

Exchange Traded Funds (ETFs) and Passive Investing

Improvement in some economic indicators coupled with the lagging performance in value stocks has seemed to lead investors to favor ETFs, passive investment vehicles and growth stocks. As investors add to market capitalization-weighted index funds, the prices of the largest weighted and potentially most expensive stocks are pushed higher. While investors continue to pull capital from actively managed funds and add to passive vehicles and ETFs, we have a growing concern about the unintended consequence of a large number of funds taking the same positions. According to Alliance Bernstein, there are only 788 U.S. stocks with a market capitalization over $5 billion, but there are 1,808 ETFs chasing them. Assets in these ETFs have tripled in value in roughly 18 months to $1.9 trillion, according to Oak Tree Capital Management. It is unknown how the underlying securities in ETFs and funds themselves will perform if investors are forced to sell in a difficult market.

Sector Analysis

Some of the largest price gains within passive vehicles have come from information technology stocks. Empirical Research Partners stated that Facebook, Apple, Amazon, Netflix and Google as a group have added $300 billion in sales over four years and have as much brand equity as the top 50 consumer brands combined. We first wrote about these stocks in the fourth quarter of 2015, summarizing a year when these five stocks accounted for 140% of return in the S&P 500. Their combined profits now account for a greater share of total corporate profits than all the large cap Consumer Staples companies and these stocks are widely owned among ETFs.

Economic improvements have also flowed through to the Energy sector as oil prices moved higher. Just three years ago, oil prices were in an accelerated decline as the growth in U.S. fracking flooded the market with excess oil. Over time, the glut was reduced as production cuts from the world energy producing countries soaked up the excess supply fueling growth in the Energy sector. The reduction in supply drove oil prices higher, providing economic incentive for management teams to resume spending on capital projects.

Bank stocks underperformed during the quarter as the shape of the yield curve and loan growth became a concern. Strong capital ratios and the positive news of the U.S. bank stress tests were not enough to push bank stocks higher during the quarter. In the final days of June, most banks passed the final Comprehensive Capital Analysis and Review (CCAR) tests, clearing them to return capital to shareholders in the form of increased dividends and share repurchases. Only Deutsche Bank failed the stress test; Goldman Sachs and

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Morgan Stanley were ordered to freeze their dividends and share repurchases until their capital ratios were strengthened. While the overall sector results were positive, the flattening yield curve may present a challenge for banks in the future.

Economic Implications

Since the Trump administration's trade spat with China began in March, the market was largely unaffected until the end of June when investors became concerned about the future implications from the dispute. The dispute impacted stocks when Chinese courts blocked sales of Micron Semiconductor products in China, spreading concerns to other chip manufacturers. On June 15th, 2018, the Trump administration hit Chinese products with tariffs of 25%, worth $50 billion. The Chinese retaliated with their own tariffs on U.S. goods of equal size. Just three days later, the U.S. trade representative was instructed to draw up another list of goods worth $200 billion that would face tariffs of 10% and threatened tariffs on an equal sized basket of goods if the Chinese retaliated again. The dispute has now gone past China as President Trump reiterated his threat to place a tariff on automobiles imported from the European Union if the EU doesn't remove tariffs placed on U.S. products.

Newly appointed U.S. Federal Reserve (Fed) Chairman Jerome Powell has the difficult task of balancing economic concerns while keeping the economy advancing in a healthy direction. On June 13th, 2018, the U.S. Federal Reserve unanimously decided to raise the Fed Funds rate by a quarter-percentage point to a range between 1.75% and 2%.

Conclusion

While economic and geopolitical events filled headlines during the quarter, we remained focused on our investment process. We continue to exercise patience and restraint in an environment when many remain focused on chasing short-term results. We spend our time identifying balance sheet strength, cash flow generation and consistent margins while focusing on management teams that generate positive returns and consistently support shareholder friendly capital deployment policies. While we are not pleased with our short-term results, the portfolios performed as we might have expected in a growth-driven market. We believe we have attractive portfolios and understand it can take time for the value of the stocks we own to be realized by the markets. We cannot promise future results but we can ensure the consistent application of our discipline over time.

We thank you for your support and look forward to speaking with you soon.