Portfolio Manager Commentary

Fourth Quarter 2018

Dear Client,

The fourth quarter of 2018 was an exciting time as we launched our Focused Growth strategy on the first day of October. In this letter, which will be longer than subsequent editions of our quarterly investor letter, we will discuss the investment philosophy underpinning our Focused Growth strategy in detail and provide examples of how certain current portfolio companies fit within this philosophy. The goal of this exercise is to provide a greater level of transparency into the thought process behind the investments made on your behalf. We will also discuss the fourth quarter market conditions and explore how our investments performed in what was a most challenging environment.

The Focused Growth Overview:

The Focused Growth strategy is designed to be the core portion of a client's equity exposure. The underlying investment philosophy is fairly simple. Within the focused growth portfolio, we purchase high quality companies in attractive industries that possess long-term growth opportunities greater than that of the broader market. We want to own these businesses as long as these advantages persist and long-term return projections remain attractive. Each investment is made with a 3-5 year time horizon in mind so that the favorable growth attributes of our portfolio companies are allowed to compound in a tax efficient manner. While the investment philosophy is straightforward, the skill comes in determining exactly which companies fit these criteria. As a general rule, the Focused Growth strategy seeks to invest in companies that are disrupting existing and sometimes sluggish business models, businesses with network characteristics that are very difficult if not impossible to replicate, and businesses with predictable and recurring revenue streams.

We live in a time in which new technologies are posing threats to entrenched business models across a number of industries. Amazon alone has caused major disruption across the retail, media, consumer staples, and technology sectors and is rumored to be exploring an entry into the health care arena. Entire business models have had to be rethought and, in some cases, reworked as the result of competition from this one company. Some businesses were simply unable to compete in the new world foisted upon them by Amazon while others endured, but at materially lower levels of profitability. While Amazon is the most obvious example of technologically driven disruption, this is a phenomenon occurring across many different industries driven by many different disruptors. Facebook and Google have driven a shift in the global advertising market towards targeted digital advertising. Intuitive Surgical is driving an ever-greater share of surgical procedures towards robotic surgery. Alibaba is doing in e-commerce in China what Amazon has done in the US and much of the rest of the developed world. In the Focused Growth strategy, we like to own the disruptors, not the disrupted.

A strong network puts up a competitive moat around a business model that can protect it from technological disruption. Visa and Mastercard are two portfolio companies that are a good example of this dynamic. With 60%+ operating margins and high rates of long-term revenue growth driven by a shift from cash towards card-based transactions, there are many seeking to disrupt the Visa and Mastercard franchises. However, the massive number of member bank and retail partners these companies have garnered coupled with the multi-decades long investments made in a reliable and secure payment network makes this a business very difficult to disrupt. The same can be said for the cable companies. Both Charter and Comcast have seen their business come under attack in recent years from direct to consumer content products that give consumers the ability to cut the cord and walk away from their cable subscriptions. However, because these companies own the broadband wires over which these new content offerings must travel, they are able to deal with the competition associated with a changing landscape in pay tv and now, broadband cable has become the center of the plate offering around which ancillary services are provided. Because of the hundreds of billions of dollars spent over multiple decades building out the cable plant, Charter and Comcast have unique connectivity with the consumer. If they cannot keep a consumer on a cable subscription, they will keep them on a broadband plan. Payment processing networks and cable businesses are good examples of defensible network businesses.

The notion of a predictable, recurring revenue stream as an attractive investment characteristic is pretty straightforward as these types of income streams are highly valued by investors. Recurring revenue streams can be found in subscription businesses, businesses with high rates of customer retention, and even consumer staples businesses, provided market shares are stable and brand loyalty rates are high. Adobe is a good example of a company that transformed its business model from one of annual sales of new software products into a recurring subscription business in which over 90% of sales are subscription based and new innovation is rewarded with higher subscription prices. Adobe products are the standard in creative fields and introduction to these products for many occurs during school, which creates a steady stream of new subscribers as creative students leave universities and rise through corporate marketing departments. Verisk collects data from the top 100 property and casualty insurers, which it aggregates, analyzes and sells back to these same companies through its analytics service business. Both the data collection and subscriber sales are recurring aspects of this business. Altria and Philip Morris International compete in the cigarette business in which government regulations restricting consumer marketing designed to reduce smoking rates have resulted in very stable market share rates in a category that, due to the addictive nature of the product, has consistent pricing power. Predictable, recurring revenue streams can be found in businesses across a variety of sectors and these businesses have a unique ability to compound earnings growth over an extended period of time.

Whether it be through owning businesses with disruptive technologies, defensible networks, or a large and recurring income stream, the Focused Growth strategy seeks to own companies that can deliver steady earnings growth that compounds over time. While this list of attributes is not a comprehensive checklist that each company must meet in order for inclusion in the portfolio, it does provide a sense of our thinking when we say we intend to purchase high quality companies in attractive industries that possess long-term structural growth opportunities.

Fourth Quarter Market Recap:

The fourth quarter of 2018 saw a reintroduction of volatility into the equity markets and the S&P 500 suffered its worst quarterly performance since the 3rd quarter of 2011. Heading into the quarter, there were three areas of uncertainty weighing on investor's minds: the US mid-term elections, the Fed policy, and the US/China trade dispute. The US mid-terms resulted in divided government, which was largely in-line with expectations. This left Fed Policy and the US/China trade dispute as the topics dominating the headlines as we exit Q4 and head into 2019. While both of these subjects have been in the spotlight for quite a while, the fourth quarter was the time when they started having consistent and large impacts on the equity markets.

We are three years removed from the Fed's first rate increase after roughly seven years of keeping the Fed Funds rate at 0% and we have had consistent rate increases of 0.25% since December of 2017, which has taken the Fed Funds rate to a level of 2.25%-2.50% following the rate increase announced in December. This process has been well telegraphed and gradual. The economy strengthened in 2018 following the passage of the Tax Cuts and Jobs Act in December of 2017, which represented the first material fiscal stimulus to the economy since the American Recovery and Reinvestment Act of 2009. We believe that the transition from an economy supported by monetary policy to one supported by fiscal policy is healthy and are encouraged that the recent improvement in GDP growth has given the Fed room to raise rates towards a "normal" level and begin the process of shrinking its $4 trillion balance sheet. This provides the ability to combat a future slowdown in the economy by traditional methods. That said, as we reach the end of the current tightening cycle and approach a neutral Fed Funds rate, uncertainty over what exactly constitutes a neutral rate is starting to be expressed through volatility in the equity market.

Federal Reserve Chairman Jerome Powell roiled the stock market on October 3rd when he suggested in a speech that we were a "long way" from a neutral rate and endorsed a December rate increase along with 3 more increases in 2019. At the time, the US economy had grown 4.2% in Q2 and 3.5% in Q3 but was showing signs of slowing in rate sensitive areas such as housing and autos. This speech triggered a spike in volatility and a sharp decline in the stock market as consensus opinion became that the Fed was going to overshoot on rate increases and that higher rates would choke off economic growth. Following that speech, economic data continued to show signs of a slowdown and the trade dispute with China seemed to escalate. On November 28th, Chairman Powell gave another speech and highlighted some of the risks to the economy and vowed that future Fed action would be data dependent and that the current benchmark rate was "just below" the neutral level. While markets initially reacted very favorably to Chairman Powell's second speech, the consensus opinion soon shifted from concern about rising rates choking off growth to falling rates indicating that a global recession could be on the horizon which led to further market declines. Our view is that the Federal Reserve is always data dependent at this point in the cycle and that if the "normal" range is a Fed Funds rate of 2.5%-3.5%, there isn't much difference between suggesting that we may need 4 more hikes to reach normal as Powell did in October or noting that at 2.25% we are "just below the normal range" as he did in November. Further, while we do expect the economy to slow from the above trend rate of growth achieved in 2018, we do not believe that the US economy is facing a recession in 2019. As such, we think the current market outlook for 6%-8% S&P earnings growth in 2019 is reasonable. Simply stated, we don't believe that the volatility in stock prices seen over the past several months is representative of any major change in the outlook for our portfolio companies.

As if the hand wringing over central bank policy wasn't enough for the equity markets to handle, the fourth quarter also saw a ratcheting up of trade tensions between the world's two largest economies. Making matters worse, these delicate trade negotiations often took place in public rather than behind closed doors. While challenging Chinese trade practices such as forced technology transfers, intellectual property theft, tariffs on US goods, and a market that in reality remains largely closed in certain areas to foreign competition makes sense from a US policy standpoint; the fact remains that a tit for tat trade dispute with China is a drag for global growth and is potentially disruptive to global supply chains. As such, this is an issue that we are watching closely. The Chinese economy has already weakened from the trade dispute and this has ramifications not only in China, but also throughout emerging Asia. Domestically, the imposition of tariffs on Chinese goods leaves companies with the choice of either raising prices or digesting margin contraction. To successfully navigate through the US/China trade conflict will require company by company analysis and is a strong argument in favor of the merits of active investing.

As we look out into 2019, we hold an upbeat view of the broader equity markets. 2018 saw a reintroduction of volatility into the market which was unsettling for many investors, but, if we step back a bit, we notice that we digested an earnings multiple correction of roughly 25% in a market that fell just 4%. As such, we head into 2019 with the S&P 500 trading at 14.7x forward earnings, a level that his largely in-line with long-term historical averages despite the fact that the long-term US treasury rate is roughly half of long-term averages. With an expected slowdown in economic growth, companies with secular growth attributes should once again be afforded a premium. This sets up well for the companies in our Focused Growth portfolio.

Fourth Quarter Portfolio Results:

The table below shows the results of the Focused Growth strategy in the fourth quarter as compared to the S&P 500 Index and Russell 100 Growth Index.

Portfolio / Index	4Q19 Return
Focused Growth Portfolio	-13.62%
S&P 500 Total Return Index	-13.52%
Russell 1000 Growth Index	-15.89%

Returns are gross of fees

Despite the sharp drop in the share price for many of our portfolio companies during the widespread fourth quarter market declines, the third quarter earnings reports that were released in October were actually pretty encouraging across the portfolio. With the exception of Abbvie, which had company specific issues and Infineon which faced intense macro headwinds, the third quarter results of our portfolio companies were generally validating to our long-term thesis for owning them.

On the positive side of the ledger, our investments in exchange businesses (CME Group and Intercontinental Exchange) and Comcast in domestic cable delivered strong business results and stock performances well ahead of the broader index. The total contribution to returns (weighting x performance) of these companies during Q4 were as follows: CME Group (+0.32%), Intercontinental Exchange (+0.03%), and Comcast (-0.40%).

Shares of both CME Group (+10.5%) and Intercontinental Exchange (+0.6%) were up in the fourth quarter as the countercyclical attributes of the exchange business overcame broader market weakness. As volatility increases, as it did sharply in Q4, there is more activity in the options and futures markets which means more business for both CME and ICE. In the month of October alone, year over year volume growth was up over 40% for CME and 32% for ICE. Shares of Comcast (-3.8%) dramatically outperformed the broader equity markets in Q4 as the company reported outstanding Q3 results from its cable business unit driven largely by strength in high-speed broadband. Cable EBITDA increased 8% at Comcast and the company showed declining capital intensity which is supportive of free cash flow and bodes well for future cash returns to shareholders.

The top detractors from results during the fourth quarter were Amazon (-1.25%), Electronic Arts (-1.22%), and Philip Morris International (-1.09%). Shares of Amazon (-25.0%) were weak throughout the fourth quarter despite the fact that the company reported 29% sales growth and operating profit of $3.7B, which was well ahead of expectations. During a period in which investors focused on the negative rather than the positive, more attention was paid to the deceleration in sales growth than to the spike in profitability. Still, we believe that Amazon remains the most disruptive company in the world and the long-term opportunity remains as strong as ever given its leading position in many large markets throughout retail, technology and media. Shares of Electronic Arts (-34.5%) have been under severe pressure since late August when the company announced a delay in the launch of its Battlefield V game. Concerns about a lack of visibility increased following the release of earnings, which discussed a major shift in earnings from the third fiscal quarter into the second fiscal quarter but with no change to the full year fiscal year outlook. While the severe share price weakness was disappointing, we were encouraged by management's discussion of a more aggressive shift into a subscription type business model. We think that over time, this will reduce volatility around new title releases and provide a compelling value to gamers. As such, we used the share price weakness as an opportunity to increase our weighting of EA from 3% to 5%. Shares of Philip Morris International (-18.1%) suffered from disproportionate multiple compression during the quarter as concerns about slowing global tobacco volumes and the headwind of a strong dollar to PM's earnings weighed on the stock. We believe that pricing in tobacco remains strong and view Philip Morris as the global leader in reduced risk products, which is a long-term growth opportunity in an otherwise contracting category.

Fourth Quarter Portfolio Activity:

Table 2 details the trading actions we took during the fourth quarter. On a long-term basis, we expect portfolio turnover to approximate 20%-30%. We were slightly above this range on an annualized basis during the fourth quarter which is unsurprising given the dramatic volatility during the period.

New Purchases / Additions			
Company	Beginning Weight	Ending Weight	Change in Weighting
AB-Inbev	0.0%	3.0%	3.0%
Electronic Arts	3.0%	5.0%	2.0%
Alphabet	7.0%	8.0%	1.0%
Altria	4.0%	5.0%	1.0%
Comcast	7.0%	8.0%	1.0%

Eliminations / Reductions			
Company	Beginning Weight	Ending Weight	Change in Weighting
Abbvie	4.0%	0.0%	4.0%
Infineon	3.0%	0.0%	2.0%
Blackrock	4.0%	3.0%	1.0%

In late October, we swapped out Infineon for Anheuser Busch Inbev due to heightened concerns regarding end market weakness for Infineon and a sharp price break following an expected and necessary dividend reduction at AB-Inbev that created an attractive entry point. The US/China trade dispute has intensified in recent months and with it has come heightened concerns regarding global growth. While the global growth outlook is certainly an issue we considered when making the decision to purchase Infineon, commentary from competitor Texas Instruments during its conference call in which the TI management team noted sharp deceleration across all end markets caused us to re-evaluate our outlook for Infineon, which shares many of the same end markets with TI. While this was happening, AB-Inbev announced a 50% reduction in its dividend in an effort to more aggressively reduce leverage. AB-Inbev is a company we strongly considered for inclusion in our initial portfolio, but we didn't want to get in front of a dividend cut which we believed was imminent. When the dividend cut was announced, the share price fell 10% which created an attractive entry point for a business that owns 7 of the top 10 global beer brands.

While Infineon was the victim of a deterioration in the macro environment, the decision to sell Abbvie was made because of company specific issues. We owned Abbvie because we believed that Humira, as a biologic, would be more resistant to generic competition than the typical simple compound drug. During Abbvie's third quarter conference call, management announced that price competition in Europe, the first region where Humira had generic competition, was greater than anticipated. This announcement was followed several weeks later by the announcement that the company was halting a trial for key pipeline drug Rova T in small cell lung cancer for lack of efficacy. The combination of greater than anticipated price competition for Humira coupled with disappointing results for a key pipeline drug drove our decision to sell Abbvie. The proceeds from this sale were used to fund increases in Electronic Arts (discussed above), Altria, Comcast, and Alphabet.

After the extreme market volatility witnessed in the fourth quarter, it is important to remember that we invest with a long-term time horizon and view ourselves as owners of businesses, not traders of stocks. While the day to day stock prices of our portfolio companies bounced around during the fourth quarter, the intrinsic values of the underlying businesses did not. In the face of market volatility, we remain focused on the long-term fundamentals of the companies we own. We thank you for the trust you have placed in us, and as always, please feel free to reach out if you have any questions.

Sincerely,

Ken Burke
Chief Investment Officer

Disclosure

The Burke Wealth Management Focused Growth Composite, created on October 1, 2018, contains fully discretionary large cap equity accounts that is measured against the S&P 500 Total Return Index and the Russell 1000 Growth indices. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The Burke Wealth Management Focused Growth Strategy invests exclusively in a portfolio of high-quality companies.

The S&P 500® Total Return Index is a widely recognized, unmanaged index of 500 common stocks which are generally representative of the U.S. stock market as a whole. Ordinary dividends are reinvested across the index and accounted for in the Total Return index calculations. The Russell 1000® Growth Index is an unmanaged index that measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values.

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Past performance does not guarantee future results and future accuracy and profitable results cannot be guaranteed. Composite performance figures are presented gross of management fees and have been calculated after the deduction of all transaction costs and commissions. For existing clients, accompanied with this investor letter is the client billing statement, which includes gross and net returns of individual accounts.

The management fee schedule is as follows: Per annum fees for managed accounts are 100 basis points of the first $5,000,000 of assets under management, 75 basis points of the next $5,000,000 of assets under management, and 50 basis points of amounts above $10,000,000 of assets under management. Actual investment advisory fees incurred by clients may vary. Burke Wealth Management, LLC is a registered investment advisor in the state of Texas and its investment advisory fees are described in its Form ADV Part 2A. The advisory fees will reduce clients' returns.

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