Portfolio Manager Commentary
Third Quarter 2019

Dear Client,

The third quarter of 2019 marks the end of the first full year for the Focused Growth strategy. It feels like we've crammed about four years of market experiences into the last four quarters. We had one of the worst stock market quarters in the last decade followed by one of the best, giving way to a final six months or so of volatile but flat market conditions. When we started a year ago, the Fed was in the middle of a tightening cycle with expectations that it would last throughout 2019 and as we stand today, we are two rate cuts into an easing cycle with an expectation of more to come. We've probably had more ups and downs on the trade front over the past year than in the prior twenty years combined. Not only did Iran start seizing ships in the Strait of Hormuz, but they actually orchestrated an attack on Saudi oil production. There was a time when either of those events in isolation would have led to a 10% market decline but thanks to the invention of shale drilling, the market was able to effectively shrug it off. Finally, we are on the cusp of a Presidential election year while also being in the middle of a formal impeachment inquiry. Interesting times indeed. If we were market timers or a macro-oriented strategy, I'd probably be typing this letter from underneath my desk. Luckily, we are a fundamental research driven strategy that focuses on owning great businesses with healthy and durable growth prospects. On that front, the past year has been successful as the weighted average revenue and earnings growth of our portfolio over the past year has been 13% and 17% respectively.

In prior letters, we've written extensively about Fed Policy and the Trade War. Our opinion on the Federal Reserve remains unchanged in that we believe that the Fed is filled with well intentioned, smart people who will take reasonable actions based on the incoming economic data. On the trade front, this continues to be one of the controlling issues for the broader market and we simply don't have any special insight as to when, or if, a deal will be reached. We have done what we can control and have built a portfolio of companies with limited direct exposure to the conflict and the ability to sustain growth through a more challenged global economic environment. As we look out into the year ahead, politics will play a more prominent role in the news flow impacting the broader market so we thought we'd offer some thoughts on the current political and regulatory environment.

I turned 18 in October of 1992, which means that the 1992 Presidential Election was my first opportunity to vote. I can still recall the awesome responsibility I felt as all three Presidential candidates that year continually warned that this was the most important Presidential election of their lifetime. The 2020 election will be my eighth election as a voter and I'm currently 7 for 7 in casting ballots in the "most consequential election" of a lifetime. I've come to realize that while any election in which a candidate is running is the most consequential election of that person's lifetime, political change in the country tends to occur gradually rather than in step function fashion so some of the life and death campaign rhetoric may be overstated. When listening to the dramatic policy proposals that will be made over the course of the next year, it is important to recall from civics class how a bill becomes a law- i.e. there are many steps required and much compromise to be made along the way. This explains why change tends to be gradual rather than sudden. This is a frustration for partisans on both sides, but a positive for the companies tasked with navigating different political environments. It is in this context that we view the heightened scrutiny that United Health Group has come under due to the calls from several Democratic Presidential candidates to replace the private insurance market with a Medicare for All option. As we've noted before in prior editions of this letter, our aim is to own businesses that can be successful across a variety of macro environments. To the extent laws are passed that no longer make it possible for one of our portfolio companies to succeed, we will exit that investment and redeploy the proceeds to companies that can still succeed. That said, it is equally important that we distinguish between the transitory headline risk that accompanies any election season and policy proposals that have a real chance of being adopted and affecting lasting change.

While on the topic of political risk, several of our portfolio companies are currently facing heightened political/regulatory risk that is weighing on near-term valuations. Facebook and Alphabet continue to take fire from both sides of the political aisle domestically as well as from regulatory bodies on both sides of the Atlantic. While the criticisms leveled at both companies have had real financial consequences in the form of fines and forced changes to business practices that have adversely impacted margins, we believe that sentiment has become too negative and that investors are placing too much value on the political risks and too little value on the fact that the underlying businesses at both companies continue to generate strong growth. The heightened scrutiny that Facebook and Alphabet are under is being compared to the DOJ case against Microsoft from 20 years ago that is blamed for more than a lost decade for that stock (MSFT was basically flat from 2001-2013). We are sensitive to the fact that fighting the government can divert management attention, but would point out that Microsoft's fight came at a time when the growth of its underlying business had slowed while Facebook and Alphabet are facing greater regulatory scrutiny at a time when their respective businesses are on much firmer footing. Finally, there is an argument to be made that breaking up the companies, which is the most aggressive remedy being sought by political opponents, would actually increase shareholder value.

Shares of Alibaba and JD.Com have been subjected to increased volatility throughout the trade war, which we find odd given that neither company is impacted directly by any of the tit for tat tariff back and forth that is occurring between The United States and China. This pressure reached a peak in late September with shares of both companies falling sharply when the press, citing unnamed sources, reported that the US government was considering delisting Chinese companies. Algorithmic trading immediately kicked into action and drove down shares of the major Chinese companies listed in the US. Alibaba and JD.Com are two of the largest companies in the world, have global operations and are audited by PricewaterhouseCoopers. Arbitrarily delisting companies like this and Baidu, another large Chinese issuer, would make no sense and cause tremendous upheaval in the financial markets, particularly for the trillions of dollars that are invested against the MSCI Worldwide Indices. This probably explains why administration officials were so quick to deny the reports. While there is certainly room to improve oversight with regards to Chinese companies listing on US exchanges, the companies that have exploited existing loopholes to defraud investors have typically been small and extremely speculative. Unfortunately, shares of Alibaba and JD.Com have yet to recover from this recent bout of headline risk. This is a good example of the type of transitory headline risk that we cannot predict, but are willing to endure so long as the growth prospects for these companies remains strong.

Third Quarter Portfolio Results:

Table 1 below shows the results of the Focused Growth Strategy in the third quarter, year-to-date and since inception (10-1-18) as compared to the S&P 500 and Russell 1000 Growth.

Table 1:

Portfolio / Index	3Q19 Return	2019 YTD	Since Inception
Focused Growth Portfolio	0.4%	23.3%	6.6%
S&P 500 Total Return Index	1.7%	20.6%	4.3%
Russell 1000 Growth Index	1.5%	23.3%	3.7%

Returns are gross of fees

Equity returns were volatile during the third quarter with the end result of the volatility being a basically flat period. Despite the volatility in the share price of many of our holdings during the third quarter, the underlying results of our portfolio companies were fairly stable and quite strong with weighted average revenue and EPS growth of 14% and 16% respectively in the period. This is roughly in-line with the 13% and 17% revenue and earnings growth achieved by our holdings during the first full year of the Focused Growth strategy. We are pleased with the consistently healthy growth rates the portfolio has achieved against a fairly dynamic macro backdrop. We expect continued strength in operating results across the portfolio when third quarter results are reported.

Tables 2 shows some notable performers during the third quarter in terms of both absolute performance as well as total contribution (% increase/decrease x weighting) to overall portfolio returns.

Notable Q3-19 Performers					
Positive Contributors			**Negative Detractors**		
	Performance	**Contribution**		**Performance**	**Contribution**
AB-Inbev	7.5%	0.23%	Facebook	-7.7%	-0.43%
Alphabet	12.8%	1.02%	JD.Com	-6.9%	-0.28%
Comcast	6.6%	0.53%	United Health Group	-10.9%	-0.81%

Returns are gross of fees

In our second quarter letter, we bemoaned the fact that $80B of market cap for Alphabet evaporated in the days following the release of Q1 results. Revenue growth fell below the magical 20% mark for the first time in three years, which to hear it told on CNBC marked the end of growth for the company. Management was also criticized for refusing to provide more than minimal color regarding the performance of the YouTube and Google Cloud businesses. What a difference a quarter makes. Q2 results saw revenue growth accelerate to 19%, despite a 4% drag related to currency, and management noted that the cloud business contributed $2B to revenues in the quarter so the same analysts that were troubled by the lack of disclosure in the Q1 release were now lauding management's openness in its Q2 discussion of results. In our view, not much has changed at Alphabet from the first to second quarter which is a good thing because this remains one of the best secular growth businesses in the world. Also, to be perfectly truthful, we didn't find the additional disclosure around the cloud business to be as monumental as some analysts made it out to be. Still, we enjoyed the $80B rebound in Alphabet's market cap following Q2 results. More importantly, despite the political risk discussed above, the business remains on solid footing and the second half of the year should shape up nicely as revenue growth comparisons ease.

AB-Inbev reported outstanding second quarter results with organic revenue and EBITDA growth increasing 6.2% and 9.4% respectively on the back of its best volume performance (+2.1%) in five years. More importantly, the company announced two major transactions that, once completed, will go a long way towards completing the repair of the balance sheet that has been stretched ever since the completion of the SAB Miller acquisition. In July, Bud announced that it was selling its Australian business to Asahi for $11.3B. In September, the company raised an additional $5B from the IPO of roughly 10% of its remaining Asian business. Together, these transactions will bring the company well below the stated goal of Net Debt/EBITDA of less than 4x by the end of 2020, which will in turn allow the Bud to resume dividend increases and share repurchase.

Comcast is one of our more controversial holdings in that one's view of the long-term prospects for this business is based on whether you view it as a cable company that is chronically losing video subscribers or a connectivity company whose value to the consumer grows as the demand for content grows. Ever since Disney announced a drop in ESPN subscribers in the summer of 2017, concern over cord-cutting has been front and center for the cable industry. Our view is that the cable companies should be viewed as broadband companies whose value to the consumer remains intact so long as demand for content is strong, regardless of how that content is delivered. Further, selling broadband is less capital intensive and higher margin than selling video. That said, from the time of Disney's negative subscriber announcement in the summer of 2017, Comcast's forward P/E multiple has contracted by roughly 30%. We think things are starting to change and that valuations in the cable sector are in the early stages of an upward re-rating. Shares of both Comcast and Charter have delivered outstanding returns in 2019, up 31% and 42% YTD respectively, despite continued video subscriber losses. Both companies have reported higher than expected margins and lower than expected CAPEX while each adding ~1.2M broadband subscribers over the past year. In fact, the best performing stock in the cable sector this year is a company, Cable One, that is actively encouraging some of its lower value video customers to cut the cord and switch to broadband only. As investor views around cord cutting evolve, so too should the views around the durability of growth for both Comcast and Charter.

With a nod to the singing Carter Family, not all of the companies in the portfolio were able to Keep on the Sunny Side of Life in Q3. Shares of Facebook, JD.Com and United Health all performed poorly during the third quarter, which was particularly frustrating because we believe that Facebook and JD.Com's second quarter earnings releases were as strong as any of the companies in our portfolio. As discussed above, Facebook remains in the cross-hairs of both political parties. Despite this, second quarter results were outstanding driven by strong growth in revenue per user due to higher advertising demand, which is expected to continue as we head into the election season. We do take some satisfaction from the fact that many of the same politicians who spend their evenings attacking Facebook on the cable news shows spend their days buying advertising on the site. Finally, Facebook is starting to lap the step-function increase in spending that resulted from the need for greater guardrails around privacy and security which will make future comparisons less challenging.

We discussed some of the transitory headline issues related to the trade dispute that adversely impact shares of JD.Com above. What is frustrating is that these headlines overshadowed what was a truly outstanding second quarter earnings report from the company. While revenue growth of 19% was ahead of expectations, the most important development in the second quarter for JD came in the form of higher profitability. Specifically, JD's third-party fulfillment and logistics business has finally achieved scale and become profitable. This coupled with the natural SG&A leverage a company achieves when delivering near 20% revenue growth allowed JD to report operating margins well ahead of expectations despite a material increase in spending on technology. Further, and most importantly, management endorsed a long-term operating margin target in the high single-digit range which is well ahead of the 3%-5% long-term range that had previously been contemplated. In time, the headline risk will subside and when it does, we will be left with a company with the same long-term revenue opportunity that drove our purchase and a higher margin structure than we had previously envisioned.

With regards to United Health Group, we own that stock because we believe that between its leadership position in the private insurance market and its Optum division, UNH is uniquely positioned to utilize technology and data analytics to provide consumers with a comprehensive healthcare solution that results in better outcomes at lower total system costs. This has not changed and the mid-teens revenue and profit growth reported at Optum in the second quarter coupled with a series of strategically sound bolt-on acquisitions have only served to strengthen our conviction in the long-term prospects for this company. Unfortunately, being the largest private insurer in the country means that UNH is at ground zero for some of the ambitious plans to reshape our healthcare system. This has caused a contraction in valuation despite continued mid-teens earnings growth. Our view remains that policy proposals designed to curry favor in a primary election will be softened by the time the general election rolls around and even if they are not, the likelihood of moving the country to a single-payer healthcare system at a time when the political parties are facing close to a 50-50 electorate is remote. We expect that at some point over the next year or so that the valuation compression will reverse and we will be the beneficiary of earnings growth and multiple expansion. Admittedly, we have little insight as to exactly when this will occur so this is a situation where we are content to own a great business and apply our long-term time horizon.

Third Quarter Portfolio Activity:

Table 3 shows the changes made to the portfolio during the third quarter. We eliminated our position in Philip Morris International and used the proceeds to increase our weightings in Facebook, JD.Com, Amazon, and United Health. We discussed the reasons why we believe that a divergence has occurred between the current share prices of Facebook, JD.Com and United Health and their respective fundamentals above. With Amazon, we were taking advantage of weakness in the share price in the face of accelerating revenue growth to increase our stake in the most disruptive company in the world. With regards to the decision to sell Philip Morris International, there is plenty to unpack so let's get to it…

Table 3:

New Purchases / Additions		
Company	**Beginning Weight**	**Ending Weight**
Amazon	5.0%	6.0%
Facebook	5.0%	7.0%
JD.Com	3.0%	4.0%
United Health	7.0%	8.0%

Eliminations / Reductions		
Company	**Beginning Weight**	**Ending Weight**
Philip Morris Int'l	5.0%	0%

We sold Altria in April in large part because we hated the JUUL deal. It could be a long time before we make a sell decision that is vindicated so quickly. Before the market gods smite our entire portfolio, let me be quick to point out that this decision was not due to some sort of analytical genius on our end. Instead we simply listened to what the company had been saying about the vapor space for years which was that the category was in the early days with no true brand equity established, market share was going to move around quickly, and limited study had been done on the impact of vaping on the lungs. Spending $12.6B for a 35% stake in JUUL was in direct contradiction to years of consistent communication to investors. When management's actions contradicted their words, we sold. This brings us to Philip Morris International. For the last seven years, the company has been touting its ambition to move the world to a "smoke free future" and saying that its heat-not-burn iQOS product would be the driver of this shift. We believe in the promise of the iQOS product and this coupled with stable fundamentals in the global cigarette category made PM a worthy investment. Then, out of the blue in early September, PM announced that it was in talks to merge with Altria. After seven years talking about building a smoke free future, PM wants to invest $80B in a US combustible cigarette business?!! Although the proposed merger was still in the "talks" phase, we decided that we could not take the risk that it would be completed and sold PM. Apparently, we weren't the only investors reaching this conclusion as shares of both stocks sold off sharply in the weeks following the announced merger talks. Shareholder pressure coupled with a warp speed deterioration in the fundamental and regulatory prospects for Altria's new JUUL investment ultimately led to a breakdown in discussions and the merger plans were shelved, for now. Given that the merger was not completed, that the share price is roughly where it was before the talks were revealed, and that we still believe in the long-term prospects for iQOS, the obvious question is "why not just buy it back?". The reason is simple. We are owners of businesses and not traders of stocks. When you invest with that mindset, the management team is a critical factor as this is the group that will be making long-term capital allocation decisions on your behalf. PM's flirtation with Altria caused us to lose confidence in the management team and forced us to question whether or not the core business is as stable as they've been indicating. As such, we stand by the decision to redeploy those funds into companies where our confidence level remains high.

We are proud of the work we have put in during our first year in business and excited about the opportunities that lie ahead. But, most of all, we are grateful for the trust you have placed in us and we approach every decision we make with the goal of continuing to earn that trust. We are confident in the composition of the portfolio and look forward to the release of third quarter results from our portfolio companies. As always, please feel free to reach out if you have any questions.

Sincerely,

Ken Burke
Chief Investment Officer

BURKE WEALTH MANAGEMENT

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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