2018 First Quarter Portfolio Review

Market Overview

Volatility came back with a vengeance in the first quarter of 2018, but despite the increase in noise, the result was basically flat performance. Global stocks, as measured by the MSCI ACWI, declined by -1.03% during the quarter led by weak performance in the U.S. and Europe with the S&P 500 Index declining -0.76% and the MSCI Europe Index declining -1.98%. The weakness in Europe was masked by the robust performance of the euro as the market declined by -4.61% in local currency. Japan was also buoyed by its currency as the MSCI Japan Index fell -4.80% in yen terms but gained 0.13% in U.S. dollar terms. The MSCI Emerging Markets Index increased by 1.28% with little help from the changes in local currencies. Asset classes with a sensitivity to interest rates represented some of the hardest hit segments of the U.S. market. The Dow Jones U.S. Real Estate Index fell -5.91% and the S&P 500 Utilities Index fell -3.30%.

The change in U.S. interest rates was the biggest news during the quarter. The Bloomberg Barclays Global Aggregate Index declined -1.46% with investment-grade credit, as measured by the Bloomberg Barclays U.S. Credit Bond Index, leading the decline at -2.32%. Bonds with a higher coupon fared better than core Treasurys and corporate bonds. The Bloomberg Barclays U.S. Corporate High-Yield Bond Index declined -0.86% while the Bloomberg Barclays U.S. Municipal High Yield Index increased 0.58%. Emerging market (EM) corporate bonds were also able to avoid the worst of the rate-driven drawdowns, with the Credit Suisse Emerging Market Corporate Bond Index declining by -0.52% in the quarter.

Portfolio Overview

Salient Global Dividend Signal Portfolio returned 0.66% (net performance) in the first quarter, outperforming the MSCI World Index, which returned -1.28%. On a sector basis, the portfolio's consumer staples and financials holdings provided the largest positive relative contribution. Within consumer staples, the portfolio's position in Norwegian salmon farmer Marine Harvest provided the largest relative positive return. Marine Harvest stands to benefit from increased global pricing and lower global yields. In financials, Virtu Financial has experienced improved market conditions with an increase in volume and volatility in financial markets. Weaker sectors included consumer discretionary and information technology. In consumer discretionary, the underperformance is attributable to Comcast as there continues to be concern around a potential acquisition. Within information technology, our position in RIB Software has witnessed an acute decline due to an unexpected capital raising by the company. From a country perspective, our stock selection in the U.S. and Hong Kong has provided for positive relative performance while our stock selection in Germany and exposure to the Japanese yen has had a negative contribution.

Investment Outlook

Global economic momentum continues as global gross domestic product estimates for 2018/2019 generally moved higher in early 2018. However, geopolitical intrigue possibly escalated to more protectionist trade policies and late quarter economic data that suggested at least some deceleration raised investor risk concerns. The business climate remains healthy. In the U.S., the tax cuts appear to be having the intended impact of lifting employment and increasing investment, and fiscal spend should be supportive with the new Bipartisan Budget Act. Europe remains on a positive trajectory with low inflation and good employment growth. Japan showed continued momentum with better-than-anticipated capital investment and a general uptrend in domestic demand. That said, the news may be as good as it gets for this part of the cycle. Purchasing managers' indices and other leading indicators have rolled over recently and the strong yen and euro may impact corporate profits in Japan and Europe. Consumer and business confidence suffered with tough trade talk dominating the headlines. Ergo, we note the mixed data coming from several emerging markets. Central and East Asia continue to be bright spots, but Brazil and Russia are not keeping up with the global economic performance averages. As noted in last quarter's commentary, China's economy should decelerate with less stimulus after last year's National Congress. Massive leverage and excess industrial capacity will continue to slowly drag on China's economic performance. Overall, however, the fundamentals remain solid. We believe the enacted U.S. trade tariffs, if not followed by more actions, will have limited impact. The 25% steel and 10% aluminum tariffs will result in an effective $11 billion tax on consumers of these metals—a potentially big pill for certain industries like aircraft and machinery, but negligible for the $19 trillion U.S. economy. The announced duties by China are even less impactful. Assuming a successful renegotiation of the North American Free Trade Agreement (NAFTA) and no full-blown global trade war, we look for very modest impact on the global business climate. We also highlight the very slow inflation burn with some wage price pressures offset by other more modest inflation data, which suggests that central banks can continue to be measured in accommodation removal.

As we highlighted at the end of 2017, we look for our higher-dividend yielding style to show better relative performance as the market expansion matures. We expect many of the momentum-oriented names in technology and other areas where growth expectations are excessive will lag in this part of the cycle. In a rising interest rate environment, our strategy will likely benefit as investors increasingly appreciate balance sheet quality and growing dividend streams. We believe our investments feature a good balance of reasonable valuation for current and future earnings power with consistent and propitious free cash generation.

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Composite net returns are calculated using a highest management fee of 2.00%, applied monthly.

Investing involves risk, including a possible loss of principal. Past performance does not guarantee future results. Portfolio holdings are subject to change at any time.

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Bloomberg Barclays Global Aggregate Index represents a broad-based measure of the global investment-grade fixed income markets, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities.

Bloomberg Barclays U.S. Aggregate Bond Index represents securities that are U.S. domestic, taxable and dollar denominated. The index covers the U.S. investment-grade, fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities.

Bloomberg Barclays U.S. Corporate High-Yield Bond Index covers the USD-denominated, noninvestment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

Bloomberg Barclays U.S. Credit Index is an index composed of corporate and non-corporate debt issues that are rated investment grade (Baa3/BBB) or higher.

Bloomberg Barclays U.S. Municipal High Yield Index measures the noninvestment-grade and nonrated U.S. dollar-denominated, fixed-rate, tax-exempt bond market within the 50 United States and four other qualifying regions (Washington D.C., Puerto Rico, Guam and the Virgin Islands).

Credit Suisse Emerging Market Corporate Bond Index consists of U.S. dollar-denominated fixed-income issues from Latin America, Eastern Europe and Asia.

Dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its share price.

Dow Jones U.S. Real Estate Index measures the performance of the real estate industry of the U.S. equity market.

MSCI ACWI (All Country World Index) is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

MSCI Europe Index is a free float-adjusted market capitalization index designed to measure developed market equity performance in Europe.

MSCI Japan Index is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of the developed markets in Japan.

MSCI World Index is a free float-adjusted market capitalization index that is designed to measure global developed market equity performance.

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index. The Russell 3000 Index represents approximately 98% of the investable U.S. equity market.

S&P 500 Index is an unmanaged index of 500 common stocks chosen to reflect the industries in the U.S. economy.

S&P 500 Utilities Index comprises those companies included in the S&P 500 that are classified as members of the GICS® utilities sector.

Volatility is a statistical measure of the dispersion of returns for a given security or market index.

Yield is the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost or on the U.S. government's debt obligations.

Indexes shown for illustrative purposes only. It is not possible to invest directly in an index.

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and the reader should not assume that investments in the securities identified and discussed were or will be profitable.

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