Index Strategy: Rothschild & Co Risk-Based US Index TR (USD)

4th Quarter 2018

Market Review

The S&P 500® Index TR USD (hereafter, "the S&P") lost -13.5% in the fourth quarter of 2018, bringing its year-end return to -4.4%. The S&P started the year strongly, following 2017's 21.8% return with a return of 5.7% in January. The January return would prove to be the S&P's best monthly result in 2018 and was followed by consecutive monthly declines in February and March, the first negative return in 16 months and first consecutive declines in two years. Following the volatility of the first quarter, the S&P marched higher delivering positive returns from April through September as positive earnings momentum and supportive economic data offset trade war concerns. The rebound took the year-to-date return of the S&P to +10.6% by the end of September putting the benchmark index on pace to break its record nine year annual positive performance streak. However, the record breaking streak was not to be as the S&P's fourth quarter of -13.5% led to a -4.4% loss for the entire year and took the market index into negative territory for the first time in ten years.

Of the S&P's eleven GICS economic sectors, seven finished the year with negative returns with the worst performers being Energy (-18.1%), Materials (-14.7%) and Industrials (-13.3%), all impacted by fears of a global economic slowdown, global trade and slower earnings growth. The best performing S&P sectors for the year were Health Care (+6.4%), Utilities (+4.1%), and Information Technology (+3.4%). During the steep Q4 decline the only S&P sector to see a positive return was the Utility sector which rose +1.4%.

Index Performance Review*

The Rothschild & Co Risk-Based US Index TR (hereafter "Index") outperformed the S&P in the 4th quarter with a return of -10.2% versus the Index return of -13.5%. For the year, the Index also outperformed the S&P, -3.6% vs. -4.4%. The 2018 Index returns when compared against the S&P were provided with a 27% reduction in volatility[1], a 25% decrease in maximum drawdown[1] and 42% higher Sharpe ratio[1].

The Index's lower loss during the quarter compared to the S&P was driven primarily by an overweight to the Utilities sector and an underweight to the Information Technology ("IT") sector. During the quarter the Utilities sector was the best performing of the S&P with a return of 1.4% and the Index benefitted by its large overweight (18.1% vs. 3.1%). In the IT sector, the Index benefitted a large underweight (8.1% vs. 20.4%) to a sector that lost -17.3% during the quarter while the Index's IT holdings lost -15.1%. Other areas that contributed during the quarter included the Index's positioning in the Financials sector, where an underweight to Banks and an overweight to Insurance helped to moderate the -16.2% decline in the sector as Insurance stocks declined less than Banks, and the Materials sector, where the outperformance was led by stock selection as the Fund's stocks in the sector declined only -0.2% compared to the -12.3% loss for those of the S&P sector. On the negative side, the Index was underweight the Health Care sector (12.4% vs. 15.3%) which detracted from relative returns as the Sector was one of the better performers for the S&P, losing -8.8%. The Index's Health Care stocks also underperformed those of the Index with a -10.6% return.

For the year, the Index's outperformance was led by its overweight to the Utilities sector which returned 4.0%. The Index's differentiated positioning in the Financials sector also helped its relative returns, particularly by a combination to overweighting Insurance stocks at the expense of Banks and by outperformance in the Banks and Diversified Financials industry groups. Performance was held back in two areas. First was the IT sector. While the IT sector saw large losses in the 4th quarter of the year, the sector was positive overall for the year, and the Index underweight to the sector held back returns. The Index underweight had been driven by the lack of exposure to some of the largest IT stocks in the S&P, notably Apple, Microsoft and Intel. The second largest area of underperformance for the Index in 2018 was from the Consumer Discretionary sector. In the sector the Index's stocks underperformed overall, losing -6.4% compared with an increase of 1.9% for those in the S&P, combined with a modest overweight allocation (12.4% vs. 9.9% on average). Also impacting the Index's relative returns in the Consumer Discretionary sector was

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not owning Amazon as the stock was a strong performer, rising 28.4%, and was a large allocation in the S&P ending with a 2.9% weight.

Index Positioning

The Index's sector weights did not change dramatically over the course of the year. The largest sector additions were to the Financials and Utilities sectors while the largest reductions were in the Healthcare and IT sectors. In the Utilities sector, the Index started the year with a 12.0% allocation and ended the year with 19%, a large overweight compared to the S&P's 3.3% allocation. In the Financials sector, the weight went from 10.6% to start the year to 14.4% by year end, a small overweight compared to the 13.3% weight in the S&P. While the Index ended the year with a small overweight to the Financials sector, the Index's positioning was quite different from the S&P as the Index was underweight both Banks and Diversified Financials and overweight Insurance. The largest reduction over the course of the year was in the Health Care sector. The Index started the year with 18.1% allocated to Health Care, by year-end the weight was reduced to 12.0%, while the S&P ended the year with 15.5%. The IT sector started the year as the Index's largest underweight with 10.1% compared to 18.7% for the S&P. By year-end the Index's weight to IT was further reduced, ending at 6.7% while the S&P's IT weight increased to 20.1%.

As a systematic risk-based manager, we do not forecast future market events or use expectations of future events to influence or change the strategy. Rather, we consistently and systematically apply a strategy that puts risk management at the heart of the portfolio construction process. The strategy seeks outperformance with less volatility over a full market cycle, relative to market-cap weighted strategies. With the events that triggered the volatility experienced in 2018 likely to persist, the Index is well positioned to continue to moderate market volatility, sharp market declines and improve risk-adjusted returns while providing a diversified equity exposure to multi-asset portfolios.

Source: Morningstar, Bloomberg.

* Performance attribution versus the SPDR® S&P 500 ETF (SPY).

1. Based on 1 year period with daily frequency.

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S&P 500® Index: An unmanaged, market capitalization-weighted index of 500 stocks of leading large-cap U.S. companies in leading industries; gives a broad look at the U.S. equities market and those companies' stock price performance.

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