Quarterly Commentary: Third Quarter 2019

Introduction

PEPPER ANDERSON, Chief Executive Officer

Despite volatile markets throughout the third quarter, Chilton Trust clients continued to enjoy strong performance. In addition to our daily attention to portfolios, we have been thinking ahead to 2020. While we remain constructive on markets, we are cognizant of the evolving economic and geopolitical risks that abound. Heading into year-end and as we prepare 2019 portfolio reviews, you can expect us to be focusing on providing thoughtful, holistic advice including rebalancing perspective and potential strategy additions.

We are also proud to share with you that Chilton Trust has recently been recognized by Barron's as a Top 50 Independent Wealth Management Firm. The wealth management industry is comprised of an incredibly broad array of firms, from global banks to niche strategy managers. Over the course of this first decade since our founding, these choices have only broadened in both style and numbers. I, alongside all of my colleagues, am immensely proud of the work we do for our clients and am gratified to see that work recognized. That said, the trust each of our clients places in us and the opportunity to partner with you in achieving your family's objectives is our greatest reward. Thank you, as always, for your continued confidence.

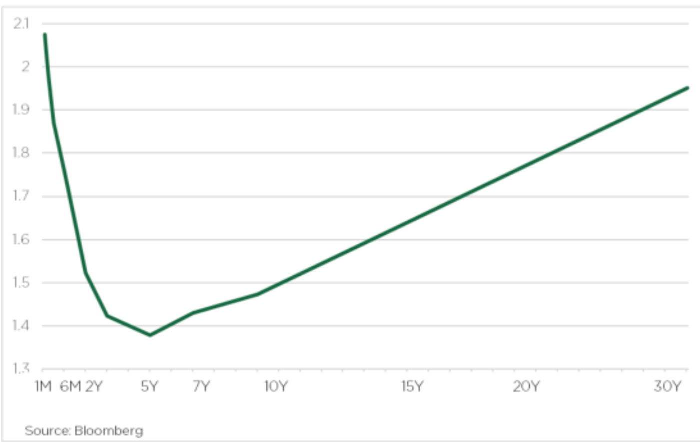
Market Overview & Outlook

Market Overview

While broad indices moved higher during the third quarter of 2019, it proved to be a more challenging quarter than the previous two. There were a number of underlying cross currents during the quarter which led to mixed performance. Volatility has intensified as the tariff battle with China continues to cast uncertainty over the economic landscape and heightens business anxiety over consumer spending, supply chain management and companies' pricing power. Even though the rhetoric from the White House is sometimes good… then bad, the lingering effects of this trade war are starting to take a real toll on business and investor confidence. Brexit remains unresolved, international growth has been hit hard by tariffs, exacerbating already weak economies, and political upheavals are seemingly everywhere. Even the U.S. is showing signs of slowing, although perhaps driven by a slow erosion in corporate confidence as uncertainties linger. A saving grace was the Federal Reserve decision to change monetary policy and start lowering interest rates which added liquidity to the system.

With the July rate cut, the Fed made a clear effort to sustain U.S. economic growth at a point when trade and tariff uncertainties threatened to disrupt the economy. By mid-summer, the weakest links in the economy were a rising manufacturing recession and a pullback in business investment. Both were driven by the escalation of trade frictions that had already disrupted some supply chains, putting further pressure on global growth. Yet with consumer demand strong, supported by full employment, the Fed seemed somewhat confident that its July rate cut would quell recessionary expectation. In particular, the Fed sought to diffuse recession concerns, epitomized in the brief, late-August inversion of the U.S. Treasury curve.

Maximum Inversion on August 27, 2019



Historically, an inversion in U.S. Treasury rates has been a key metric in predicting an eventual recession. Yet with approximately $17 trillion in global debt trading at negative yields due to easy global monetary policy, U.S. yields continued to decline, paving the way for continued interest rate cuts by the Fed which took place at the September and October meetings.

This quarter, some dynamics occurred in the market that we believe are a healthy indicator for fundamental stock picking. WeWork dominated the business news headlines with issues of concern about their business despite sales momentum. Theirs is a model that relies on short term leases but takes on long term obligations, leaving many to question the vulnerability the company will face at the end of a business cycle. In addition, lavish spending and questionable governance practices became concerning enough to public market investors that the bankers and the company pulled the deal, deciding to instead change leadership, cut expenses and address some of the concerns that were raised during the pre-IPO meetings. Perhaps it was this very public posterchild that stimulated the market's skepticism, or maybe it was just time, but some companies that missed profit expectations, even if revenue growth was strong, were treated with swift justice. While these events contributed to volatility in the markets, they also led to lower correlation between stocks which is healthy for active management. Our research process works to avoid poor business models, though for years many young high growth companies with unprofitable business models have been richly valued. This change is a welcome development.

Market Outlook

Mixed U.S. economic data, low inflation, further monetary loosening, continued trade uncertainty, Brexit deadlines, and the coming U.S. political cycle all make predicting the direction of markets difficult. It is no wonder that volatility has increased of late while investors digest and make sense of this slew of macro inputs.

While the poor economic readings in the rest of the world have much to do with economies that are inherently dependent on trade for growth, the sluggish U.S. data may be more linked to waning corporate confidence since ours is not an economy dependent on trade. The U.S. Consumer, still the strongest part of the U.S. economy, remains fairly resilient as evidenced by solid reports from consumer companies like Walmart and Target over the summer, as well as the rebounding housing sector which shows that low unemployment and low rates work to keep housing strong. Housing has a strong multiplier effect for jobs, and jobs appear to be hanging in there, which is key. Though the picture is mixed, we must remember that trade uncertainty may clear up quickly if the trade truce proceeds. Of course, many have been awaiting a deal (or at least a more permanent truce) since the beginning of the calendar year – us included – so the question becomes, why do we still expect this?

The simple answer is that the self-interest of the two parties at the table – the Trump Administration and President Xi Jinping and his advisors – is only more powerful today than it was six months ago. The Chinese economy is suffering, making the country more vulnerable to social unrest especially at a time when neighboring Hong Kong citizens are publicly airing grievances toward the Chinese rulers. President Trump, under formal impeachment proceedings in the House of Representatives and facing his own re-election campaign, knows how important a strong economy is to remain in office. While the U.S. consumer is probably strong enough to forestall a recession in 2020, economic worries, which may be amplified by a left leaning media, are not the headlines he wants going into the election next year. This should have the desired effect to lessen the pressure that is weighing down business confidence, though it will not remove it entirely.

Volatility may continue given the uncertain backdrop both here and abroad. This persistent low interest rate environment favors equities over bonds, and one must be highly selective when selecting sources of yield. We continue to be most constructive on the U.S., and advocate heavily in favor of actively managed, high quality portfolios.

Equity Markets Review

RICHARD L. CHILTON, JR, Chairman & Chief Investment Officer – Equities
JENNIFER L. FOSTER, Co-Chief Investment Officer & Portfolio Manager– Equities

The U.S. equity markets continued their march higher during the third quarter. Chilton Trust continues to perform well thanks to a broad list of holdings whose fundamentals are performing above expectation which have fueled the stocks higher. The Rails are one segment that have not performed as well as we hoped due to sluggish volume trends tied to economic uncertainty. Despite this, we continue to be positive on these business models for the future.

Railroads have long been duopolistic operators with natural pricing power and flexible labor, enabling remarkably consistent earnings growth over time, regardless of rail industry volume growth. Since 2000, two leading domestic Rail operators have grown earnings per share at an average of 18% and 21%, respectively, during years when total rail industry volumes were positive. More importantly, during years in which total rail volumes were negative, these operators have grown earnings per share in the mid to high single digits. Beyond this cyclically agnostic advantage, numerous recent and ongoing dynamics make them particularly attractive in our view.

The rail operators that we most like are at varying stages of implementing Precision Scheduled Railroading (PSR), a holistic operational approach designed to improve and optimize rail service, asset efficiency, and ultimately operating margins and profitability. In recent years, railroads have undergone a structural and sustainable improvement in cash flow generation, both on an absolute level driven by efficiency-based earnings growth (partly as a result of PSR implementation) and improved cash flow conversion due to lower capital spending requirements.

Leading rail operators have acknowledged this transformation and are using it as an opportunity to leverage their business models and balance sheets and return this cash to shareholders through dividends and share repurchases. For example, one of our portfolio companies has committed to returning twenty billion dollars to shareholders from 2018 through 2020 via share repurchases alone.

Lastly, railroads remain naturally advantaged as low-cost networks, which we consider unlikely to face new entrants and positioned to benefit from broadly increasing demand for the transportation of goods; according to the American Trucking Association, domestic freight tonnage is expected to increase 26% through 2030, driven by economic and population growth as well as the proliferation of e-commerce, which should help support long-term railroad demand.

We can't think about the outlook for equities in a vacuum. With the U.S. 10-year Treasury now trading at 1.77% as of this writing, where are investors going to find yield? The S&P Index has a Free Cash Flow yield of 4.26% which is about 7% more expensive than its 30-year Median. However, the average yield for the 10-year is meaningfully higher than current levels, which we believe makes equities a relative bargain. As of the end of September, 56% of the companies in the S&P 500 sported dividend yields greater than the 10-year treasury, and 43% have higher yields than the 30 –year treasury. To quote our friend Jason Trennert of Strategas when he describes the search for yield, "There is No Alternative" and in this environment, equities are likely to remain attractive to investors.

Fixed Income Markets Review

TIMOTHY W. A. HORAN

Executive Vice President & Chief Investment Officer - Fixed Income

Fixed income outperformance in the third quarter was driven by longer-dated securities and credit exposure as long end Treasury rates rallied and credit spreads remained well-contained. For example, our Crossover Plus strategy returned 1.55% on a net basis, benefiting in particular from a 25% weighting to Preferred securities. These instruments are often issued by financial institutions and typically have longer maturity profiles, thereby realizing outsize gains from the quarterly decrease in yields, as well as benefiting from solid earnings in the U.S. banking sector. And our 36% allocation to corporate bonds – much of which was in the BBB and BB rating categories - proved beneficial as well given the additional yield offered on a tax-adjusted basis relative to municipal bonds. By comparison, the Municipal Crossover strategy returned 0.49% on a net basis as the strategy does not invest in preferred securities and has a lower weighting to corporate bonds. While the strategy's municipal bond holdings rallied strongly in the first half of the quarter, most of these gains reversed in the second half of the quarter as Treasury yields rose, an environment in which the lack of credit spread yield on high-quality municipal securities manifests as a performance headwind. The Short Term Municipal Crossover strategy exhibited similar performance characteristics as net total return of 0.39% was largely attributable to the corporate bond allocation.

For portfolios subject to taxes, we favor strategies that incorporate municipal, corporate and preferred securities in a tax efficient portfolio. We maintain a core allocation to municipal bonds due to the attractive tax-free income, however our municipal sector allocation detracted from performance as municipals price gains lagged a rally over the quarter in taxable bonds. Our corporate bond allocation partially offset this effect given their higher yields.

External Manager Investment Review

LOUISA M. IVES

Managing Director & Head of Manager Research

The WeWork saga, coupled with recent IPOs like Uber, Lyft and Peloton, all of which have stumbled post-IPO, are a clear signal that equity markets have very little appetite for "growth at all costs", and is a very strong shot across the bow to private "unicorns", or startups that achieve a $1B valuation, regardless of losses incurred along the way. The heady valuations that late-stage private companies garner only highlight a growing disconnect between private and public market appraisals, and help reinforce a notion we have long advocated: invest with disciplined, experienced high quality managers that don't feel the need to chase the latest "hot" deal. Reflective of this discipline, we do not have exposure to WeWork in our portfolios.

The performance of our Recommended Managers in the third quarter of 2019 was solid, although weakest for those funds more aggressively exposed to growth sectors. Our U.S. hedge funds had mixed results; strength was found in more idiosyncratic and less trafficked positions, and our managers with Tech, Media, and Telecom exposure were hardest hit, particularly in September. Our long only managers demonstrated nice stability in the quarter, most of whom continue to put up very strong relative and absolute performance. Our international managers performed generally in line with their relative benchmarks, and continue to navigate well more challenging markets abroad.

We were on the road a fair amount this quarter, attending investment conferences, meeting with clients, managers and prospective managers alike. We continue to work hard to meet your needs and have appropriate, accessible solutions that reflect both today's environment and our long term investment horizon.

As always, we are grateful for your support. If you have any questions, please don't hesitate to reach out.

Richard L. Chilton, Jr. is the founder, Chairman and Chief Investment Officer of Chilton Trust Company, which in April 2012 was the first company in eight years to be awarded a trust charter in Florida. Mr. Chilton also serves as the Chairman, CEO and Chief Investment Officer – Equities of Chilton Investment Services and is the founder, Chairman, CEO and Chief Investment Officer of Chilton Investment Company.

Since founding Chilton Investment Company in 1992, Mr. Chilton has built a team of investment professionals focused on building wealth in favorable markets and preserving capital in declining markets. Under Mr. Chilton's leadership, Chilton Investment Company has developed an investment approach committed to fundamental, bottom-up stock selection and disciplined portfolio management.

Prior to forming Chilton Investment Company, Mr. Chilton was a managing director of Allen Value Incorporated and a vice president and equity portfolio manager at Alliance Capital Management Corporation. Mr. Chilton began his career in the Mergers and Acquisitions group at Merrill Lynch and Company.

Mr. Chilton is a trustee of The Metropolitan Museum of Art and a trustee of the Classic American Homes Preservation Trust, both located in New York.

Mr. Chilton received his B.S. in Finance and Economics from Alfred University.

Jennifer L. Foster is an Executive Vice President, Co-Chief Investment Officer & Portfolio Manager– Equities and is an equity specialist who has worked at Chilton Investment Company for over 20 years. Prior to taking on her role as Portfolio Manager in September 2012, Ms. Foster served as Chilton Investment Company's Director of Research for seven years. She also serves on the Chilton Investment Company Risk Management Committee, Board of Directors, and Executive Board. Preceding her tenure as Director of Research, Ms. Foster served for seven years as an equity analyst at Chilton covering the Software and Technology sectors.

Before joining Chilton, Ms. Foster worked at GE Capital as a financial analyst in several divisions of the company including commercial finance, commercial real estate, equipment leasing and corporate planning. Ms. Foster graduated summa cum laude with a B.A. in English from Boston College and earned an M.B.A. with distinction from Harvard Business School. She is a current trustee of St. Luke's School and the Calvin Coolidge Presidential Foundation.

Timothy W.A. Horan is an Executive Vice President & Chief Investment Officer – Fixed Income. With over 30 years of experience, Mr. Horan is a specialist in fixed income investing, ranging from municipal and US taxable securities to international bonds and currencies. He leads a team of nine professionals managing client assets across a variety of strategies including intermediate liquidity, tax-advantaged, taxable, international and global.

Prior to joining Chilton Trust, Mr. Horan was a Managing Director at Morgan Stanley Smith Barney and served as MSSB's Chief Investment Officer of Fixed Income Investment Advisers, a division of MSSB, providing customized portfolio management to ultra-high net worth private clients, charities, endowments, foundations, and family offices, primarily in North America, the Caribbean and Latin America. Earlier, Mr. Horan led Morgan Stanley's Private Wealth Management Fixed Income business in London serving European, Middle Eastern and Swiss private bank clients. Mr. Horan also served on the Morgan Stanley Global Asset Allocation Committee. Before joining Morgan Stanley, Mr. Horan was Director of International Fixed Income at Lord Abbett & Co. He also held senior management positions in fixed income and foreign exchange portfolio management at Credit Suisse, Aubrey G. Lanston & Company, Inc. and Bankers Trust. At Bankers Trust, he helped pioneer the fixed income risk management frameworks. Mr. Horan began his career at the Federal Reserve. During the Volcker years, he was an Economist in the Sovereign Debt Unit at the New York Fed, working on the debt restructuring of Brazil, Mexico and Argentina. Following the Plaza Accord, he also served as a foreign exchange trader for the Federal Reserve Bank of New York. Mr. Horan earned an AB with honors in Economics and History from the University of Pennsylvania, Wharton-Sloan Program. He was an Andrew Mutch Scholar in Economics and Politics at the University of Edinburgh and holds a post graduate law degree from the University of Cambridge, where he was a Thouron Scholar.

Louisa M. Ives is a Managing Director & Head of Manager Research. Ms. Ives is responsible for external manager selection and due diligence for Chilton clients and is also a member of the Executive and Investment Committees at Chilton Trust. Prior to joining Chilton, Ms. Ives was a Managing Director at Chilton Investment Company, where she was a research analyst covering the financial services sector. She also served on the company's Board of Directors. Prior to joining Chilton, she worked at Coopers & Lybrand Consulting Group, reporting directly to the CEO, and began her career at Chemical Bank in their Middle Market Lending Group. Ms. Ives graduated cum laude from St. Lawrence University with a B.A. in English Literature and earned an M.B.A from Harvard Business School.

Ms. Ives serves on the boards of The First National Bank of Long Island, the North Haven, ME Casino (Yacht Club), The Project Y Theatre Company, and on the Investment Committee of Vinalhaven, ME Land Trust.

Pepper Anderson is a President & Chief Executive Officer. Pepper Anderson is President and Chief Executive Officer of Chilton Trust, with nearly three decades of experience in financial services and wealth management. Prior to joining Chilton, Ms. Anderson spent more than 20 years with J.P. Morgan Private Bank, where she most recently served as Managing Director and Market Manager for Connecticut and Westchester County, NY. During her tenure at J.P. Morgan, Ms. Anderson developed a deep understanding of both technical investing and private client relationship management, holding roles of increasing responsibility across a diverse range of businesses, including U.S. Head of Discretionary Fixed Income, Head of the Private Bank's Fiduciary Investor Group, and Investment Team Lead for High Net Worth and Fiduciary. After obtaining her B.A. degree from Tulane University, Pepper's successful foray into the financial world began in equity trading at Bear Stearns & Co. She then held roles in fixed income portfolio management at Meredith, Martin & Kaye and the Union Bank of Switzerland.

Pepper serves on the board of the Greenwich YWCA, as a committee chair for Impact Fairfield County and enjoys additional volunteer opportunities with her church and children's schools.

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