

MP McShane Partners

DECEMBER 2019 INSIGHTS

INVESTMENT OVERVIEW

SMALL-CAP EQUITY: OUT-OF-FAVOR OR DOWN-AND-OUT?

The strong simultaneous underperformance of *small-cap* and *value* stocks has created a unique opportunity for patient, long-term contrarian investors. Concerns over slowing global economic growth, combined with lingering memories of the pain felt during last year's **-19.8%** "Christmas correction" in the S&P 500® Index, led to investors' favor *lower-volatility* (i.e., *lower-beta*), *high-quality large-cap* U.S. equities at the expense of *higher-beta*, *cyclical* equities, including small-cap stocks.

With market-cap-weighted stock market indexes continuing to hit new all-time highs this year, the relative valuation gap between large-cap and small-cap equities is greater than normal with a particularly large discount apparent in small cap value stocks with small-cap value trading at an extremely compelling **±64.0%** discount to small-cap growth.

MC SHANE PARTNERS' 2020 SIGNATURE PORTFOLIO MANAGER PANEL EVENT: INVESTMENT OPPORTUNITIES IN SMALL-CAP EQUITY

Given the compelling and controversial nature of the aforementioned opportunity in small-cap equities, particularly small-cap value, McShane Partners' fifth annual Portfolio Manager Panel Event will feature regarded small-cap equity managers from across the country to provide their thoughts on the market and

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WEALTH ADVISORY OVERVIEW

FOUR WAYS TO PROTECT FAMILY ASSETS FROM DIVORCE

How do I protect my (or my family's) assets from a divorce settlement? We often get asked this question by parents who want to leave money to their children. It is not a judgement of their child's choice of partner (usually). The question comes from a desire to leave a legacy to their children and grandchildren without potential disbursement to a divorcing spouse. Just as often, we get the question from a divorcing spouse when asset division discussions get sideways and they realize that "marital assets" is a pretty broad category. If you have substantial assets that you want to protect, you absolutely must work with a family law attorney and your financial planner to identify and implement strategies that are right for you. The time and effort expended on the front end may ensure your financial future (and that of your children) is what you envisioned.

While these conversations can be awkward, the discussion of finances and expectations around assets and liabilities coming into a marriage can go a long way toward preventing disputes after marriage.

PRENUPS

Most people hear the term prenup and perceive it will set a marriage up to fail. In reality, it may provide clarity around how a couple intends to treat assets and liabilities created prior to the marriage and may avoid confusion once bills or checks start arriving after the honeymoon.

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INVESTMENT TEAM

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POINTS OF INTEREST

- [Monthly Index Review](#)
- [Stock & Strategy Spotlight](#)
- [Around McShane Partners](#)

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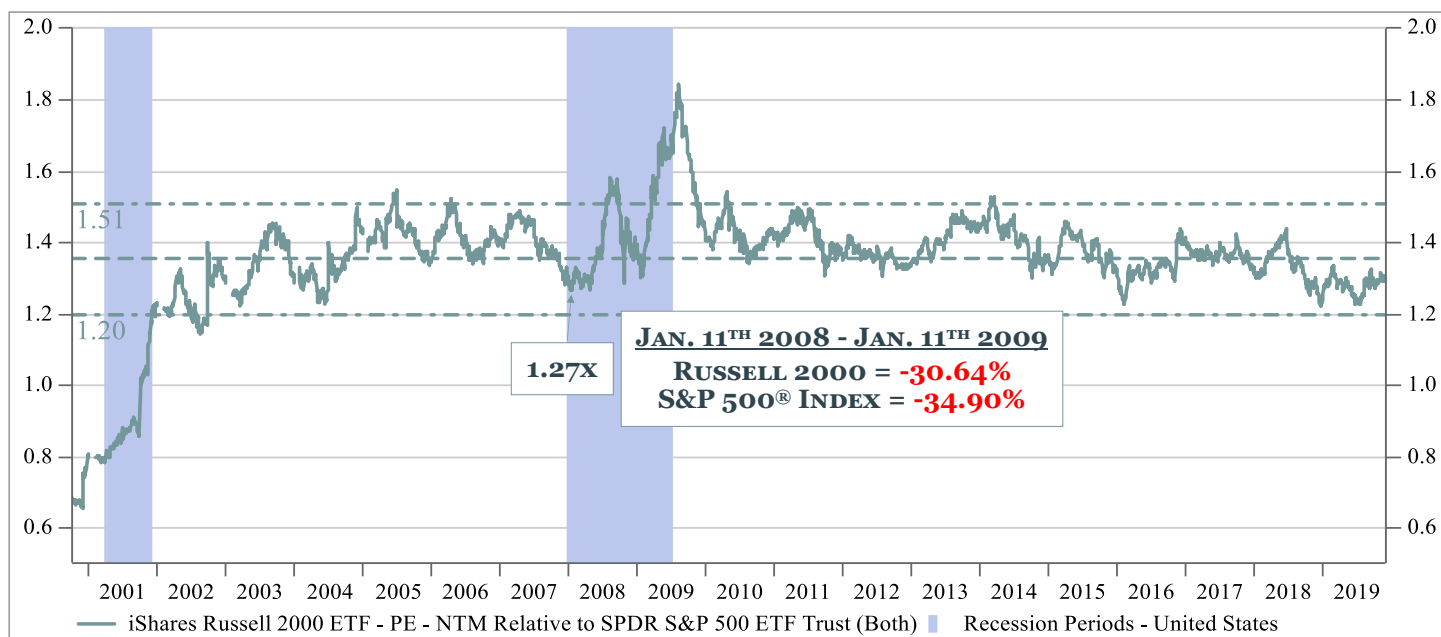
specific investment opportunities. This carefully curated panel of institutional portfolio managers will convene in Charlotte to discuss their views of small-cap equity investing at a time when the asset class has been blatantly disregarded by the majority of investors, while also providing insight into how and why *active management* continues to maintain a *comparative advantage* within the space, despite the exponential proliferation of passively managed, index-tracking investment vehicles over the past ±10-15 years. Given the timeliness of the topic, the caliber of our panelists, and the popularity of prior years' events, we recommend that you RSVP and reserve your spot as early as possible by contacting [Lesley Burke](#) directly via [email](#) or telephone (980) 585-3368. The event is scheduled for the evening of Tuesday, February 25th 2020 and will be hosted at Carmel Country Club, as the event has outgrown the previous venue: as such, you can expect a larger format event allowing for more guests, so please feel free to RSVP and indicate any additional guests that might enjoy this highly anticipated, unique event.

SMALL CAPS VS. LARGE CAPS: ATTRACTIVE/COMPELLING VALUATION

Small cap stocks normally trade at a premium to large cap stocks and the premium ebbs and flows according to

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CHART I: SMALL CAPS TRADING AT ATTRACTIVE VALUATIONS RELATIVE TO LARGE CAPS



Source: McShane Partners - FactSet Research Systems, Inc.

MONTHLY INDEX REVIEW USD TOTAL RETURN

DATA AS OF NOVEMBER 30 TH 2019	NOVEMBER 2019	2019 YTD	2018	2017
S&P 500®	+3.63%	+27.63%	-4.38%	+21.83%
Dow Jones Industrial Average	+4.11%	+2305%	-3.48%	+28.11%
NASDAQ Composite	+4.64%	+31.91%	-2.84%	+29.64%
Russell 2000	+4.12%	+22.01%	-11.01%	+14.65%
MSCI Emerging Markets	-0.13%	+10.56%	-14.24%	+37.75%
MSCI EAFE	+1.14%	+18.78%	-13.36%	+25.62%
Bloomberg Barclays U.S. Aggregate Bond Index	-0.05%	+8.79%	+0.01%	+3.54%

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investor appetite for small cap companies. Chart I, below, illustrates the historical relationship between the *forward-looking, price-to-earnings* (“PE NTM”) multiple for the iSHARES RUSSELL 2000 ETF (“IWM”) relative to that of the SPDR S&P 500® ETF (“SPY”) over the past **±19 years**. Small-cap equities are currently below their long-term historical average relative multiple vs. large-cap equities, reflective of negative investor sentiment surrounding small caps after the significant outperformance of large caps. Prior instances of extreme discounts in relative PE NTM multiples for small caps have typically been followed by relative outperformance vs. large caps over the subsequent 12-month period: for example, after the IWM traded down to a relative multiple of **±1.23x** vs. the SPY in June 2004, the Russell 2000 returned **+15.12%** over the following year vs. a comparable return of **+8.93%** for the S&P 500® Index.

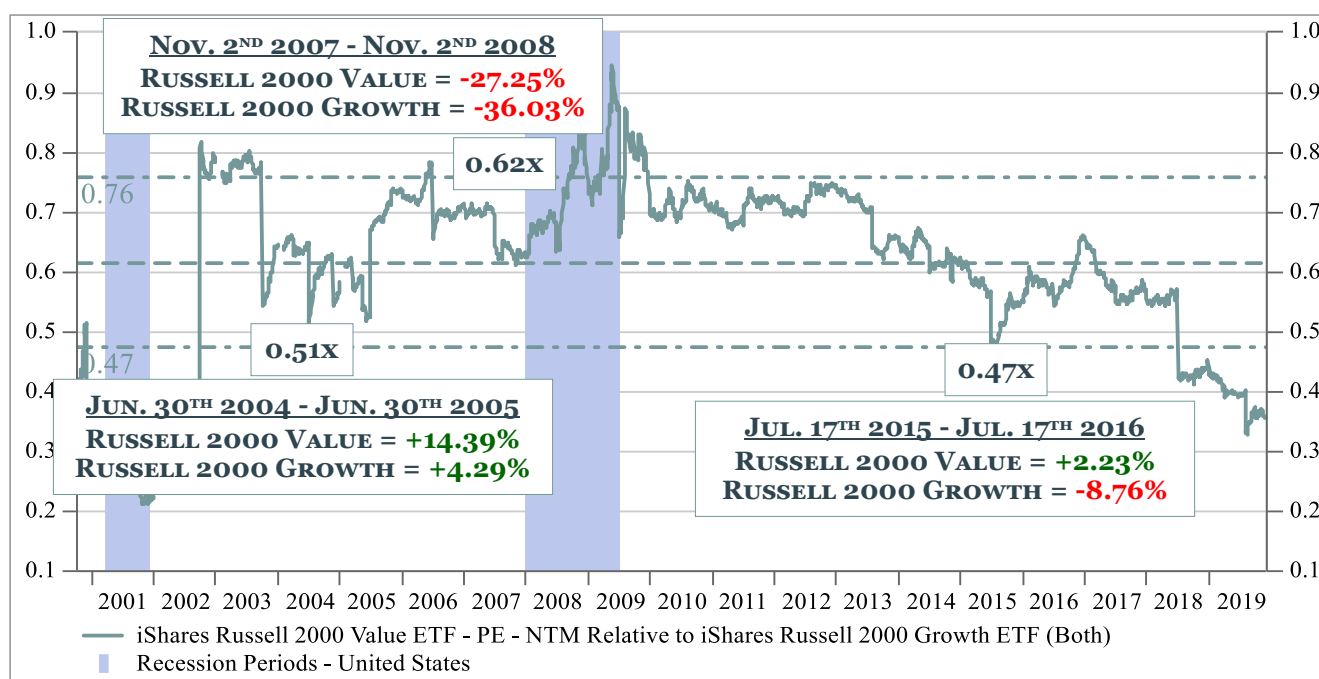
Furthermore, at the onset of the Global Financial Crisis (“GFC”) and through the preliminary phases of the recession, the IWM traded down to **±1.27x** vs. the SPY in January 2008: the lowest relative multiple since June 2004. Over the next 12 months, however, the Russell 2000 provided incremental downside protection, exhibiting a smaller negative return of **-30.64%** vs. a comparable decline of **-34.90%** for the S&P 500® Index: from January 2008 through January 2009, during some of the worst months of the recession and equity bear market cycle, the Russell 2000 generated **+426** basis points (“bps”) of incremental outperformance vs. the S&P 500® Index. Thus, increasing ownership of inexpensive small cap stocks relative to large caps during instances of extreme negativity has shown to accentuate performance if done correctly.

SMALL-CAP VALUE PARTICULARLY ATTRACTIVE

Dissecting the small-cap U.S. equity investment universe further unveils value stocks trading at an exaggerated discount to *growth* based on index-level relative PE NTM multiples. As can be seen in Chart II, below, the iSHARES RUSSELL 2000 VALUE ETF (“IWN”) is currently trading at a relative discount of approximately **-64.0%** to the iSHARES RUSSELL 2000 GROWTH ETF (“IWO”), despite IWN historically trading at an average relative discount of **-38.0%** vs. IWO over the past **±19 years**. As indicated in Chart II, prior episodes of small-cap value stocks trading at extreme relative discounts to small-cap growth stocks have typically resulted in considerable relative outperformance for value vs. growth over the subsequent 12-month

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CHART II: SMALL-CAP VALUE ATTRACTIVE RELATIVE TO SMALL-CAP GROWTH



Source: McShane Partners - FactSet Research Systems, Inc.

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period.

After bottoming and hitting near-term “trough” relative multiples vs. small-cap growth, small-cap value has typically generated meaningful relative outperformance over the following year: in the three instances highlight in Chart II, the Russell 2000 Value outperformed the Russell 2000 Growth by an average of **+996** bps over the next 12 months.

“Rallies that follow good news are not nearly as likely to last as those that anticipate the event.”

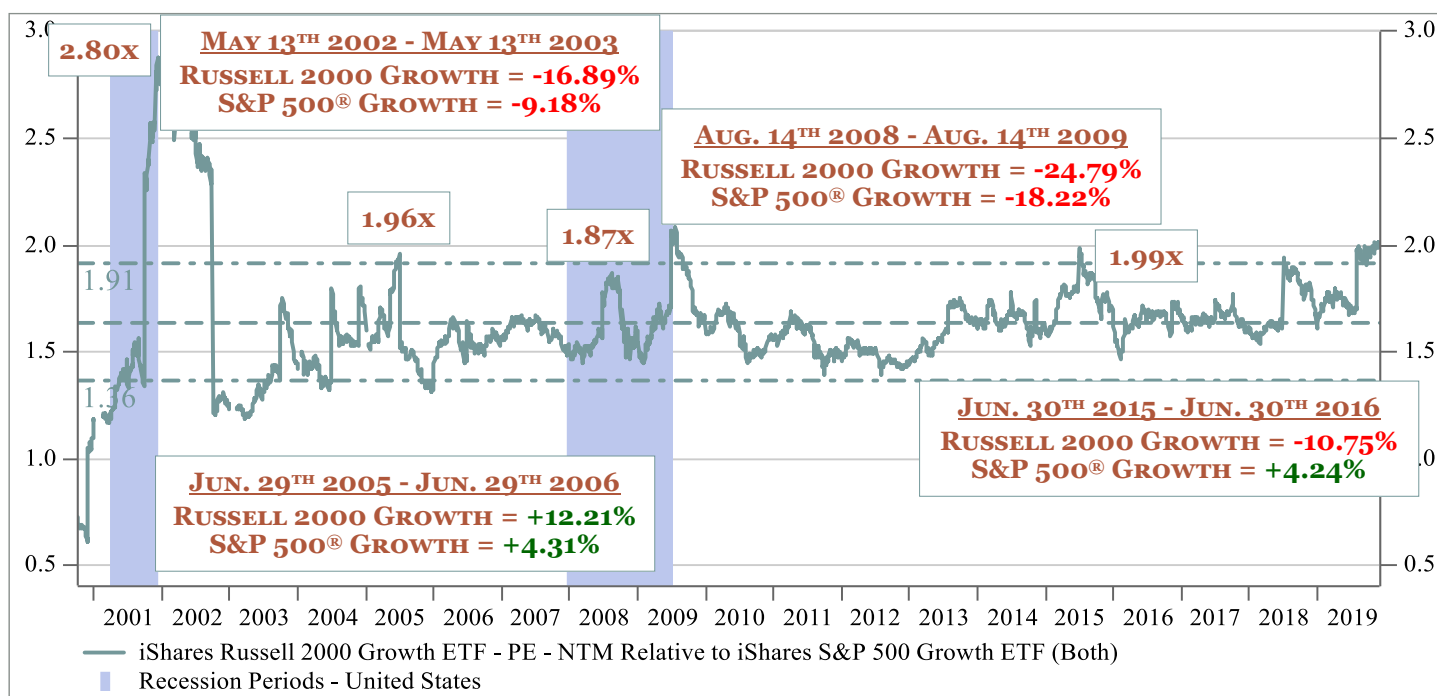
- Laszlo Birinyi, Jr.

SMALL-CAP GROWTH APPEARS EXPENSIVE

Not only does small-cap growth appear expensive relative to small-cap value, as previously illustrated in Chart II, but it is also historically expensive relative to large-cap growth. Chart III, below, highlights how the IWO is trading at relative PE NTM multiple of **±2.0x** vs. that of the iSHARES S&P 500® GROWTH ETF (“IVW”): while this is within **±1.0** standard deviations vs. the **±19-year** historical average of **±1.6x**, the **+25.0%** premium reflected in small-cap vs. large-cap valuations may be reflective of investors paying a premium for growth in the later stages of the economic cycle as growth rates compress.

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CHART III: SMALL-CAP GROWTH APPEARS EXPENSIVE VS. LARGE-CAP GROWTH



Source: McShane Partners - FactSet Research Systems, Inc.

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SMALL-CAP VALUE TENDS TO EXHIBIT LATE-CYCLE DURABILITY

As can be seen in Table I, below, while small-cap value has historically underperformed small-cap growth in the years immediately *preceding* a broader slowdown in the business cycle, small-cap value has typically exhibited *better* downside protection and has generated relative *outperformance* vs. small-cap growth during and through prior U.S. recessionary periods.

TABLE I: LATE-CYCLE EQUITY MARKET & HISTORICAL INDEX-LEVEL PERFORMANCE
USD TOTAL RETURN

INDEX PERFORMANCE	2001	2002	2007	2008	2019 YTD
S&P 500®	-11.89%	-22.10%	+5.49%	-37.00%	+27.63%
S&P 500® Value	-11.71%	-20.85%	+1.99%	-39.22%	+27.94%
S&P 500® Growth	-12.73%	-23.59%	+9.13%	-34.92%	+27.40%
Russell 2000	+2.49%	-20.48%	-1.57%	-33.79%	+22.01%
Russell 2000 Value	+14.02%	-11.43%	-9.78%	-28.92%	+18.25%
Russell 2000 Growth	-9.23%	-30.26%	+7.05%	-38.54%	+25.61%

Source: McShane Partners - FactSet Research Systems, Inc.

STOCK & STRATEGY SPOTLIGHT

NAME	TICKER	2019 YTD
Absolute Convertible Arbitrage Fund	ARBIX	+5.85%

DESCRIPTION & INVESTMENT THESIS

The Absolute Convertible Arbitrage Fund (“ARBIX” or “the Fund”) recently announced that it has approved a *reduction* in the net expense ratio for the Fund from **1.60%** to **1.40%** effective immediately through August 1st 2020. ARBIX has been a core holding/position within our Hybrids’ allocations across applicable client investment portfolios since the Investment Team decided to add the Fund to our firm-wide buy lists in May 2018: as a quick reminder, ARBIX should **not** be confused with the Absolute Strategies Fund (“ASFIX”), which the Investment Team effectively rotated out of back in September 2017 after having removed it from our firm-wide buy lists. The Investment Team continues to believe that ARBIX is an extremely attractive strategy and offers complementary exposure for long-term investors with dedicated allocations to alternative investment strategies (i.e., Hybrids). As part of its in-depth research and due diligence process, the Investment Team reviewed the historical performance of the Mohican VCA Fund, LP (the “Predecessor Fund”) during the later stages of the previous market cycle and believes that the Fund is capable of providing enhanced risk-adjusted returns (i.e., alpha) at this stage in the current market cycle. After returning **-19.62%** in 2008, the Predecessor Fund generated an extremely impressive **+51.12%** return in 2009, for a cumulative 2008-2009 return of **+21.47%**: outperforming both the Bloomberg Barclays U.S. Aggregate Index (**+11.48%**) and the HFRI Fund Weighted Composite Index (**-3.56%**). Furthermore, ARBIX delivered crucial diversification benefits just this past year, returning +2.07% in 2018 vs. comparable returns of **+0.01%** and **-1.22%** for the Bloomberg Barclays U.S. Aggregate Index and the HFRI Fund Weighted Composite Index, respectively.

As always, Please feel free to reach out to a member of the Investment Team if you would like any additional information on ARBIX, including our investment thesis, or if you have any questions, comments, or concerns regarding the strategy and/or your investment portfolio.

WEALTH ADVISORY OVERVIEW

FOUR WAYS TO PROTECT FAMILY ASSETS FROM DIVORCE

A prenuptial agreement is a private agreement between a couple signed before they get married which sets forth the division of their assets in the event of divorce or death. Each state has its own laws regarding the enforcement and validity of prenuptial agreements. Which state's law to apply depends on where the marriage took place, where the parties live during the marriage, and what law the agreement specifies. Often, couples will seek out the laws of the state that will be most beneficial in carrying out the terms of their prenup. Prenup agreements may be particularly helpful where one or both spouses have children from a previous marriage.

In most states, the agreement has to be fair, the parties have to fully disclose their assets prior to signing the prenup, and the parties each need their own attorney.

POSTNUPS

Depending on state law, couples may also be able to enter into a postnuptial agreement, which is signed after the marriage. The basic components of a postnuptial are the same as a prenuptial, although postnuptial agreements may be harder to enforce depending on the state, and some states require consideration to be given. Consideration is something of value that one party gives to the other to induce him or her to sign the agreement. That could be cash, real estate, stock, or other assets.

DON'T COMINGLE

Adding a spouse to an account or moving inherited funds into a joint account may make those funds jointly owned property. Even if you can trace the origin of the money, often a difficult task, you can't take pre-marital money back from a joint account. Therefore, this may mean maintaining separate accounts for some portion of your assets, including transferring income from a separate investment account to a separate checking account. Conversely, both parties should be listed on any asset they want to have viewed as a family asset. That includes houses, investments, boats, etc. The title on an account is not just optics, it determines access and legal ownership to the assets. Changing the title on assets is not as easy as filing a form and may require in-person signatures, and/or notarized releases, or formation of an entirely new account to change the owners of the assets.

TRUSTS

While a discussion of trusts is beyond the scope of this article, keep in mind that trusts can act as a shield against creditors as well as disgruntled spouses. In general, a trust must be irrevocable to be effective, whether created by parents for a child or by a wealthy individual prior to marriage. The less control the beneficiary has over trust assets, the less likely the trust assets will be endangered during a divorce. The timeframe for creating a trust is important to establish its validity. Creating a trust and transferring assets immediately prior to filing for divorce may be viewed as a fraudulent or inappropriate transfer.

Finally, different types of trusts may be suitable for different assets. Your attorney may advise for a different type of trust depending on the type and location of the property, age and income of the intended beneficiaries, and charitable giving goals. Recommendations may include Qualified Personal Residence Trusts, Domestic Asset Protection Trusts, Revocable Living Trusts, Grantor Retained Annuity Trusts, or others. All of which should be modeled and discussed to determine the pros and cons relative to the desired outcomes.

IN SUMMARY

When dealing with money, especially in situations of disparate wealth or family money, it is important to understand your options. You should clearly communicate with your attorney, financial advisor, and most importantly your spouse to ensure that everyone gets what they want, and deserve.

AROUND McSHANE PARTNERS

McSHANE PARTNERS SPONSORS VERSE & VINO

2019 was our fifth year sponsoring this premier event, which supports the Charlotte Mecklenburg Library Foundation. Verse & Vino was an extraordinary evening featuring multiple New York Times best-selling authors.



Clients and guests enjoyed their new found knowledge on the essential pillars of the art of entertaining followed by an intimate luncheon honoring the world-renowned event planner.

CELEBRATING

The McShane Partners team hosted its annual offsite meeting on November 18th. This meeting was held at The Duke Mansion Library. We reviewed a successful 2019 and set new initiatives and goals for 2020. Lesley Burke, won the coveted Most Valuable Employee (“MVE”) award this year!

McSHANE PARTNERS SUPPORTS THE LEARNING SOCIETY AT QUEENS UNIVERSITY

The *Learning Society* of Queens leads the way in influencing intellectual dialogue in the Charlotte region. On November 19th, McShane Partners sponsored the Fall Learning Society program, A Conversation with Michelle Alexander at the Belk Theatre. In her acclaimed best-seller, *The New Jim Crow: Mass Incarceration in the Age of Colorblindness*, Michelle Alexander peels back the curtain on system racism in the American prison system.



We will celebrate our accomplishments at this year's office holiday party on December 19^h at Peppervine in South Park.

We would also like to congratulate Corey Meyer and Daniel Hudspeth on passing their Series 65 exam — the NASAA Investment Advisers Law Examination.

CLIENT VISITS IN PHILADELPHIA

McShane Partners and clients had a wonderful time at Fork, a modern American restaurant in historic Old City Philadelphia.



MINT AUXILIARY FALL EVENT WITH BRONSON VAN WYCK

The Fall Enrichment Forum, hosted Bronson Van Wyck at the Mint Museum Uptown at the Levine Center for the Arts on November 14th. This is the man *Vogue* called “The Wizard of Oz of New York party planning.”



HOLIDAY HOURS

Our offices will be closed on Wednesday, December 25th and Thursday, December 26th, as well as Wednesday January 1st 2020.

Please provide any planning needs or cash distribution requests accordingly.

**We Wish You & Your Loved Ones
A Very Happy Holiday Season and
A Peaceful & Prosperous New Year!**

McSHANE PARTNERS

Wealth management is our only business; therefore, our attention is undivided and our intentions are transparent.

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