OSTERWEIS
CAPITAL MANAGEMENT

Equity Investment Outlook
April 2019

After suffering a tumultuous fourth quarter last year, the stock market rebounded nicely in the first quarter of 2019. Fears of an economic slowdown, escalating trade wars and monetary tightening gave way to optimism over continued economic expansion, low unemployment, a trade deal with China and a recognition that the Federal Reserve (the "Fed") was pretty much done with its tightening cycle. The rally stalled a bit in March following Fed Chairman Powell's remarks about a possible slowdown in the economy, but by then the markets had already posted substantial gains driven by strong earnings.

Moreover, parts of the yield curve again inverted, a "true" sign of impending recession. The real truth is that the yield curve has a habit of inverting more often than the economy has of going into recession. While there is no question the world faces a broad-based global slowdown, we think the U.S. economy should continue growing at a moderate pace with inflation well in check. The Fed has a dual mandate of (1) maintaining full employment and (2) stabilizing prices (i.e., low inflation). Since inflation is at or below the Fed's target of 2%, we expect the Fed to be focused on maintaining full employment. Conclusion: a partially inverted yield curve in a low-interest rate environment does not necessarily indicate impending recession. Central banks around the world are running very accommodative policies, and underlying economic activity continues to be healthy, albeit moderating.

Our forecast, therefore, is that we will continue to be in a slow growth environment with moderate inflation. This has been the theme ever since the great financial crisis of 2008. We remain cautious given the extended duration of our economic recovery. As such, we continue to focus our investments in companies that are enjoying strong secular tailwinds, that have strong balance sheets and relatively low leverage, that have significant competitive advantages (often called moats), and that can experience accelerating earnings and cash flow growth. These are the same themes we have discussed in previous Outlooks.

Going forward, the stock market may well experience some volatility as investors vacillate in their collective assessment of economic growth, inflation, interest rates and the political landscape. And, of course, there is some risk of an earnings recession as opposed to a general economic recession. But to the extent we own companies with steady or improving earnings and cash flows, we expect to be well served over time. To give you a sense of what we mean, please review the following case study of Brookfield Asset Management, a company that embodies all the themes we think are important at this time.

> Brookfield Asset Management (BAM) is a 100-year-old asset manager of real estate and infrastructure assets. It has a long history of operating globally and a shrewd ability to acquire assets cheaply in times of stress. The company has a pristine, cash rich balance sheet and generates vast amounts of free cash flow. It benefits from strong secular tail winds as institutional investors around the world devote an ever-greater percentage of their portfolios

to the type of assets managed by Brookfield. Brookfield's scale and global reach give it a significant competitive advantage.

Because Brookfield has such extensive liquidity (cash), it should also benefit from either a recession or market dive by being able to acquire assets cheaply or buy its own stock at bargain prices. Moreover, it pays a modest but growing dividend. This is the kind of company one could own for many years.

We believe a majority of the companies we are currently invested in share many of these same favorable characteristics and should be able to continue growing earnings and free cash flow through periods of economic weakness. As another example, consider Digital Realty Trust (DLR), a REIT that invests in data centers. DLR is the largest independent developer, operator and owner of data centers. The massive trend towards the digitization of business processes, communications and entertainment, as well as the use of cloud computing to enable this trend, have created an almost insatiable demand for more data centers. DLR leases out space in its centers to extremely credit-worthy tenants such as Facebook, Microsoft and JPMorgan Chase on a long-term basis with annual rent escalators, thereby creating a highly predictable, growing revenue and earnings stream. It pays a 3.5% dividend that we believe will grow over time.

While BAM and DLR are two examples of companies that have delivered predictable earnings growth, we believe many of the stocks in our portfolio should be able to do likewise. Please let us know if you have any questions.

Sincerely,

John

John Osterweis

Past performance is no guarantee of future results. Index performance is not indicative of fund performance. To obtain fund performance call (866) 236-0050 or visit osterweis.com.

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As of 3/31/19, the Osterweis Fund held Brookfield Asset Management (4.4%), Digital Realty Trust (2.6%), Facebook (0.0%), Microsoft (4.2%) and JP Morgan (0.0%).

Holdings and sector allocations may change at any time due to ongoing portfolio management. References to specific investments should not be construed as a recommendation to buy or sell the securities by the Osterweis Fund or Osterweis Capital Management.

Earnings growth is not a measure of the Fund's future performance.

Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

Free cash flow represents the cash that a company is able to generate after laying out the money required to maintain and expand the company's asset base. Free cash flow is important because it allows a company to pursue opportunities that enhance shareholder value.

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