PORTFOLIO NOTES	**APRIL 2020**

To our Business Partners:

- ***SO, WHAT NOW?*** The coronavirus outbreak continues to dominate the news. With widespread economic disruptions and now the recent government lockdowns, there is little question that our economy will be significantly negatively affected. Companies are starting to report weak results for the recent quarter ended March. They are forecasting further weakness which has become extremely difficult to quantify. We have no way of knowing what the future holds (and neither does anyone else!). While much of this may already be reflected in current stock prices, we're concerned about further damage being caused by the business lockdowns. History shows that there are aftershocks following the initial economic and market "earthquake." However, this crisis will not last forever and long-term forces will again prevail.

  So far, these events have driven stock prices down to cheaper levels, which should mean that future returns will be higher. Whether they are at their cheapest, we don't know. Companies that we have been closely monitoring have become attractive for the first time in many years. This should give us an opportunity to buy high quality companies at prices that provide a good chance of achieving satisfactory returns. It bears repeating – high valuations set the stage for below-average returns, so we cut back on stocks; low valuations set the stage for above-average returns, so we accumulate them slowly and methodically. No one is ever going to call or buy at "the bottom," but we're moving closer to that stage.

  As always, our research activities continue to focus on companies that have a high probability of providing above-average returns, by buying them at substantial discounts to estimated long-term value. Taking on added importance in the current environment will be financial soundness. Many companies, including some of ours, have taken advantage of low interest rates to load up debt over the past few years. Many used that debt to buy back their own stock, at prices that were perhaps too high. Not only did they not use more funds to reinvest in their businesses, but they now have much less margin of safety to weather tougher economic times. While paying attention to balance sheets, the other company attributes like profitability, growth, size, and insider ownership are still important. Of course, Mr. Market has to offer them at attractive prices.

- ***VALUATION.*** The Crash of 2020 began on or around February 19. At the time, our group of portfolio stocks* was selling for 88% of value. Now it's at 68%, indicating better upside. At the same time, more companies we monitor have reached our two-thirds-of-value threshold, so we're intensifying the research effort and building a buy list. Given the uncertainty discussed above, we're likely to build positions in stocks a little bit at a time, rather than "backing up the truck" and buying everything in sight at once. Looking back three years from now, we ought to have acquired a basket of high-quality companies that earned satisfactory returns.

- ***RECENT RESULTS.*** As the effects of the coronavirus continue, stocks have declined as portions of the economy have essentially been shut down. Indexes were down 10-20%, with small and medium sized companies booking the worst declines as they are perceived to be more vulnerable in an economic downturn than large companies. For the first quarter, declines range from 14% for the NASDAQ Composite to over 30% for the small and midcap indexes. The "average" stock of those traded on the New York Stock Exchange has declined 25%. While somewhat of a hollow victory, over the last twelve months our group of portfolio stocks* compares favorably to most of the indexes, while still trailing the S&P 500 and the NASDAQ Composite.

Steve Nichols, CFA   *Bill Warnke, CFA*

****The group of "portfolio stocks" -- our Equity Composite for the purpose of evaluating investment performance -- consists of 19 stocks that are held in our clients' accounts. Portfolios might hold some or all of these stocks, depending on investment guidelines unique to each client, the timing of purchases and sales, and start dates of accounts. The performance of this group of stocks is a good proxy for our equity performance but might vary widely among accounts. Of course, past performance is not necessarily indicative of future results.***