PORTFOLIO NOTES	MAY 2020

To our Business Partners:

- ***BIPOLAR INVESTING.*** While we have talked extensively about "Mr. Market" and his manic/depressive behavior, another aspect of the current environment deserves some attention. There are widely divergent guesses about future corporate profitability. The U.S. economy is now in completely uncharted territory because of the coronavirus lockdowns. One will have to consider possibilities that prior experience simply do not cover. One optimistic group thinks our economy will return to normal quickly – the so-called "V-shaped" recovery. On the other hand, the possibility now exists for outcomes rarely seen historically – perhaps a level of economic activity and slow recovery not experienced in decades. In any case, don't believe ANY forecasts of the economy or the stock market; nobody knows, and it doesn't matter.

  Despite the seemingly wide range of possible outcomes when looking at the "big picture," when one analyzes individual companies, like we do, there's usually a higher level of confidence in the future. The analyst relies to some extent on a company's historical trends, financial strength, average profitability, returns on invested capital, and other operating fundamentals. This yields a reasonable range of future estimated values for companies, compared to the nearly impossible task of forecasting the aggregate economy or valuing the stock market.

  We have been concerned for some time whether the trend of rising corporate profitability over the last 10-15 years was sustainable. It's not … the trend has been broken in a few short months. Companies in strong financial condition with sustainable competitive advantages will prevail in this highly uncertain environment, but it is likely to be a rocky road, with alternate levels of mania and depression depending on current events. A new "normal" range of business outcomes over the next 10-15 years will probably result in a wider range of expected stock values.

  Mr. Market is going to be even more schizo than ever before (meaning stock prices will be more volatile). Our job, then, is to maintain reasonable, conservative expectations, remain rational, disciplined, and patient to ensure there's a large enough margin of safety in all our stock purchases to minimize the risk of loss and earn a satisfactory return on invested capital.

- ***OUR INSPIRATION***. Benjamin Graham, the father of modern security analysis who established the Value Investing discipline, was born May 9, 1894. (His "Mr. Market" parable appeared in The intelligent Investor.)

- ***VALUATION.*** More high-quality companies at attractive valuations are coming our way. We continue to slowly build positions among our stocks* while researching possible additions to the group.

- ***RECENT RESULTS.*** Stocks continued to rally in April, with gains of 11-15%. The tech-heavy NASDAQ, led by the wildly popular and overpriced FAAMGs (Facebook, Amazon, Apple, Microsoft, and Google), recorded the largest gains. This group of 5 stocks has an undue influence on the popular averages, accounting for over 20% of the S&P 500 and nearly 40% of the 3,300-stock NASDAQ Composite.

  "The market" isn't nearly as good as it looks. FAAMG is up 10% through April, while the remaining 495 S&P companies are down 13%. Meantime, the "average" stock in the larger New York Stock Exchange group is down over 26% this year to date. Historically, this has never yielded a good outcome. Even though we own none of the FAAMGs, our stocks* continue to compare favorably to most of the indexes over the last twelve months and year to date. We still trail the S&P 500 and the NASDAQ Composite for obvious reasons.

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.