PORTFOLIO NOTES	JUNE 2020

To our Business Partners:

- ***BACK TO SQUARE ONE?*** There's been a powerful rally in stock prices over the last 11 weeks; so quick and sharp that stocks have gone from overvalued (mid-February) to moderately undervalued (late March) to overvalued again in less than 60 days. These stock market moves, combined with the collapse in the U.S. economy, are truly extraordinary events. As one commentator put it, equity valuations are in the top 10% of historical highs by almost every valuation measure, while the economy is quite possibly in the bottom 10%, near 1930s depression levels. It's extremely difficult to put one's mind around the disconnect between prices and underlying business fundamentals.

  While recent employment data has been positive, we are still in unknown territory. Many believe that the catalyst for the economic recession was the coronavirus lockdowns, while the latest run-up in stock prices is largely driven by the liquidity has been injected by the Federal Reserve to prevent the economic cycle from running its natural course. Two phenomena seem to be driving up stock prices: "TINA" (there is no alternative (to stocks), and "FOMO" (fear of missing out).

  Heading into the March lows, we established some new stock positions at attractive prices. Of course, in retrospect, we wish we had done more. But we have now reached a point where stocks in general are again priced to produce below-average future returns at a time when risks have markedly increased. Balance sheets have gotten considerably weaker due to an explosion in debt at every level – corporations, government, and individuals. To boot, corporate profitability has likely been impaired for the next year or two, possibly longer, due to the staggering economy. While we will add to our positions on a case by case basis as prices dictate, overall market conditions do not fully reflect some of the difficulties seen down the road.

- ***NEW WEBSITE!*** Long overdue, we have completely revamped our website. Please navigate to **www.warnkenichols.com** to check it out. It looks good on the computer screen and is also attractively formatted for your tablet and smart phone. There might be a few future tweaks, but it's live today.

- ***VALUATION.*** We prefer not to add to our favorites during a euphoric melt-up in stock prices. Many remain cheap, and we'll add to them as prices weaken or consolidate. As a group, our portfolio stocks* are priced at around 73% of value – good, but not great.

- ***RECENT RESULTS.*** Stock price gains continued in May, with indexes rising 4-7%. Indexes containing small- and medium-sized companies finally improved. After many years underperforming the large-cap stocks, it remains to be seen whether it's the beginning of better results from small- and mid-caps. Year to date and over the last twelve months they still trail the large company indexes by a significant amount.

  The "average" stock in the larger New York Stock Exchange group is still down over 23% this year through May. Small and medium company indexes are likewise down 15-20%, while large company indexes have declined by 5-11%. The lone exception is the NASDAQ Composite, dominated by a few favored expensive stocks, has gained about 6%. Our stocks* compare favorably to most of the indexes over the last year and year to date, but trail the S&P 500 and the NASDAQ Composite due to the heavy influence of the "favored few," none of which we own.

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.