Warnke/Nichols Ltd.
Investment Management

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PORTFOLIO NOTES **NOVEMBER 2020**

To our Business Partners:

- ***WINNERS AND LOSERS.*** It has been a market of haves and have-nots ever since the coronavirus shook the markets in March. Stocks are being priced with the assumption that current conditions will be permanent. Companies perceived to benefit from the pandemic (health care, stay-at-home, technology, big-box retailers, utilities) are seemingly immune from economic forces and any normal valuation standards and will trade at perpetual price premiums. At the same time, companies and industries deemed to be permanently crippled by the pandemic (travel-related, energy, banking, restaurants) are relegated to the dustbin of stock market losers and are seemingly lucky to even survive.

  No doubt there are some trends already in place that have been reinforced in the current environment, but nothing is ever permanent. Trends do not last forever. The technical term is "Mean Reversion." Investopedia (www.investopedia.com) defines it as "a theory used in finance that suggests that (stock) prices and historical returns eventually will revert to the long-run average level of the entire (market)." When events swing in one direction for too long, countervailing forces come into play and the pendulum starts to swing back. In the stock market, valuations never stay at extremes indefinitely. Most glamour stocks fall because they don't live up to rosy expectations, while cheap, unpopular stocks come back into favor as they tend to exceed lowered expectations.

  We strongly believe in reversion to the mean, so we're confident the gravitational financial forces are still at work. Investors got a taste of that recently when the effectiveness of a Covid-19 flu vaccine was announced by both Pfizer and Moderna. Some of the extremes at both ends of the market eased. Groups like energy, banks, and travel companies soared off their price lows, while big tech and stay-at-home stocks went flat. We're still a long way from erasing these "permanent" disparities, but it will happen, just as it always has in the past.

- ***VALUATION.*** Prices to values of our group* are mixed. The cheap, unloved stocks have had a terrific last few weeks, so we hold off on adding to them for the time being. On the other hand, we continue to pare back on stocks selling above 100% of value because their potential for satisfactory future returns has diminished. The buildup of cash might not yield much today, but it seems like a good investment while economic and political happenings sort themselves out in the coming months.

- ***RECENT RESULTS.*** Market results were mixed in October, with somewhat of a reversal in the prevailing trends this year. The major indexes – the Dow Jones Industrials, the S&P 500, and the NASDAQ Composite – all declined in October from 2% to nearly 5%, while the small- and mid-cap indexes all recorded gains of over 2%. Over the last 12 months, the mega-indexes are still way ahead, but smaller companies are narrowing the performance gap. The S&P 500 is up about 8%, while the S&P 400 (mid-cap) Index is down around 3% and the S&P 600 (small-cap) Index is down about 9%. Believe it or not, a large segment of the market is still DOWN over the last year, evidenced by the median stock on the New York Stock Exchange, which is down over 15%. (The median stock is the one in the middle of the list.) Our widely held stocks*, as a group, compare favorably with the small- and mid-cap indexes.

Steve Nichols, CFA   Bill Warnke, CFA

The group of "portfolio stocks" -- our Equity Composite for the purpose of evaluating investment performance -- consists of 18 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.

We hereby offer to deliver to you without charge a copy of our current Form ADV Part 2, in accordance with the U.S. Securities and Exchange Commission's "Brochure Rule." Please contact us if you would like us to send you a copy.

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