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Opportunity is Knocking!

A. Market Update

Finally some excitement in the markets! As we have discussed many times with each of you, the markets go up and the markets come down. Over a reasonable period of time, we want to be ahead of the market. We will accomplish this by investing in great businesses and staying focused on the playing field! We are not the least bit surprised by the recent turbulence or fazed by it in the least. On the contrary we are very excited with the opportunities that are emerging out of the market volatility. What surprises us most is that we have not had a correction (a 10% reduction in the stock market) for so long!

Rest assured, we are spending the majority of our time patiently looking for companies to pick away at so that we can use these market swings to increase the long-term performance of your portfolios. This is one of the major reasons we like to maintain a cash position in your portfolios. In a correcting or downward moving market "cash is not trash"! It's also a great reason to own precious metals securities, which typically advance in the face of market turbulence!

We have provided you with two recent excerpts from newsletters we published last year. They encapsulate some of our current thoughts and reinforce our investment philosophy and approach, in the midst of the current market swings. Please note the highlighted and underlined sentences.

B. Excerpts from Recent Newsletters

Excerpt from our March 2017 Newsletter

The Federal Reserve has finally initiated the fifteenth tightening cycle since 1945[i], after the some of the most lax monetary policies in human history! It is important to point out that in 80% of the prior fourteen episodes, recessions followed, with business contractions taking place in eleven of the fourteen tightening periods. "What is notable today is that the economy is in the 93rd month of this expansion, a length of time that is well beyond periods in prior expansions where soft landings occurred (1968, 1984 and 1995)."[ii] This means that the economy is extremely vulnerable to a shock, which could lead to recession. It is interesting to note that regardless of whether there was an associated recession, during the past interest rate tightening periods, the last ten cycles of tightening all triggered financial crises. **It is not a time to be complacent.**

We must move forward with caution in the current environment, despite increased optimism in many areas of the global economy. Optimism is wonderful, but it can be misplaced at times!

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Four important considerations that exist today that were not present in past cycles, and that could magnify the current restraining actions of the Federal Reserve:

1. The Fed has initiated a tightening cycle at a time when the overall economy is still very weak with growth in nominal GDP lower than in any of the prior fourteen cases when tightening occurred.

2. Business, government and personal balance sheets are laden down with record amounts of debt. This means that even small changes in interest rates will likely have a whopping impact on investment, spending, and savings decisions within the economy. If debtors are now at the end of the rope, in terms of their ability to service their debts, what happens when rates climb materially?

3. The aging demographics within virtually all the industrialized countries are unprecedented. The underfunding of pensions and other social programs is at a record level and the demands that are being placed on governments from an aging population, that are short of savings, are simply not payable, without a substantial restructuring of obligations. Restructuring is a code word for economic pain!

4. The addiction to free/easy money has never been so entrenched in the economy. Getting off this addiction will not be easy. Whatever is free is generally squandered. This is certainly the case with money in the hands of politicians and a decadent populace. Over the past 8 years there has been very little motivation to invest wisely and consider the opportunity costs of spending versus long-term saving. This has resulted in substantial malinvestments around the world. It will not be different this time! We will have to experience payback, for wasting precious resources, and living beyond our means!

Excerpt from our December 2017 - Newsletter

Our refrain continues to be the same. Stay focused, buy great businesses, look for the best value, and keep an eye on the macro economic environment. **We know that there will have to be a correction in the market sooner, rather than later.** We know that there will eventually be some piece of bad news that the market has not factored into its omniscient view of the world, and this will cause some market volatility. More importantly, we know that we cannot control these items, and when it co1mes to investing over the long-term, these issues or unknowns are not the most important factors! What is most important is to get the businesses right, and to buy them at the best prices.

As we have stated many times, if the market gets manic-depressive, we are prepared to take full advantage of the volatility! Our basic strategy, continues to be summarized in the following five points!

1. Diversify across asset classes, sectors and geographic regions.

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2. Invest in businesses with strong balance sheets and backed by hard/tangible assets.
3. Invest in firms that produce essential products and services in growing industries.
4. Avoid/minimize highly leveraged financialized firms that have incomprehensible balance sheets loaded with risky derivatives.
5. Keep high quality liquidity in portfolios in order to take advantage of any extreme moves in the stock market.

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[i] Hoisington Investment Management, Quarterly Review and Outlook (First Quarter 2017).
[ii] Ibid.