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2nd Quarter 2020 Investment Review

"I feel no shame at being found still owning a share when the bottom of the market comes. I do not think it is the business, far less the duty, of an institutional or any other serious investor to be constantly considering whether he should cut and run on a falling market, or to feel himself open to blame if shares depreciate in his hands. I would go much further than that. I should say it is from time to time the duty of a serious investor to accept the depreciation of his holdings with equanimity and without reproaching himself."

John Maynard Keynes, British Economist (1938)

Investment Thoughts

The nuttiness, or madness, continues. Rapid, large stock market declines are followed by almost equally rapid stock market rebounds. As we survey the past six months or so, you could be forgiven for thinking, "did I miss something?" The stock market, if you consider the S&P 500 as the benchmark, is now trading close to its previous all-time highs. As the television jingle says, "Gee, that was easy!"

If only it were so.

I started my investment career a few years before the October 1987 stock market crash. The market dropped 22% in one day. I also lived through the late 1980s Leveraged Buyout and real estate bubble that turned into a big bust and recession in the early 1990s. Next up was the late 1990s Internet bubble. Which was followed by the spectacular market crash in the early 2000s. That hangover lasted just long enough for investors to forget about bubbles and crashes. Another real estate bubble ensued, fueled by poorly underwritten "subprime" loans to marginal borrowers, and "liar loans" to, well, people who banks didn't bother to verify their household income. Eventually, the balloon inflated, financial institutions gorged on rotten mortgages, and the dominoes eventually fell during the Global Financial Crisis of 2008-2009. You'd think investors might learn not to overdo things after all of these events.

But unfortunately, you'd be wrong - now we have the COVID-19 crisis. It is what the economists call an exogenous shock, or external event, wholly unpredictable. People say this is the worst one ever. I don't know. I've been through so many. Each crisis seems to be the worst one when you're in the middle of it. We'll get through this and the world will get back to normal, but it's a pure guess as to when that will happen. Sometime next year? There have been recent positive developments with vaccines, and therapies to treat the disease continue to progress.

Meanwhile, markets continue to be influenced almost exclusively by the daily news headlines. Bad news pushes the market in one direction, good news in the other. We see this most prominently with investors piling into a small group of larger, ostensibly safer businesses that are more impervious to economic, financial, and social risks. It's akin to passengers jumping into a lifeboat to escape a sinking ship. Trouble arises when too many passengers join the lifeboat. In our case, too many investors jumping into a handful of stocks can raise valuations into bubble territory. Are we there yet? In some cases, we believe certain stocks are trading largely on fear and likely greed.

Amazon is one example. It's been a great business and a great investment. So far. It's been a beneficiary of the virus as consumers stay home and order online. I do it myself. The ability to succeed in this environment gives investors comfort, easing their fears. At the same time, Amazon's strong stock market results have caught the attention of many day-traders and momentum investors. The chance for a quick profit stimulates the greed side of the investor equation. Amazon, and others like it, appeals to both investor fear and greed.

As I write this, Amazon is valued at around $1.5 trillion. Note the T, as in trillion. That's a big number. Amazon is now more valuable than Wal-Mart, Target, Walt Disney, Merck, American Express, Citigroup, J.P. Morgan-Chase, Intel and Marriott. Combined. Is this justified? Maybe. History is on the side of the disbelievers. It's very hard to grow at very high levels for a very long time period.

Consider the case of the Manhattan Native Americans, who supposedly sold Manhattan Island for the equivalent of $24 to Dutch settlers around 1626. Forgetting for a moment the veracity of this tale, had those Native Americans invested that money instead, and earned 8% per year for almost 400 years, by my calculations, and based on a rough Bloomberg estimate of the value of Manhattan real estate today, they'd have enough money to buy back Manhattan, with spare change left over. This example illustrates the power of compound interest over long time periods.

Why don't we actually see these sums of money in the real world? For the same reason that trees don't grow to the sky. And mammals reach a certain size, but no larger. It becomes very difficult to sustain a high growth rate for a long time. Increased size means larger absolute gains are needed to grow at the same rate. Other growth inhibitors such as recessions, wars, bankruptcies, competition, regulatory and societal changes can conspire to reduce growth, or create outright declines for a period of time. Over centuries, the challenges can be even greater. War, revolution, famine, climate change, disease, asteroids—ok asteroids is a bit out there, but they do happen—and other unanticipated events can interrupt the growth process. Or worse, put it into reverse.

Tesla offers yet another example. Electric cars are a real thing. They improve upon many aspects of gasoline-powered vehicles, especially lower emissions and reduced operating costs. As manufacturing costs come down, driving ranges increase, and more charging stations proliferate, electric cars should continue to gain in popularity at the expense of gasoline-powered vehicles. No doubt about that. How much of the market will Tesla control? Tesla is valued more highly than General Motors, Ford and Fiat Chrysler. Again, more than all three combined. But it gets worse. Tesla is valued at three times all three combined. Another way to look at it: for the price of Tesla stock, you could buy Ford 10 times, General Motors 7 times, or Fiat-Chrysler 17 times. The three old-school car companies make around 20 million cars per year. Tesla makes around 500,000 per year. Which would you rather own?

I mention these examples to highlight the dichotomy in the stock market today. Here's where I break out my "Broken Record" hat, to acknowledge my repeating of this line of reasoning for far longer than I'd like to admit. Here goes. A relatively small group of large "growth" stocks—so-called, although who doesn't like growth?—has been driving the stock market bus for years now. It's a virtuous circle, as the strong investment performance attracts new investors, who buy the momentum leaders, fueling more price gains, attracting more investors, and on it goes. Here's what the results of this follow the leader strategy looks like for 2020 through July 3rd:

S&P 500 Median Results Through July 3, 2020

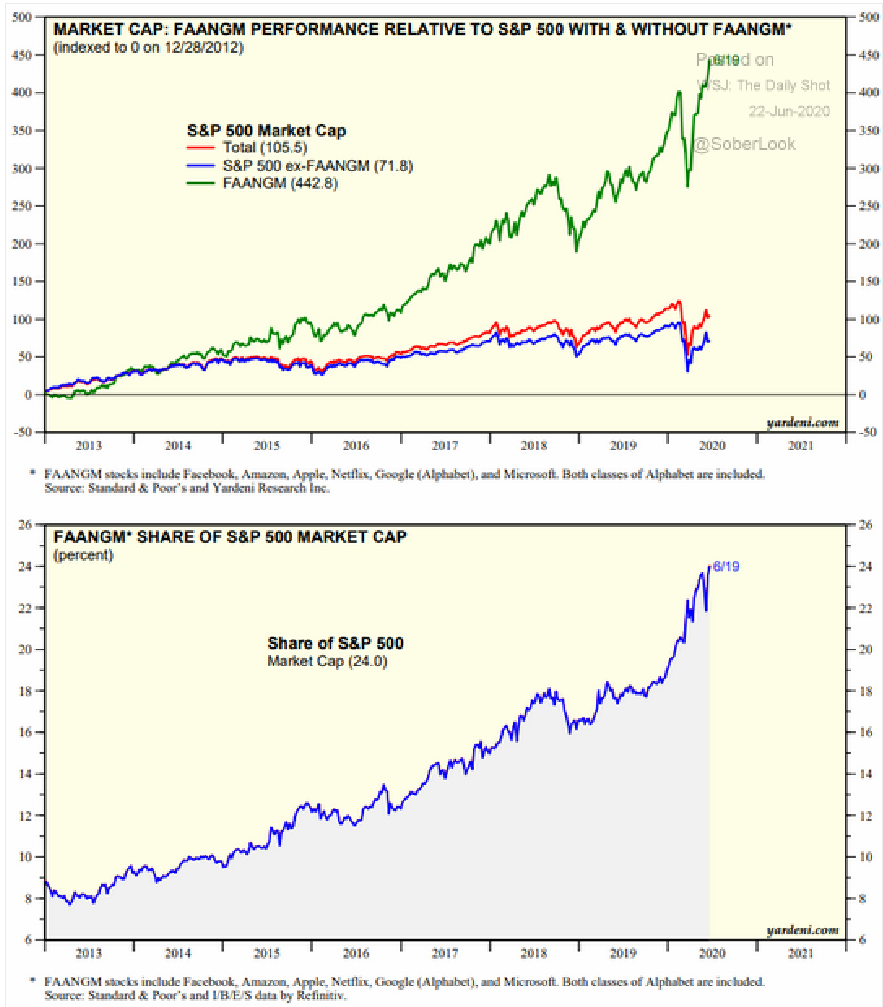
Company Size	Market Cap	P/E	P/S	P/FCF	P/B	YTD Returns
Top 10	$848.5 billion	31.4	6.3	33.2	6.3	9.6%
Top 50	$198.7 billion	28.7	4.6	23.3	5.5	2.4%
51-100	$77.6 billion	26.0	3.8	25.0	5.3	-5.7%
101-150	$49.5 billion	22.9	3.9	23.6	4.1	-1.9%
151-200	$30.5 billion	26.4	3.0	23.5	4.1	-6.7%
201-250	$24.6 billion	24.4	2.6	20.0	3.2	-9.3%
251-300	$20.2 billion	23.2	2.6	21.8	3.3	-5.5%
301-350	$14.9 billion	23.9	2.8	22.8	2.5	-8.5%
351-400	$11.8 billion	22.1	1.8	18.4	3.0	-17.6%
401-450	$8.9 billion	13.3	1.4	12.8	1.9	-22.6%
451-505	$5.1 billion	13.9	0.8	10.0	1.2	-38.5%
S&P 500	$21.8 billion	22.8	2.4	20.4	3.0	-11.0%

Souce: Ycharts

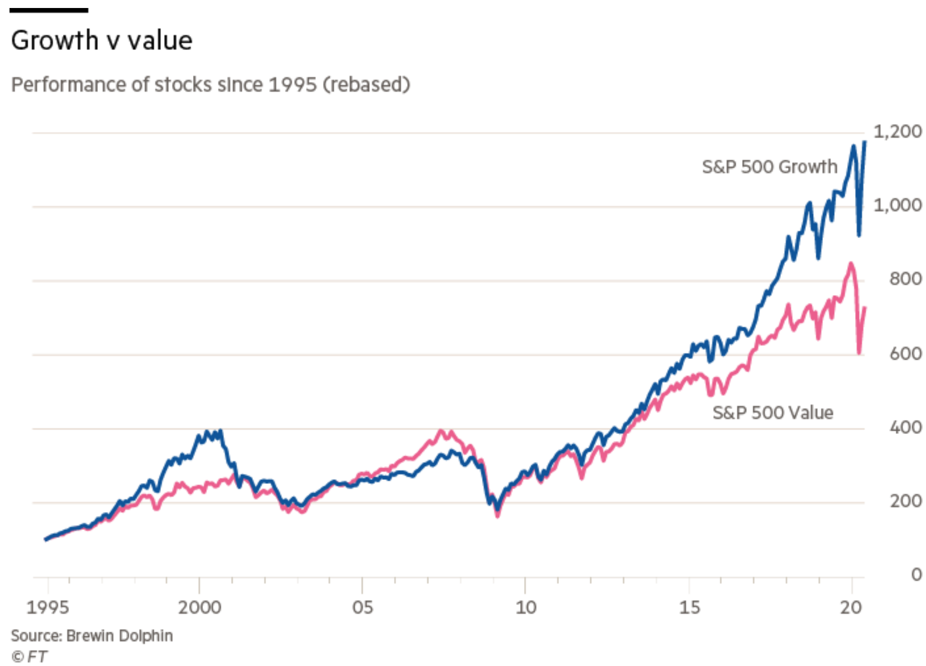
It's quite apparent that the bigger you are, the better you've done, as can be shown by the YTD returns in the far-right column. The giants are in the black, and the smallest companies are deep in the red. This isn't normal. Narrow markets like this have historically been a precursor to looming change. When it happens is hard to say, but we repeat that trees don't grow to the sky.

Below are a couple more charts, depicting the now well-known FANG stocks but including a few more members: Facebook, Amazon, Apple, Netflix, Google and Microsoft—FAANGM. The top chart shows the dramatic outperformance of this small group of companies. The bottom chart demonstrates that this bundle of stocks was around 8% of the value of all stocks in the S&P 500 back in 2013. Now?

Almost 25% of the total index value. What's next, 50% of the index value? We should again remember that trees don't grow to the sky. And $24 invested at 8% per year could eventually consume the world. Except that it never works out that way:



The next chart is a comparison of the S&P 500 Growth index versus the S&P 500 Value index from 1995 through today. The chart shows that returns were fairly similar from 1995 through about late 2014-early 2015, when growth stocks started the afterburners and have recently earned the performance award:

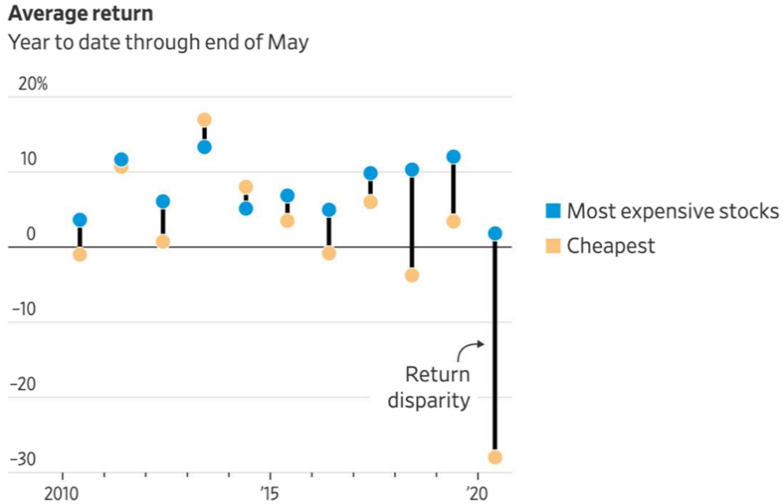


Remembering our "trees don't grow to the sky" analogy, history suggests a reversion of returns where growth cools off and value begins to perform relatively better. I'd point out that we've been singing this song for several years now, with disappointing regularity. I'd much rather be talking about the event having actually occurred. After so many years of relative underperformance, it could be tempting to throw in the towel and join the party happening across the street. The danger lies in doing this at exactly the point of maximum return disparity, when it's the exact time to hold on for a reversal of fortunes. And that's what we've been doing. Holding on, waiting for investors to migrate to where the intrinsic value is, and away from the speculative bubbles. We don't know what will cause change to happen, but it's often the unforeseen and the unexpected, just as we've seen with COVID-19.

One more chart shows the return difference between the most expensive stocks and the cheapest stocks from 2010 through today. For most of this 10-year period, the more expensive stocks have had higher annual returns than the cheaper stocks. This disparity exploded in 2020, with expensive stocks in positive territory, and the cheapest stocks floundering with large losses. Why is this? Our guess is heightened investor fears brought on by COVID-19 led investors to pay up for the perception of enhanced safety. What makes sense at one price can make no sense at another price.

Haves vs. Have-Nots

Despite the pandemic, massive unemployment and growing social unrest, U.S. stocks are down only a few percentage points in 2020. This helps mask wide return disparities.



Note: S&P 500's 50 priciest and 50 cheapest stocks based on price/earnings ratio on Dec. 31 of the previous year. Excludes financials, real estate, and companies with negative P/E ratios or P/E ratios above 100. Returns don't include dividends.
Source: FactSet

Great expectations are built into the prices of many expensive stocks. That's why they're expensive. If history is our guide, failure is likely to occur. Not business failure. Investment failure. Investment failure occurs despite business success, simply because investors become too optimistic and push prices far beyond intrinsic business value. The common stock of Intel Corporation, one of the world's most successful semiconductor manufacturers, is today selling for less than in December 1999, over 20 years ago. Intel sales and earnings have prospered over the years, so why not the stock? Investors got a bit carried away during the Internet bubble of the late 1990's. Twenty years is a long time to wait for an investment to earn a return. We're hoping not to participate in another episode of bubble-bust.

Despite our recognizing that the environment is frothy, and that many assets were trading at very elevated valuations, and despite feeling that our investments were trading at very inexpensive valuations, we still got slammed with everyone else during this recent downturn. In fact, to rub salt in our wounds, while expensive investments have rebounded significantly since the mid-March market bottom, our inexpensive stocks have not rebounded as much and in our opinion are now ridiculously undervalued, cheap, depressed, bargain-basement, whatever the right adjective is. As I remarked last quarter, whoever said the market is rational hasn't taken a good look at our portfolio after this recent drubbing.

The solace amidst the neglect is that we should witness a strong rebound from the entire portfolio, given that almost all of our assets are selling at what we consider silly prices. It might take a year, but we feel now is not only the time to be patient but for those with additional capital and fortitude, ***it's the time to add to holdings.*** It's better to shop when the 50% off sign is flashing, like now.

Economic Conditions

The economy, thanks to Covid-19, remains in recession. The economy will only recover when Covid-19 is dealt a decisive blow. We still think it's going to take another 6-18 months. Yes, that's a wide range. The wide range is because we need several important variables to work together, including new treatment therapies, an effective vaccine, further behavioral changes by all of us, and global cooperation.

The economy could take a bit longer to repair itself fully, perhaps 12-24 months, which implies late 2021 or early 2022. Stock markets typically anticipate economic recoveries around 6 months prior to recession end, which implies later this year or the first half of 2021. We'd welcome a sooner resumption of life and markets, but we're realistic that the healing process might take longer.

Investment Conditions

While the major stock market averages have rebounded, as the prior charts demonstrate, the majority of stocks continue to languish. Especially so for the economically sensitive stocks that we generally own. When investors sense a durable economic recovery, we should see a significant improvement in our portfolio returns. So, the coil winds tighter. We expect strong rebound potential, given the compressed valuations we see today. Many of our stocks have the potential to increase by 100% to 300% over the next few years, such is the degree of despair and undervaluation.

The real question is, "***where do we go from here***?" Large, small, or does it even matter? All we can say is ***at this moment in the cycle,*** growth has been in charge for the past 10+ years, and value has lagged behind. Historically, one particular investment style doesn't stay in the lead forever. If you believe in some form of reversion to the mean, or that the pendulum could swing in the opposite direction, then it doesn't seem right to change styles now. We'd feel pretty foolish to jump on the growth bandwagon just as that bandwagon was about to drive into a ditch.

The chart below indicates the disparity between growth—aka Momentum—and value stocks. Only twice before in the past 20 years has value traded as cheaply now versus momentum stocks. If history is our guide, we're due for a significant reversal of fortunes:

We realize this recent period has been difficult, and can test your patience. We appreciate this, and feel that we're on the right track, not out of stubbornness but through carefully weighing the pros and cons of our current investments versus the alternatives. We still believe that markets change, cycles come and go, and with a bit more patience we'll have our time to shine. When I look ahead to what could happen given the current investment climate, I am optimistic about the future of our portfolios. The current situation is unlikely to persist and as we see improvement in virus trends and the economy that should be reflected in our portfolios.

We are always available to talk. Triad continues to function very smoothly, with Dave and I working from our fully functional home offices for the time being. We will also be staying in touch with you more frequently as the situation calls for via email updates, as we have been doing since the start of this situation. As always, please keep us updated of any changes to your financial situation that might suggest altering your investment portfolio and let us know if you'd like a current copy of our SEC Form ADV Part 2.

Your LOYALTY and PATIENCE remain our secret weapons. We remain diligent, disciplined, and (particularly) optimistic.

We continue to eat our own cooking, which means investing in many of the same securities as clients—yes, even those that haven't necessarily gone up. It's the right way to operate.

Sincerely,

John Heldman, CFA

July 21, 2020

"Many shall be restored that are now fallen and many shall fall that are now in honor." **Horace**

"Always do right. This will gratify some people, and astonish the rest." **Mark Twain**

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%	**2Q20**	**YTD**	**1 Year**	**3 Year**	**5 Year**	**Inception***
Concentrated All-Cap Equity Composite	22.20	(24.54)	(22.07)	(8.72)	(6.28)	2.52
S&P 500 Index	20.54	(3.08)	7.51	10.76	10.74	9.15

As of March 31, 2020. Periods over one year are annualized. Results presented net of management fees.
*Inception date April 30, 2008

The Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. All indices are unmanaged and may not be invested into directly.