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Sawtooth Market Makes Perfect Sense

Summary: We continue to see the current market dynamic as representative of the tension between current conditions and corporate results (which are very strong) and expected economic growth which is being impaired due to 1) lapping tax reform, 2) rising interest rates, 3) inflation in labor rates, 4) slowing housing-related metrics, and 5) potential disruption due to tariffs and trade disputes. This is just a description of the current market, not a forecast. Our *best guess* is that the momentum in economic and corporate profit growth will continue, supporting further gains in equities.

Resolution of Political Uncertainty is Usually Positive

Unless the outcome is a Brexit or similar event. Today's 500 point move in the DOW reflected in part relief that the outcome did not change the situation much but also reflected that there was an outcome. In short, the mid-term election is no longer something that investors have to worry about. So, stocks go up.

Smarty-Pants Hedge Fund Analysts Are Trying to Anticipate a Recession

The market discounts the future and big changes in the future yield changes in the value of equities. Professional investors believe it is part of their job to predict the future. However, some take this to mean that it is their job to anticipate and position their investments for *unlikely* outcomes. In this case, *unlikely* means an outcome not predicted by most people or currently reflected in stock prices. The trouble with this tendency is that an outcome most are not anticipating usually does not occur and predicting macro trends is inherently very difficult. So these guys are often wrong, in our opinion.

Wall Street Also Sometimes Believes That the Market Drives Consumer Activity, Instead of the Other Way Around

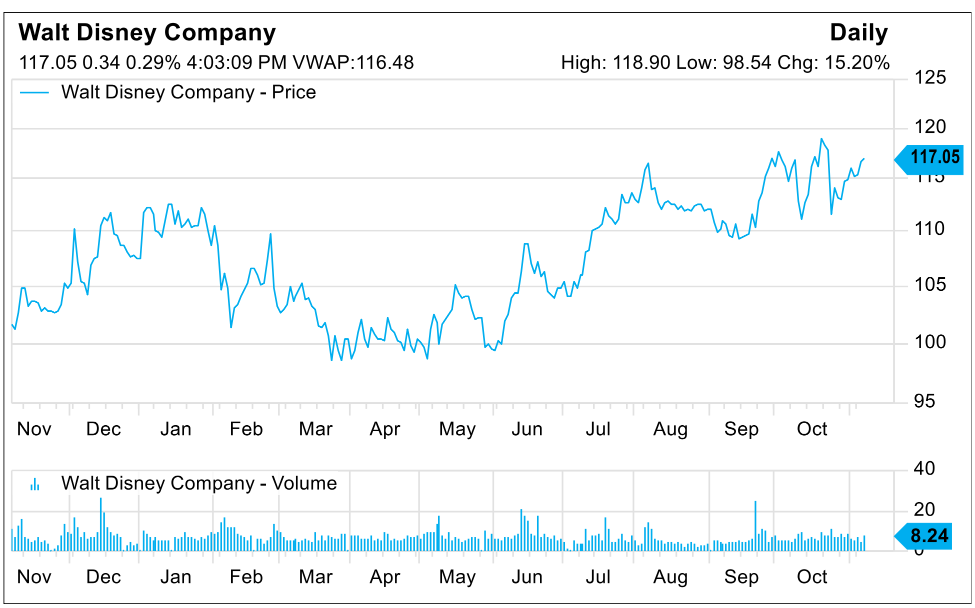
An extreme market move can disrupt consumer confidence, but recent volatility is not even close to the levels needed to upset current trends. We have started to hear questions regarding whether the consumer has slowed *because of* the market's decline in October. Maybe this sounds surprising to you, but we have fielded this question or heard this sentiment many times in our career. It represents a kind of Wall Street hubris. Underlying it is an assumption that the stock market drives the average family's behavior. There may be *a little* bit of a relationship (again, excepting very extreme market moves) but generally our view is that jobs and (after-tax) income is the most powerful determinant in consumer spending. The economy continues to create jobs, hourly wages are rising, and we haven't yet cycled the benefit of lower tax withholding rates (which will also create larger-than-normal refunds early next year, we understand) so we expect spending to remain robust in the near-term.

How We are Managing Our and Client Money:

It's always a good time to buy the shares of a great company (assuming an appropriate time horizon). It's almost never a good time to invest in a company with a flawed business strategy, that is destroying value, has bad management or is losing market share. Accordingly, we spend our time trying to ferret out which companies are pursuing the best strategies, have management teams that are innovative and focused on shareholder value, are taking share, or have sector or industry-specific tailwinds. We spend little time trying to out-think other investors on the direction of the overall economy (although we do spend a lot of time understanding current conditions).

Selection from our model portfolio: Our approach is to own high-quality companies, bought opportunistically, and own them long-term with the intention to minimize trading costs and taxes. Our portfolio is concentrated (~20 positions) and generally we are favorably inclined towards companies we *know* or at least find easy to understand.

Walt Disney Company (DIS): Our thesis on Disney is a *business model transformation* thesis. We'll get to this in a second. First a quick review of Disney's four operating segments. The largest is the media segment, which is mostly EPSN. Next is the theme parks. Third is the Studio division which includes Disney movies and TV, Pixar, Lucas Films, and now 21 Century Fox and other properties. Last is the company's consumer products division. Disney shares have traded in a range over the past three years, with the main issue revolving around concern over consumers moving away from cable subscriptions and thus hurting ESPN's revenues. This brings us to our thesis. Basically, Disney is developing a direct-to-consumer capability via ESPN+ which will permit subscribers to consume sports content on demand via an app. Separately, DIS is developing a streaming service for the substantial pantheon of Disney TV and movie properties. We think both of these efforts have the potential to be extremely successful and in particular, we believe a Disney streaming offer could easily become a must-have subscription, perhaps even more successful than Netflix (which currently has access to much Disney content). Our thought is that as these services are rolled out and become more important, DIS shares could see valuation expansion due to the transformation of its business model to one with significant growth potential. Further, even if those not occur, we are confident that DIS will remain a very strong, attractive company. See the DIS chart below.



This week I am in Chicago to attend Ulta Beauty's (ULTA) analyst day meetings. While in Chicago I am visiting stores, meeting with other investors, and braving the wind off Lake Michigan during my morning runs. However, the point of attending these events is to get insight into the strategies of top-performing companies, and to keep up on the state of the consumer and consumer trends. Also, I am going to learn a lot about make-up, social media and Kylie Jenner. I consider that last part just a big bonus of my job.

If you or someone you know is looking for help investing in the markets, please get in touch to discuss whether our equity portfolio is appropriate.

Yours,

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