February 4, 2020

Dear Investor,

On average investor accounts performed somewhat better than our risk weighted benchmarks (70% S&P 500, 30% Barclays Aggregate Index). Note that your actual account performance is detailed in your statement and personalized letter. The year's performance reflects strong gains for many of our stockholdings as well as more modest gains for our fixed income holdings.

The US stock market continues to be supported by the combination of low interest rates and steady economic growth. Markets were also helped this year by signs of progress in US-China trade discussions.

Last quarter I mentioned that economic indicators, including the yield curve and industrial manufacturing surveys, signaled possible economic weakening. For the time being those concerns have receded, as continued growth in the US service sector, which represents about eighty percent of the US economy, has more than offset weakness in the smaller manufacturing sector. Further supporting the market is the growing view among investors that the Fed stands ready to stimulate the US economy in the event of external shocks to growth.

Despite these positives, there remain plenty of risks, including the potential for escalating geopolitical conflict. Because our stock holdings have appreciated, stocks now represent a larger percent of your account than has been the case historically. I am looking for ways to reduce your portfolio's exposure to the stock market without unduly detracting from the potential for future gains. For many years preferred stocks and select bonds provided portfolio diversification while still providing attractive returns. However, the potential returns on those securities have fallen as a result of low interest rates.

As a result, I am looking elsewhere. Companies that are being acquired at a fixed price, but where the deal has yet to close, remain an area of interest. Those securities provide potential returns above those available on fixed income securities, while still having low correlations to stock market performance.

I also have added to our investments in businesses that are not highly correlated with the economy. Recent purchases include companies that own apartments in high density, supply constrained cities. Those apartments will likely remain in demand in a weaker economy. I am on watch for similarly defensive businesses, with one possibility being dollar stores.

Notes on specific holdings

A few of our small company investments notably outperformed the market last year. Chief among them were Infusystems, Builders FirstSource and Constellium, all of which roughly doubled in value over the year, albeit from somewhat depressed price levels at the end of 2018.

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Infusystems provides doctors' offices with sterile, reusable, ambulatory infusion pumps. It also repairs those pumps and bills insurance companies for their use. The company benefitted last year as two of its competitors exited the market, one at the insistence of regulators and the other as new management prioritized other business lines. Those departures have left Infusystems as the dominant provider of pumps in this niche market. The company is now considering providing services for other medical equipment in need of recurring service, sterilization and billing. Possibilities include devices used in negative pressure wound therapy and deep vein thrombosis.

Shares of Constellium, a manufacturer of enhanced aluminum, rose substantially from depressed price levels at the beginning of the year. The company continues to make steady progress in reducing its debt levels and expanding sales to automotive and aerospace customers. About half of Constellium's sales are to manufactures of beverage and food cans. Sales of those products are growing as customers increasingly appreciate the recyclability of aluminum.

There were a few disappointments. Notable among these was Garrett Motion, a manufacturer of turbochargers for cars and trucks. Turbochargers are increasingly used to improve vehicle fuel efficiency while maintaining performance. Within the highly competitive auto market, Garrett's business is a good one, generating high profit margins and consistent financial performance. However, investors are concerned about the global auto market as well as the longer-term prospects for turbochargers. Turbochargers will be used in some next generation vehicles but offer no utility to pure electric vehicles. Garrett is developing other parts for electric vehicles including a highly efficient electric motor, but it's too early to say if those products will be commercially successful. That said, Garrett's current share price heavily discounts the risks ahead. With that in mind, I continue to monitor this holding.

As always, please contact me with any questions.

Doug

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