Summary of April 2017 Conference Call

Good evening and welcome to tonight's SFP Conference call. At the suggestion of one of our long term clients, we are changing the tone and direction of the call for at least, tonight. As many of you recall, in our conference calls we have focused the attention on variables that affect markets and we have talked little about the investment process or particular stocks. Tonight, we will concentrate our call mostly on the securities that we choose why we choose them and little of the factors that are affecting the market. Tonight ROBERT, Stevens First's financial analyst, will be interviewing Steve. We hope you will find the conversation most interesting.

ROBERT*: When you work with a client's portfolio, what is the most important factor that you look at?*

STEVE: When I first started out managing money in the 1970s, it couldn't have been a worse time to start out. The stock market peaked in 1969 and remained essentially flat until 1984. Those investors who had an all stock portfolio and held it from 1969 until 1984 actually lost money during that period. I remember my grandfather leaving me $15,000 in a trust. That $15,000 became $10,000 by 1984. My professors at UCLA and my boss at Security Pacific (Now Bank of America) taught me some valuable lessons about investing. First, look at the risk you are taking and manage your portfolio for risk.

ROBERT*: How do you manage for risk?*

STEVE: Whenever I look at a stock or bond for purchase, I carefully think about the downside risk. Without getting too technical, I like stocks that have low volatility and are not "flavor of the month."

ROBERT: *What do you mean flavor of the month?*

STEVE: My boss, at the time, told me and so did my reading of Benjamin Graham in *The Intelligent Investor* that it is very dangerous to follow the crowd and buy stocks that everyone else does. This has to do with the flow of information more than anything else. For example, let's say you like Tesla. How many analysts follow it? How many individual investors follow Tesla? Everybody knows about Tesla. However, how much more do you or I, for that matter, know about Tesla than the other guy? Not much. Therefore, Tesla is efficient and it is hard to make a market beating return buying efficiently priced stocks.

ROBERT: *Hasn't Tesla gone up in price a lot and hasn't it surpassed Ford Motor Company in value?*

STEVE: Yes Tesla has gone up in price a lot, although the stock price has been essentially flat for 3 years. That's my point, how can Tesla be worth more than Ford when Ford has 6 times the revenues, a broad lineup, and makes 100 times the profit of Tesla. Where is there more risk? In my opinion, not Ford, especially when one considers that Tesla is mired in debt. These are the things I think about.

ROBERT: *What are other factors that you look for in a stock?*

STEVE: I look at what the potential downside could be. I also carefully look at the debt level and the company's strategy. If a company has too much debt, they may not be around if earnings decline or they can't roll their debt over. Of course, it doesn't end there because when we examine a stock or bond, there are over 60 factors we consider.

ROBERT: *Why are you so cautious?*

STEVE: I don't want to go to my clients and tell them I lost 40% of their money and now they will have to work at Burger King.

ROBERT: *Can that happen?*

STEVE: Of course it can happen. Anything can happen. However, experience has taught me to take prudent risks and that involves looking at the risk of the stock and that of the portfolio.

ROBERT: *Has this happened in the past?*

STEVE: Not with me, but certainly with other money managers. For example, if an investor was totally in the stock market in 1973-1974 with a 100% stock portfolio, they might have lost 45% of their money. In 2000, one client told me that he had lost 95% of his money because he was 100% invested in tech stocks. In 2008, the S&P 500 was down 37%.

ROBERT*: So that is why you have balanced portfolios.*

STEVE: I not only assess the risk of each security, but I assess the risk of the entire portfolio. This is why I have stocks, bonds, and alternatives and my portfolios are generally diversified. I would not have wanted to have been 100% in stocks in 1973-1974, 2000, or 2008.

ROBERT: *Wasn't 2000 a particularly bad year?*

STEVE: Yes, it was for several reasons; some of which parallel today. The dot-com stocks were absurdly priced. For example, Qualcomm sold for 4000 times earnings and Cisco had a measure of book value to price of 144. That was insane. The market darlings were WorldCom, Enron, Qualcomm, and Cisco.

Today, Cisco is much more reasonably priced as is Qualcomm (Chart 2). WorldCom and Enron aren't even around. By the way, neither is AOL, another loser. Those investors weren't investing, they were gambling. It is no different today. For example, Tesla, which we mentioned before. Amazon really doesn't make any money either. Yet people buy these types of stocks like they did in the dot com bubble. People will relearn an expensive lesson once again. Look at the Cisco Chart (Chart 1) - you can see that it has never recovered from its fall in year 2000. If you don't think that can happen in stocks like Amazon, Tesla, Facebook and Netflix, you would be wrong.

ROBERT: *What type of stocks do you like if you don't like Tech or "flavor of the month" as you say?*

STEVE: I never said I didn't like Tech. I love Tech, but at a reasonable price. And I am not going to buy Tech stocks that I feel I could get trampled upon even though the price could be going up. I like companies that do everyday stuff and more importantly, they have a competitive advantage.

ROBERT: *What else can you tell us about your investment style?*

STEVE: I like individual stocks and bonds because over time I don't have to worry about getting trampled on if everyone heads to the exits. That doesn't mean I will totally escape or not lose money. For example, the folks in the S&P 500 index fund who invested in the top of the market in 1999 did not get back to even until 2012 (Chart 3). What about those investors who bought the dot-com stocks? They never fully recovered. However, a balanced portfolio allows the investor to patiently sit there until the market recovers collecting his or her dividends and interest. For the most part, I think balanced accounts did better than index funds between 1999 and 2012. Of course, each investor is different and those results could vary.

ROBERT: *I think we understand now. Could you please discuss some of your stocks?*

STEVE: Sure, some folks hate utilities. They think they are just plain boring. I have news for you: utilities can be great performers and, over time, not too risky. At least in comparison with some other stocks that are more aggressive. NextEra Energy is one of these. This company is the largest utility of solar and wind power. The dividend is increased regularly and its future is bright (Chart 4). The same goes for Avista, another electric utility in Seattle. Investors get so excited about stocks like Apple even if they go up a few points and they don't consider stocks like NextEra Energy. Looking at the Apple chart (Chart 5) we can see that Apple was essentially flat from 1982 until 2006 while NextEra continued to grow and pay its dividends.

ROBERT: *What else do you have?*

STEVE: I like railroads because they are a monopoly. To me that is a low risk play over time. Think about it for a moment. Do you think anyone in the U.S. will build another transcontinental railroad? Not in your lifetime! However, railroads like CSX (Chart 6) and Norfolk Southern (Chart 7) have duopolies because more railroads will never be built. Combine that with increasing dividends, and you have a recipe for success.

ROBERT: *What about a tech stock?*

STEVE: Like I said before, I like tech stocks but I don't want to overpay for them. What if their market dries up or some unforeseen competition heats up. Technology changes frequently and I like Tech stocks that have a defensive strategy; an Elbit Systems (Chart 8) which is a cyber security company has a very defensive posture and is in a good space within the tech industry or CyberArk, is another example of a high tech, defensible cyber security firm.

ROBERT: *You Like Timber Stocks, Why?*

STEVE: Timber stocks pay great dividends, perform well over time and can be inflation hedged.

ROBERT: *Can you explain inflation hedged to me.*

STEVE: Nothing in my opinion is inflation proof, including gold or silver. In fact, gold has had a terrible track record in in inflationary times. For example, during the 1980's when inflation was averaging 4% to 5% the price of gold went nowhere.

ROBERT: *What is your favorite timber stock?*

STEVE: My favorite timber stock used to be Plum Creek Timber, but it merged with Weyerhaeuser a few years ago. We still have Rayonier and Potlatch, but my favorite is Weyerhaeuser (Chart 9). It is the world's biggest tree farmer. They practice sustainable forestry and they care about the environment. They do not have to scorch the earth mentality. Interestingly enough, Weyerhaeuser is a low volatile stock except for the period when they converted from a paper and timber company to a timber company. They have a very healthy and growing dividend.

ROBERT: *What else do you like?*

STEVE: I like Sysco (Chart 10). This is the other Sysco, with an 'S'. They deliver food to restaurants, camps, colleges and the like. Very reliable and a growing dividend. This is an example of a boring stock that has a strategic advantage and that can do very well over time. I would rather have non-sexy than sexy. Less risky to me, at least in my **opinion.**

ROBERT*: What about Alexander and Baldwin (Chart 11)?*

STEVE: We have had this one for as long as I can remember. The stock has not performed as well as I would have liked, but it has done reasonably well because of the dividend. These guys own a lot of property including over 100 industrial parks on the mainland and 93,000 acres of land in Hawaii.

ROBERT: *You have owned Pepsi (Chart 12) for a long time. Isn't there a problem with soda and sugar?*

STEVE: Sure! But believe it or not, Pepsi is not all sodas. In fact, soda is becoming a small part of Pepsi. Frito Lay is the biggest cash generator for them. Pepsi has also diversified into healthier foods. Pepsi has really transformed itself.

ROBERT: *What about a "dog"?*

STEVE: You are always going to have some stocks that don't perform well in the short-term but if an investor is patient enough and he is correct in his or her analysis, then the stock may turnaround. Our biggest disappointment is Gilead Sciences. This is such a great pharma company. They are a leader in HIV and HEP-C. They have a huge market share for both diseases, but the stock is languishing. It shouldn't be, but it is. The market thinks that Gilead should have a deeper pipeline and that the company should acquire another drug firm. My opinion is that they will acquire someone or they will be acquired themselves. In the meantime, the stock is cheap and it throws off a lot of cash. I am willing to be patient with this one**.**

ROBERT: What about Vodafone? That doesn't seem to be doing too well?

STEVE: Actually, Vodafone is doing very well. They have a stronghold in its major market - Europe- and Africa – India, too. It is a great company! The stock has done poorly because of the BREXIT fears and the declining value of the British pound.

ROBERT: *I heard that you are starting a sustainability fund? Could you tell us a little about the fund?*

STEVE: As many of you know, I am concerned about the environment and corporate governance. Building a sustainable responsibility portfolio is easier said than done. You have another set of investment factors to consider in addition to the ones I mentioned earlier. It is very time consuming and not easy to measure corporate governance and find companies that practice sustainability and are good environmental stewards. A lot of fact checking and on-the-ground analyses need to be accomplished before an investment management company can truly say it is a sustainable investment. Some firms claim to have a sustainable responsible portfolio, but they are not in the pure sense of the word. In conjunction with Oxford University, SFP has been working on a sustainable responsible fund that screens for corporate responsibility, the environment and social impacts. We are excited about this portfolio. We are putting the finishing touches on this and it will launch in August. We have no comparable benchmarks in which to judge the returns of this fund, so we don't know what the returns will be, at least, not at this time. However, I do believe that we are at the cutting edge with this type of investment and one day it will become the norm. I am very excited about it.

ROBERT: *As always, this has been an informative conference call. If you have any feedback or comments, we would love to hear them. I would like to thank Steve and all of you for participating in tonight's call. I will now open up the phones for questions and comments. Thank you*.