**Subject**: January 8, 2019 Conference Call

Looks like we are having some competition in tonight's conference call with President Trump speaking. However, I think tonight's call is as important, if not more so than any other call that we have had in the past. We are going to talk about the markets last year, what may have caused the downturn, and what this year may serve. We will also talk about some of the fundamentals why we stuck to our strategy in the manner we did.

Last year's market gyrations were not that unusual in some respects. What was unusual was the lack of volatility in 2017. 2017 was an unusually quiet year. Markets during transition phases usually experience heightened volatility. 2018 was no exception. In the past, I have talked about how the withdrawal of liquidity from central banks would cause turmoil. Previously, I had thought that the market would not experience any heartburn until the 10-year Treasury yielded 3.50% or more. Now, the magic number looks like 3.20%. When interest rates on the 10-year Treasury hit that mark last February, the global stock markets started to tumble. The U.S. market recovered in the spring and summer and returned towards a downward path in the fall through December. December was a particularly bad month for stocks. What caused the turmoil in 2018 and especially in December? One reason was the withdrawal of global liquidity from the global financial system by central banks raising interest rates and withdrawing bonds from the marketplace. A second reason was that program traders, quantitative hedge funds and wise guys accentuated any market move. Add in panic selling by the common man in December and you have a recipe for a market decline.

I have warned investors before that index funds are not as wonderful as people think they are. Yes they are low cost, but what does that matter when you lose far more money when you sell than what an active management fee would cost. With the push of a button, without any thought, index investors stampeded out of their index funds which were overvalued to begin with. No thought or reason was taken into account when they were bought and when they were sold. The wholesale selling of index funds accentuated the market decline and especially in December. The government shutdown had little to do with any market decline.

In May and June, we spoke of the trade war with China, Mexico and Europe. At that time, I had thought of the effects of a broad trade war on the markets and I reduced the exposure to stocks by a good margin. Of course, each account will vary, but in general, that is what I did. My thinking on how a trade war would affect the market was essentially correct and a reduction in stock exposure paid off. Should we have reduced stocks even more than what we did or completely sell out? Absolutely not! This correction was a plain vanilla correction due to Fed tightening and trade war issues. If we had sold a lot or even the whole stock position, how would we know when to get back in? There have been some explosive up days as well as the explosive down ones. By sticking to the plan and riding out the volatility, we have the upper advantage over the program traders. In my opinion, this is not a full blown bear market. Part of the problem was that the market was getting ahead of itself. The P/E ratio, which is a useful guide to determine broad market value, was approaching 18 for the S&P 500. However, P/E ratios grow and shrink and the S&P 500 P/E ratio shrunk by 30% to a more reasonable 14.

Although the market decline has reduced the stretched valuations, the market is still not cheap enough for me to dive in and substantially increase our stock exposure. In some accounts, we have nibbled here and there, but in general, we have not sold or bought with the exception of Vodafone. We had bought AT&T earlier and that replaced Vodafone. AT&T pays a high dividend of 6.5% and has better growth prospects than Vodafone.

Is the expansion coming to an end?

Not just yet. The economy is in great shape and still has room to run. A recession most likely will not occur until 2020 and maybe 2021. For example, last Friday's job report was a winner and demonstrates the resiliency of the economy.

**The Stock Market**

With a P/E of 14, there is not too much to dislike about equities at this point. If our base case scenario holds up, equities should produce a 10% return in 2019 if the trade skirmish settles down, Washington reopens and the politicians actually do something. More money is made when things go from terrible to bad than from good to great.

We had sold one of our long time favorites (ALEX) not because of any stock market decline, but because the business model had changed. Essentially, the new management team is selling off what they consider unproductive assets which is different than what I think. First, they sold off Matson Navigation which is a near monopoly on Ocean transportation between the mainland and Hawaii. Second, they are peeling off very valuable Hawaiian Agriculture land at $6,000 per acre to buy shopping centers. This is very stupid in my opinion. Therefore, it was time to sell at a profit.

Therefore, we are sticking to our balanced approach tweaking the stock exposure here and there but not buying or selling much. We continue to buy bonds, but are patiently waiting for interest rates to rise in the market without the Fed raising rates. This should happen shortly.

In the past few years, we have added technology stocks to our portfolio when they make sense. Not the FAANG stocks, but stocks like Cisco, Gilead, CyberArk, Elbit, and Paypal. Many of you have some of them. We like these low key stocks because they are leaders in their field and are not subject to the same panic buying and selling that Facebook, Apple, Amazon, Netflix and Google experience. Amazingly enough, PayPal, although affected, did not get slaughtered.

Katie will be calling you to set up a time and date where we can meet to talk about strategy in detail. Thank you for your confidence in us and we wish you a happy new year.