October 2017

Dear Clients and Friends:

Good afternoon. I am sitting here writing this on October 19, 2017. 30 years to the day of Black Monday, where the US stock market fell over 22% in one day. I have vivid memories of that, as I am sure many of you do. Grant it, I was 10 years old, but my dad had been working in the financial markets for almost 20 years at the time. If memory serves me, he was actually in New York on that day. Let's hope history does not repeat 30 years later.

I have been remiss in writing an Investor Letter for a few months, and wanted to put something short out in the interim. Something that is important to me is for my clients to understand the investments used in their portfolio. That falls on me to ensure that you have that knowledge. So, consider this a short primer on it.

You may recall a very unique substitute teacher in a small elementary school 27 years ago ask a very direct and powerful question to his students.

Arnold Schwarzenegger was of course trying to find the bad guy who happened to have a son in that kindergarten class. This may be the first time Kindergarten Cop has been the inspiration for an investment letter, but I am titling this short write up.

WHAT DO YOU OWN AND WHY DO YOU OWN IT?

I use a relatively small number of investments/funds/managers with my clients, and while you may not own each particular fund I will reference below, you probably do own most or all of them. This is just a highlight of a few of the funds currently in my models and the reason why they are there. As you probably have seen in past writings, I categorize my managers in 3 buckets: Alpha Generating, Fixed Income/Tactical and Alternative. I will do the same here.

Alpha Generating Bucket

1. Vulcan Value Partners Fund-Vulcan was founded in Birmingham, Alabama in 2007 by C.T. Fitzpatrick in order to manage his personal capital. CT is from Montgomery and had spent the previous 17 years at Southeastern Asset Management in Memphis as a principal and portfolio manager. The team at Southeastern was extremely successful and it allowed CT the ability to decide how he wanted his career 2.0 to be. In the 10 years from its founding, Vulcan now manages over $13 Billion in assets for a wide range of clients. All of Vulcan's strategies are managed with the sole philosophy of purchasing high quality companies trading at a discount to their intrinsic worth. Basically, he wants to buy stocks trading on sale in his teams opinion. Vulcan has closed all of their strategies to new investors. Fortunately, we have a relationship that allows us to continue buying them and investing with them. Vulcan has done very well for investors. As of this writing the fund is up over 13% YTD and over 12% annualized over the past 5 years. His portfolio is concentrated in 34 large cap US stocks from a variety of industries.
2. Coho Relative Value Equity Fund-Coho Partners was introduced to me by a due diligence consultant that I use that has extensive experience in finding overlooked and unique money managers. Coho, founded in 1999, is headquarted in Pennsylvania and is named after the Coho salmon which demonstrates endurance and tenacity in spite of adversity. Coho says they work to emulate those properties by focusing on providing downside protection during difficult periods and capturing consistent, competitive upside. The team at Coho has a wealth of experience and truly operates with a disciplined process. The Coho fund owns a small group of 25-30 US stocks. I consider many of them kitchen cabinet names or names you know. Holdings include: 3M, Amgen, CVS, Dollar General, JM Smucker, Johnson and Johnson, Lowe's, Procter and Gamble, and United Health. The fund is up over 12% YTD and 10% annualized per year over the past 3 years.
3. Evermore Global Value Fund-Evermore was also introduced to me by the same consultant. David Marcus is the founder and portfolio manager at Evermore and he started the firm in 2009. David has 30 years of experience and was mentored by legendary value investor Michael Price at Mutual Series. After Mutual Series was purchased by Franklin in 1996, David stayed on managing the Franklin Mutual European fund until 2000, when he left to parter with the late Swedish industrialist Jan Stenbeck to manage a hedge fund. Stenbeck passed away 2 years later and David stepped in as chairman of the family's US holdings. Evermore is very unique in my opinion and is quite different than any other fund I use. They seek to own a concentrated portfolio of individual businesses undergoing some sort of strategic change. David calls these catalysts, and believes that those catalysts are vital to long term shareholder value creation. The majority of its roughly 30 holdings are from Europe, with a smaller allocation to the US and Asia. Evermore takes large positions in its core holdings with roughly half the portfolio in its top 10 names. Also, the majority of the holdings are small and mid-cap, meaning they are not huge companies. Evermore has an Active Share of near 100. That indicator essentially says that the fund has very little overlap with a benchmark and acts independent of the market. I know David and he could talk for hours about each holding he has in the fund and why he likes them. His level of knowledge is quite remarkable. Trust me when I say that you have probably not ever heard of any of his holdings. Many of them are family controlled holding companies, often extremely diverse. The fund is up over 19% YTD and about 15% annualized over the past 5 years.

4. Reaves Utility Energy and Infrastructure Fund-Reaves was founded in Jersey City, NJ in 1961 as a investment research company. They are employee owned and have a amazing long term record. They focus on the utility, energy and infrastructure sectors. Companies like electric, gas and water utilities, energy companies as well as telecommunications and cell phone related industries. I know the team at Reaves very well and have visited them numerous times both in New Jersey as well as down here. In fact, I will see their marketing director in a few days. I have strong relationships with many of the managers I use and Reaves is no exception. The Reaves portfolio provides diversification, but also a strong focus on dividends. It is up nearly 8% YTD and nearly 10% over the past 5 years annualized.

Fixed Income & Tactical

1. Wells Fargo Absolute Return-This fund is a tactical or allocation style fund. Essentially it can go anywhere in search of the best return/risk tradeoff. The fund is managed by GMO in Boston. GMO (Grantham, Mayo and Van Otterloo) was founded by Jeremy Grantham who is legendary in the business and still is a huge part of the team. Jeremy has a record of predicting bad markets before they happen. GMO manages money primarily for large institutional accounts and typically has a $20m minimum. This fund offers the exact same portfolio without those minimums. The GMO team seeks to identify and exploit mispricings in markets based on their belief that asset classes can become grossly overvalued or undervalued and will revert back to fair value. This fund historically is much less volatile than the overall stock market. In fact currently they only have 5% in US stocks. The rest is 35% International Stocks, 20% Bonds, 20% Cash and 20% Alternative Strategies. This fund only lost 12% in 2008 when the US market lost nearly 40%. It may not knock the cover off the ball, but it provides appropriate diversification to help in the overall mix. But, it is up over 11% YTD.
2. PIMCO Income Fund-You have all heard me discuss PIMCO for a long time. I am just focusing on one of their funds. You may own a few. While some of the managers I use are somewhat smaller and less well known, PIMCO is not that. They manage over $1.5 Trillion. Their clients include Global Central Banks, Sovereign wealth funds, Public and Private Pension Funds, Foundation and Endowments and Individual Investors like us! They are headquartered in Newport Beach, CA and have offices in 11 countries around the world. Their diligence in their process is truly amazing. The IC or Investment Committee meets 4 days per week. These are extremely busy fund managers and they take the time almost every day to group with the other managers and discuss ideas, the economy etc. Also, 4 times per year their Global Advisory Board comes to Newport Beach to discuss the global economy. That board includes former Fed Chair Ben Bernanke, former head of the European Central Bank Jean Claude Trichet, former UK Prime Minister Gordon Brown and other equally amazing people. Less amazing to PIMCO, but cool to me is that I serve as one of 20 people on their Independent Financial Advisor Advisory Council. Anyway, the Income Fund has done exceptionally well. Morningstar named the manager the Bond managers of the year a couple of years ago. It is globally focused on finding bonds with steady income and capital appreciation potential. There is a high level of analysis that goes into this strategy and all of their strategies. The returns have been excellent on this fund. Up over 7% this year and nearly 7% per year over the past 5 years. And remember, this is a bond fund. Not meant to produce stock like returns. It has defied the odds.

Alternatives

1. Catalyst Millburn Hedge Strategy- Alternative strategies seek to provide sources of returns that are non-correlated and different from traditional stock and bond markets. Alternative managers are generally more flexible and are able to seek profits from either an asset's decline or increase. This fund is managed by Millburn Ridgefield in Greenwich, CT. Millburn and their process date back to 1971 and this strategy has been around since 1997. In short, it is a trend following strategy or managed futures strategy. Unlike many of your other managers, this fund is based on a system or algorithm built by Millburn which analyzes data continuously and invest according to the systems output. Simply put, very smart people build the parameters and then the system runs based on those. Kind of part person and part machine. The emotion is removed from the investment process in this strategy. The fund is 50% active, tactical, long and short futures. Think-currencies, commodities, interest rates and stock indices. The other 50% of the fund is a passive portfolio of global stock ETFs (just index based stock funds). The Catalyst fund has a very low correlation to traditional stocks and bonds. The past performance is great. Up almost 12% YTD and over 11% annualized over the past 5 years. More unique is that the fund made money in 2008 when the S&P 500 lost -38% and it also made money each year 2000-2002 when the S&P was down each year. The fund has had 1 down year in the last 20 years.
2. Aptus Behavioral Momentum ETF (BEMO)-this is also a relatively new strategy for me and I discovered it right in my own backyard in Fairhope, Alabama. Aptus Capital was founded by a group of former basketball players (of course) who have put together a very unique strategy that I believe fits well in my allocations. The fund is based on a system similar to the Catalyst fund, but it is much simpler. In fact, their tagline is "simple beats complex". The fund is a basket of up to 25 stocks, rebalanced monthly. They are bought according to a rigorous ranking system that is agnostic of human emotion. Basketball analogies abound with Aptus. They say, "defense wins games" and work to show that by building in loss aversion in the portfolio. BEMO has the ability to move out of stocks and into treasury bonds during times where the system signals market weakness. While downside protection is great it can be said that "good offense also wins games". They work to do that by having a concentrated portfolio to capture what the market can give them. Aptus hasn't been around too long, but it is up near 14% YTD. They have run backtest on the strategy which shows impressive results during past poor market environments. At the risk of being cheesy-I like having them on my team.

This ended up being longer than I anticipated, but if you made it this far you now know a bit more about some of your investments and how they fit together in your portfolio.

Past Performance on any investment is not indicative of future results. Fund are sold by prospectus. Please refer to the prospectus for additional information including risks associated with the fund, fees, and performance.