LESA SROUFE&CO INC. VALUE ADVISORS

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## First Quarter Update and Outlook

Something has changed. After years of the most popular market index, the Standard & Poor's 500, usually leading the world; the first quarter of 2018 ended with a thud. While beating many of its peers for the overall quarter, the month of March resulted in a downdraft that exceeded most other indexes. In a word: the popular FAANG trade, which is heavily weighted in the S&P 500 came to an end and was usurped by better performance in stodgy industries including real estate, energy, and utilities. Investment strategists have voiced a variety of reasons for this downdraft including company specific scandals, shortfalls in results relative to high expectations, concern over inflation and political pressure, but in our opinion, the only really right answer might be "It was just time." The rotation to better relative performance of other kinds of companies and sectors played out as it always does: the highest rated sectors and stocks couldn't fulfill investors' lofty expectations anymore.

During the quarter, we purchased three new stocks, sold one stock and sold a partial position out of the model portfolio. In January, we purchased Universal Corporation, a worldwide contract purchaser and reseller of tobacco leaf. We believe Universal will benefit from consolidation in the agriculture industry, as the company arguably is the strongest of the tobacco importer/exporters. We regard the stock as reasonably priced, even in view of the slow or no growth prospects of the tobacco leaf industry and its end products: cigarettes, smoking, and chewing tobacco. The stock offers an attractive dividend yield of 4.4% on its common stock.

We purchased Weis Markets, a Pennsylvania-based operator of 205 retail food stores in the region. Weis has the distinction of having very little debt in an industry that has leveraged up over time. The Weis family owns about two-thirds of the common shares outstanding. We believe that Weis Markets has an opportunity to benefit from other retailer troubles in the area and that the Weis family may someday choose to take the company private, eliminating the hassle and cost of being publicly traded. In the meantime, earnings will benefit from a significantly lower tax rate beginning in 2018 and improving profits from store locations purchased in 2016.

We also initiated a small position in CARBO Ceramics, a maker of ceramic proppant and software and engineering consulting services for the oil and gas industry. When oil and gas prices began to decline in 2014, demand for CARBO Ceramics products dried up as drillers eliminated the higher cost but more effective ceramic proppant from its wells. After being a "darling" of the market, the stock lost over 90% of its market capitalization. To get through this difficult environment, the company realigned its debt to supportive private lenders, has diversified its product offerings, and has significantly cut its operating expenses. As oil and gas prices have risen recently, we believe the company is in the early stages of experiencing a pickup in demand for its products.

During the first quarter, we sold our position in Wal-Mart Stores. The stock benefitted from strong earnings and investor excitement over early results from its online sales platform. At the time of our sale in January, the stock fulfilled our price objective. We also sold a partial position in Abercrombie & Fitch, the fashion retailer, after adding to our original position in 2017. Many fashion retailers, including Abercrombie & Fitch,

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have soared as holiday results were better than expected. We continue to hold our remaining shares in Abercrombie & Fitch.

Going forward, we expect that the U.S. Federal Reserve Board will try to raise interest rates another two or three times this year or until the stock market goes on strike. Beware that the weak ending to the first quarter was small compared to a real buying strike by investors. Valuations are coming down to average historical levels as earnings estimates have risen partly due to the tax cut which will significantly benefit U.S. corporate earnings in 2018 and beyond. We consider the market fairly priced on that metric, but acknowledge that a slowdown in earnings growth, higher interest rates or negative effects of a trade war or political unrest would further take the wind out of investors' sails. We believe our portfolios are prepared for that outcome, when it happens.

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