April 5, 2019

First Quarter Update and Outlook

The S&P 500, the U.S. focused index notched its best quarter in a decade, almost mirroring its 13.5% decline in the fourth quarter of 2018. The LSC portfolios declined less than most of the broad indexes in the fourth quarter of 2018, but also rebounded less than most of the broad indexes in the first quarter of 2019. Our weighting in defensive stocks and safe haven stocks, such as silver and gold, underperformed riskier assets in the first quarter. Also, our Brazilian company investments gave back some of their earlier gains experienced after the 2018 presidential election. We continue to have exposure in companies that operate in Central and South America, where the long- term growth demographics remain favorable.

During the quarter, we purchased Alcoa, a world leader in the production of bauxite, alumina and aluminum. Alcoa operates in 40 locations across 10 countries. We expect improvement in the company's aluminum segment to follow the upturn in alumina in 2018. In the meantime, Alcoa has made significant financial progress. We expect profits to climb over the next several years, as the company benefits from higher prices and its more streamlined operations. Also, a resolution to the ongoing trade talks between the U.S. and China, would benefit Alcoa's business.

We also added to our position in Fluor Corporation during the quarter. Fluor, the worldwide construction company, is a beneficiary of an expected upturn in infrastructure spending. We expect a sharp uptick in Fluor's earnings over the next several years.

During the quarter, we sold Groupon, at a loss. The company has yet to earn much of an annual profit, even though its loss-making businesses have been culled, as we had expected.

Just after the end of the quarter, we completed the purchase of Diana Shipping. Diana Shipping provides worldwide shipping services to the dry bulk industry. The company operates a fleet of 48 dry bulk vessels that ship commodities including grains, iron ore and coal. The company's earnings would benefit from an upturn in commodity prices and a tariff resolution between China and the U.S. In addition, China's stricter pollution laws will require the import of cleaner low Sulphur coal for its power generation.

Higher wage, materials and transportation costs are all contributing to an earnings slowdown in the U.S., in the face of jobless claims that are running at a 49-year low. Just three months ago, S&P 500 earnings were expected to rise by almost 9% in 2019. Since then, earnings growth estimates have been sliced by half. We are likely in the early stages of a reversal of profit margin expansion by many sectors of the S&P 500, including the most heavily weighted sectors: technology, healthcare, banking and consumer. We are much more optimistic regarding commodities and cyclical related industries including energy, materials and construction that had suffered depressed profits in recent years. A combination of rising commodities pricing and a higher proportion of fixed costs and strengthening balance sheets are combining to benefit earnings, just when other industries are entering an earnings slowdown. Our 40% weighting in non-U.S. based companies about matches the MSCI All World Index weighting, reflecting our belief that international stocks offer excellent value and that their valuations don't yet reflect improving global growth, outside of the U.S.

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