LESA
SROUFE&CO INC.
VALUE ADVISORS

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Second Quarter Update and Outlook

The U.S. markets were remarkably resilient during the second quarter, even in view of trade wars and short-term rate increases, which are often a bad omen for equity returns. Not noticed by many was the strength in U.S. small capitalization stocks (less than $2 billion in market capitalization), both growth and value oriented, which led the U.S. market. Many of our strongest performers fit in this latter category.

International markets have lagged the U.S. for the majority of the last five years, including 2018 year-to-date. Emerging markets took the brunt of the strong U.S. dollar, rising U.S. short-term interest rates and trade war rhetoric. In addition, the usual skepticism over government transparency or perceived instability in some major economies (China, Brazil, Turkey, South Africa, and Italy to name a few) didn't help the international stock market indexes either. We have been amazed and delighted that through this all, the U.S. markets have held up as well as they have. However, on closer inspection, the U.S. broad stock market indexes, which are market capitalization weighted, have been fueled by a declining number of rising stocks. This narrower participation is sometimes the sign of a market top, if even for a short period of time. If so, the LSC Opportunistic equity model, which has significant cash reserves, is well positioned, in our opinion.
During the quarter, we purchased one new stock and sold one stock in the model portfolio. We purchased Franklin Resources, a financial services firm best known for its Franklin Templeton mutual funds. The company has one of the strongest capital ratios of the publicly traded investment companies and is known for its international investments, an area which in recent years has been out of favor, in our opinion. We believe that many international markets are undervalued and may catch up to or outperform the U.S. stock market in the future. The founding Johnson family continues to own 40% of the outstanding shares.

We sold Universal Corporation, the U.S. based importer/exporter of tobacco leaf. In May, the company announced that it is raising its annual cash dividend to shareholders by 37% and will also seek to raise shareholder value in other ways. Subsequently, the stock reached our price objective.

We sense that investors have become used to the positive and even outsized returns of many asset classes in recent years. As U.S. bond returns have become less consistent after several decades of strong returns, some equity investors have become more confident of the future resiliency of their perceived alternative, the U.S. focused stock market. We are not so convinced of either, hence our large cash reserves in the LSC Opportunistic model and our focus on investments that would likely outperform in an inflationary environment including; energy, other commodity-related stocks and international focused companies. It's a difficult exercise to speculate on the cause or outcome of the next stock market downturn, and the circumstances are always a little different every time. Our guess is that the biggest surprises might lie with those businesses that have made their outsized returns from the use of a combination of leverage and cost cutting, in a rising economy.

We look forward to the second half of the year, as we expect that ever changing investor attitudes will create investment opportunities not even yet considered.

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