LESA
SROUFE&CO INC.
VALUE ADVISORS

October 4, 2019

Third Quarter Update and Outlook

The market capitalization weighted S&P 500 Index is within inches of its all-time high, yet doesn't reflect the huge divergence in performance of many of the companies that make up the index. We are not sure if this is a precursor to a broader market decline, or an opportunity to buy good companies while they are out of favor. We think it's a little of both. Historically, when investor confidence is high, it often coincides with a stock market top. Currently, investor attitudes are mixed, as measured by recent surveys, likely reflecting the slowing economic trends in the U.S., among factors. Yet investors' guarded attitude belies near record low cash reserves among a broad range of equity investors.

S&P 500 per share profits have significantly led aggregate U.S. corporate pretax profits in recent years, due in part to the historic tax cut, record stock buybacks and significant acquisitions made with borrowed funds. Recent economic indicators imply that the U.S. is now acknowledging what the rest of world has been feeling for several years; slow or no growth. We are comfortable with holding significant cash reserves while the general market adjusts to this reduced outlook. Many cyclical industries including banks, materials, energy and industrial companies already fairly discount this environment, in our opinion. Growth related stocks, which in recent years have carried premium valuations are just starting to. Our holdings in these former sectors have lagged, but we are comfortable with their current reasonable valuations and their positive long-term prospects. We think their underperformance will not last.

Among the strongest performing industries in recent months has been the U.S. home builders, a beneficiary of low interest rates and pent up demand among first time buyers. This turn in fortune for home builders over the past few years gives us confidence in the long-term success of buying into companies and industries when they are out of favor with investors. In recent months, the gas and oil sector's decline has placed it at the bottom of the performance charts, as oil and natural gas prices have declined. The precious metals sector, previously a perennial underperformer has shown relative strength, as interest rates around the world have declined (in some cases to negative rates) in line with a sharp retrenchment in business capital spending. We do think the current environment merits a cautious outlook when considering the current premium valuations for many of the largest U.S. stocks; valuations not matched by the rest of the world.

During the quarter, we purchased one stock, Nokia Oyj, a worldwide telecommunications equipment provider, based in Finland. The company has four main businesses: Ultra Broadband Networks, Global Services, IP Networks and Applications, and Nokia Technologies. Nokia sells its products to a broad range of telecom service providers around the world. Revenue and net income totaled $26 billion and $1.5 billion in 2018, respectively. Nokia is a major provider of the new 5G (fifth generation) telecom equipment to cellular service compansssssies, offering end-to-end solutions. We believe Nokia will be a beneficiary of the worldwide upgrade to 5G as it is rolled out over the next five years.

Investors have wondered in recent years if the U.S. especially is in an era where innovative companies should be bought at any price. We think not. Recent struggles in the funding of private company startups and related, their struggles to attract additional capital in the public markets is a reminder that fair valuation never goes out of favor for too long.