LESA
SROUFE&CO INC.
VALUE ADVISORS

January 6, 2020

Fourth Quarter Update and Outlook

2019 was a rebound year for many investors after a decline in 2018. Large cap U.S. growth stocks led in returns among a broad array of asset classes for most of the past six years, a remarkable run given the fact that earnings on average likely rose just modestly. 2019 started off with great expectations, yet by the end of the year, earnings for the S&P 500 companies had been whittled down to just 1% estimated growth for the year. Even with significantly dimmed expectations, that index returned 31% including dividends. To put that into perspective, average stock price valuations as measured by the S&P 500 Index rose from a factor of 14 times 2019 estimated earnings at the beginning of the year to a whopping 20 times earnings by year end. If it wasn't earnings growth that fueled the stock market, what did? We think the Fed's U-turn away from prior interest rate increases combined with renewed investor optimism, and more specifically, a "fear of missing out" both were factors, beyond any good news. We should add, the biggest buyers of U.S. stocks have been the companies themselves. A record 40% of publicly traded U.S. corporations now sport negative tangible book values. A decade of acquisitions, mergers and stock buy backs have been an important factor in earnings per share growth. Today, U.S. based publicly traded companies with no debt are very rare indeed.
In the fourth quarter of 2019, we added no new stocks to the model portfolios. We did purchase additional shares in China Mobile Ltd ADR and in Schnitzer Steel Industries. China Mobile is the largest telecom company in the world, one of three serving China. We think political upheaval in China (mainly Hong Kong) will look tame relative to other regions of the world in 2020. This company is alone among its worldwide peers with a debt free balance sheet. Schnitzer Steel recycles and sells scrap metal to a variety of industries. An end to tariff uncertainty and a pickup in infrastructure spending in the U.S. would likely benefit metal prices. We reduced our weighting in MDC Holdings and in Pan American Silver during the quarter. MDC Holdings stock has benefitted from continued strong demand for entry level priced homes, a sector that it specializes in. Pan American Silver stock has benefitted from a rise in the price of silver and from good production and reserve results at its gold and silver mines. We continue to believe both companies will produce strong results in coming years.

2020 has started out with a bang. In view of the events in the Middle East, we are reminded why our Opportunistic model portfolio has been hedged with invested cash reserves and with exposure to defensive stocks such as gold and silver producers. Outside of that, an orderly Brexit, a weaker U.S. dollar and/or a pickup in international economic growth would reflect well on our international holdings and on our commodity sector issues. Our U.S. focused stocks include construction and industrial companies that have fared poorly to date. An infrastructure bill, if passed by Congress, would perk up interest in that sector.

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In the past we have written about the crazy hot returns recorded by luxury investments such as fine art, collector wines and antique cars. This was not to be in 2019, a year in which these categories' returns were subdued and even negative. We sense that there is growing caution among wealthy investors, and not unjustifiably. The recent uptick in gold and energy prices hints at what is to come, in our opinion.