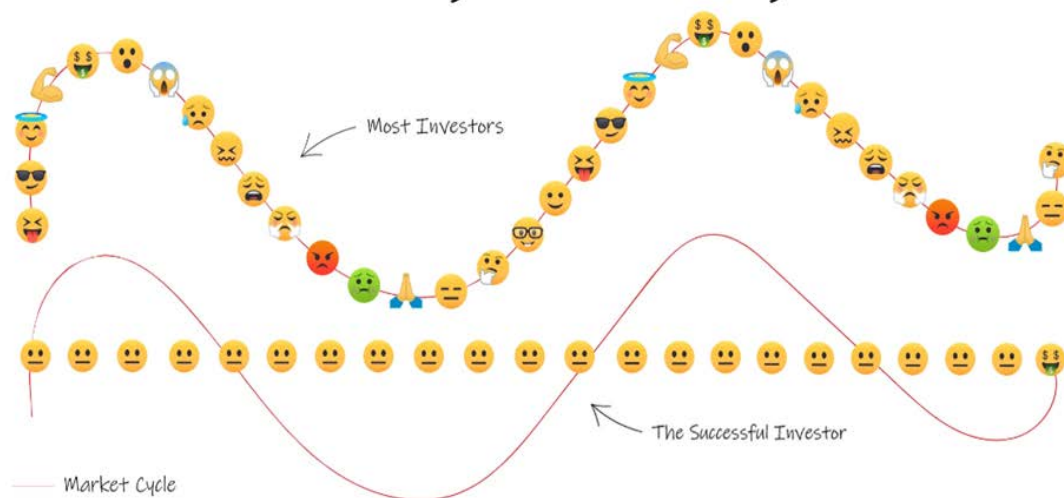


An emoji guide to investing



Source: Neligan Financial

Setting Expectations

Recently, in a discussion with one of our clients, they looked at our portfolios of roughly 30 stocks and noticed that when we add a new investment it can take years for that investment to show meaningful returns. An analysis of the portfolios showed that the stocks recently added to the portfolios have mixed results while many of the best performing stocks had been held for years. Moreover, many times in client meetings we are asked to discuss stocks that are showing what can kindly be referred to as "mixed results."

One of the purposes of our monthly piece is to explain our investment process and communicate to clients what to expect from our investment philosophy. One of our core features is a desire to buy quality businesses at Dow 22,000 prices when the Dow is trading at Dow 26,000. To find these rare mispricing's typically requires buying the stock when there is some controversy or misunderstanding that creates a near term cloud over the stock. Such an opportunity occurred in 2007 with United Healthcare when a stock option controversy related to management compensation placed the stock price under pressure. While ancient history now, the stock underperformed for a year before regaining its form.

One of our favorite graphics is the emoji guide to investing that can be used for not only the stock market but can be applied to individual stocks as well. While sentiment around the market or an individual stock can follow a wave of emotions, our edge is seeking to keep a level head (bottom graphic) and buy when others are in the red or green stage. When purchasing stocks during this timeframe, famed investor Warren Buffett noted in his 1961 partnership letter, "sometimes these work out very fast; many times they take years. It is difficult at the time of purchase to know any specific reason why they should appreciate in price. However, because of this lack of glamour or anything pending which might create immediate favorable market action, they are available at very cheap prices. A lot of value can be obtained for the price paid. This substantial excess of value creates a comfortable margin of safety in each transaction. This individual margin of safety, coupled with a diversity of commitments creates a most attractive package of safety and appreciation potential." Temporary near term underperformance can be outweighed by the upside potential and limited downside risk.

But because we want both growth and value, if an individual stock works according to plan, it should move from pessimism to performance to potential. United Health emerged from the stock option controversy to



Performance Highlights from United Healthcare's 2018 Annual Report



Source: United Healthcare

become a consolidating force in the industry that dramatically improved the profitability for the company during a period of performance. More recently, it has been realizing its potential by acquiring companies in the higher margin healthcare information technology segment. Other stocks did not perform as well, such as Alliance Data, can confirm the market's pessimism in their performance and require us to move on. If a stock in the portfolio is lagging or conversely has a large gain, one question may stem from where it is in the typical path from pessimism to performance to potential. As famed Fidelity Magellan Portfolio Manager Peter Lynch stated, "in my investing career, the best gains usually

have come in the third or fourth year, not in the third or fourth week or the third or fourth month." Through this lens, we see value in patience, waiting for the more recent purchases to fulfill their potential and add value to client portfolios.

As always thank you for your interest and trust managing your investments.

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