MANNERS-KOESTERS MONITOR

Spring has Sprung! April 15, 2018

D|A|DAVIDSON

Remain Calm and Carry On

The first quarter of 2018 started just as the year ended, with stock markets around the globe rallying. However, as interest rates began to rise in early February, the stock market slumped rather dramatically falling over 2,200 points on the Dow Jones Industrial Average or close to 10%. We suppose a market correction shouldn't be a surprise to anyone, but the recent 500 point hourly swings do take a little getting used to. When all the dust settled by quarter end, our portfolios were generally down a few percentage points. Volatility has continued into April and we suspect, if interest rates continue to rise, we will see more money leave stocks and longer term bonds in favor of shorter term money market funds and cd's, which now yield about 1½% to 2%. More than the tax cuts or possible trade wars, the sharp rise in short term rates is probably the real story over the last twelve months.

One thing that has been a bit surprising to us has been the weakness in most of the "consumer staple" stocks. Companies like Proctor & Gamble, Pepsi, Colgate and Kraft Heinz historically have held up very well during declining markets. Investors tend to favor the relatively stable predictability of these steady dividend payers over the faster growing more exciting alternatives. Many of these multinational "brand" powerhouses have, in fact, found themselves struggling to evolve in our "brave new world" of social media and online advertising. But this isn't the first time they have been challenged (think generics) and we suspect they will once again use their significant resources and distribution strength to deliver superior value. In some ways the current situation is reminiscent of the tech stock boom of the late 1990's. The excitement generated by the internet sparked a gold rush in anything "net" related in the stock market, while more traditional companies like Target and Berkshire Hathaway were shunned.

As portfolio managers, it is difficult not to get caught up in trying to out-do the stock market averages by shifting in and out of securities we think might perform better over the short run. However, we are reminded of our most important mission every time we meet with our clients and review where they wish to be and what kinds of returns they need (and risks to avoid) to get there.

As we've recently been reminded all stocks are subject to short-term unpredictable volatility. But over the long run, we remain convinced that focusing on building a portfolio of businesses that have weathered many economic cycles and proven their resiliency, is one of the wisest ways we can help meet the needs of most of you reading this update.

We celebrated Russ' 60th Birthday in February!

(He's the one standing with the gals!)

Cash, who needs it?

As we navigate each of your portfolios with suggestions or changes, one important component for us is your anticipated withdrawals from your D.A. Davidson accounts over the next 12-18 months. With this advance notice, the goal is to have at least that much in cash equivalent holdings like money market funds, CDs and short term, highly rated bonds. These holdings are stable and not impacted by the volatility of the stock market. If planned correctly, you should avoid being a forced seller of stocks if markets are down for an extended time period when you need cash. The returns on short term, high quality holdings are minimal, but they are an essential element when trying to mitigate risk. After your needs are covered, we also don't mind having a little available cash ("dry powder") in the event the stock market offers up any real bargains.

As you may know, Berkshire Hathaway has a similar philosophy. During the financial crisis, many financial institutions found themselves in a liquidity squeeze and some (like Bear Stearns) were forced to sell out at bargain basement prices. In Warren Buffett's most recent letter to shareholders (www.berkshirehathaway.com/letters/2017ltr.pdf), he wrote:

> Charlie and I *never* will operate Berkshire in a manner that depends on the kindness of strangers – or even that of friends who may be facing liquidity problems of their own. During the 2008-2009 crisis, we liked having Treasury Bills – *loads* of Treasury Bills – that protected us from having to rely on funding sources such as bank lines or commercial paper. We have intentionally constructed Berkshire in a manner that will allow it to comfortably withstand economic discontinuities, including such extremes as extended market closures.

At yearend 2017, Berkshire held $116 Billion in cash and U.S. Treasury Bills. We're sure you won't need this much, but if we don't already know your anticipated cash needs from your D.A. Davidson accounts, please let us know. As the stock market has performed nicely since 2009, the equity portions of your accounts have increased (a good problem to have!) but this also increases the importance of having advance notice of your short and intermediate term cash needs.

TIPS (Treasury Inflation Protected Securities)

As previously mentioned, short-term rates have risen rather dramatically over this past year from about ½% to 1 ¾%. Interest rates rise as bond prices decline and the first quarter of 2018 saw the Barclays bond index fall 1.5%[1]. We haven't been investing in longer term bonds for some time now and in hindsight we've been overly cautious, however we have been comfortable buying a unique kind of bond called "Treasury Inflation Protected Securities (TIPS)". These bonds are AAA rated and U.S. government backed. They pay a modest amount of interest every six months but unlike other traditional bonds the principle rises daily by the level of inflation, as measured by the Consumer Price Index (C.P.I.). Of course we understand the difficulty in macroeconomic forecasting (economists were invented to make astrologers look good!) but we believe the elements are ripe for a return of inflation. We very much like the downside protection of owning TIPS in our portfolios and suspect they might also provide some upside surprises.

([1] Morningstar ™)

Retirement

Bob Kathol retiring after

47 years in the business!

Our long-time colleague, mentor and friend Bob Kathol is retiring at the end of April. Bob began his investment career 47 years ago with Kirkpatrick Pettis. He also spent 18 years on the board of NYSE listed American States Water Company. A native of Hartington Nebraska, Bob graduated from Creighton University and in 1963 worked as a CPA with Arthur Andersen until 1971. We all have been beneficiaries of Bob's vast experience and willingness to share. Many others have benefited from Bob's generosity with scholarships at Creighton University, Mount Marty College and Duchesne Academy. Bob won't be in the office every day anymore, but when we need his insights we know where to find him and we're sure, as always, he will be happy to help.

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Jennifer's Journey Back in Time

March 10, 1862 - The first issue of U.S. government paper money occurred as $5, $10 and $20 bills began circulation.

April 15, 1912 - In the icy waters off Newfoundland, the luxury liner Titanic with 2,224 persons on board sank at 2:27 a.m. after striking an iceberg just before midnight. Over 1,500 persons drowned while 700 were rescued by the liner Carpathia which arrived about two hours after Titanic went down.

May 5, 1865 - Decoration Day was first observed in the U.S., with the tradition of decorating soldiers' graves from the Civil War with flowers. The observance date was later moved to May 30th and included American graves from World War I and World War II, and became better known as Memorial Day. In 1971, Congress moved Memorial Day to the last Monday in May, thus creating a three-day holiday weekend.

(Source: The History Place™)

About Us

We look for businesses that we can truly understand and value. It is important to understand our "circle of competence" and stay within that circle no matter how promising a potential investment might appear. Sound investing requires discipline and the ability to keep emotions from corroding common sense — one of the greatest challenges to successful long-term investing. Our philosophy tilts towards well-established companies with solid balance sheets, good pricing power, and strong management. We have confidence in our ability to find quality companies that are run by proven management. We strive to act like business owners. We search for the characteristics that an actual long-term owner would seek in choosing to purchase of an entire business.

About D.A. Davidson

At D.A. Davidson Companies, we believe there is only one way to navigate through the wealth of financial services options: straightforward. We offer clear strategies with smart, personalized solutions that match your goals and show you the path to achieve them. We're with you every step of the way—leveraging our nationally-recognized research, capital market and expertise, and the largest network of financial advisors headquartered in the West. Our personal approach is rooted in the values, stability, and discipline of our 80-year-old employee-owned company that is as independent as you are.