TPS

SPECIAL REPORT: SPRING 2020

THE DEATH OF VALUE HAS BEEN GREATLY EXAGGERATED

- While returns for Value[1] stocks were terrific in 2019 and Value turned in a very good decade of returns, Growth[2] stocks have outperformed for a while now, as shown in Figure 1 on Page 4. And while Value may continue to lag Growth in the future, we continue to recommend investments in Value stocks, especially as those stocks trade for what we believe are inexpensive price multiples and largely higher dividend yields.
- Growth stocks are often young companies whose earnings and sales are expected to increase at a rate much higher than the average company. We believe that most investors in Growth stocks pre-pay for potential growth that may or may not materialize. Conversely, we believe that Value stocks trade below their estimated fair value for the company's shares, essentially making them "on sale." Their prices are discounted based on bad news or low expectations that may or may not materialize.
- Value investing should resonate with investors, given that most live their lives in search of bargains, be it at the grocery store or the Ferrari dealership.

[1] Please refer to the last page of this report for a definition of Value stocks
[2] Please refer to the last page of this report for a definition of Growth stocks

CLIMBING A WALL OF WORRY

The S&P 500 climbed more than 9% during the fourth quarter of 2019, even as the first two days of October reminded us that the Halloween month has historically been the worst of the year. Sizable losses across the board in the equity markets this time around renewed concerns about the strength of the U.S. economy. The main culprit was a weaker-than-expected reading of 47.8 on the ISM Manufacturing Index (PMI) indicative of contraction in the factory sector. Less optimism among the purchasing managers who respond to the survey is not surprising, given the persistent trade tensions around the globe, the strong dollar and the General Motors strike. Yet, we offer the reminder that, per the ISM, "The past relationship between the PMI and the overall economy indicates that the PMI for September (47.8) corresponds to a 1.5% increase in real gross domestic product (GDP) on an annualized basis."

Our commentary in *The Prudent Speculator* at the time offered perspective: Certainly, we understand that economic data has not been as strong as we would like, and there is tremendous uncertainty about the long-playing trade hostilities with China. However, per Bloomberg, the odds of recession have remained unchanged at 35% since the end of August and the current GDP growth projection from the Atlanta Fed stands at 1.8%. Further, Jerome H. Powell said last month, "My colleagues and I all think that the most likely case is for continued moderate growth, continued strong labor market, and inflation moving back up to 2%." Even as the Federal Reserve trimmed the Fed Funds Rate by 25 basis points, the Fed Chair added, "We're not forecasting a recession. But we are adjusting monetary policy in a more accommodative direction to try to support what is in fact a favorable outlook."

THE WAY FORWARD

We further noted: Our view is that the economy will still muddle along, and history shows that even in a contraction, Value stocks are the place to be. We remain sanguine about the prospects for our broadly diversified portfolios of what we believe to be undervalued stocks. We also note that interest rates have retreated again, making dividend-payers even more attractive, while corporate balance sheets and income statements generally remain healthy.

While the heightened drama on Capitol Hill per the Impeachment Inquiry against President Trump added another wildcard to the equation during September, we actually liked the equity market developments last month. Yes, as discussed in this issue's Graphic Detail, Value stocks enjoyed a little time in the sun. We also noted a newfound emphasis on investing in sound businesses with valuations that make sense…at least in the market for the latest initial public offerings. Following disastrous IPOs of two startup businesses, a couple of other even higher profile deals were pulled. At IPO, teeth-straightening startup SmileDirectClub priced at $23 and now trades below $13. Peloton, an exercise bike vendor and virtual spin class operator, priced at $29 and now trades for around $22.

Deals pulled included Endeavor, which owns the largest talent agency in Hollywood, but has lost money in four of the last five years. WeWork, a shared office space company that lost $1.37 billion in the first half of 2019, was also stalled due to questions surrounding financial dealings with its CEO and its corporate accounting. As University of Florida finance professor and IPO tracker Jay Ritter said, "Even if it's a good company, at too high a price it's not a good investment." We believe that advice should carry over to the public equity markets.

Not surprisingly, we think that we are invested in good companies that trade for reasonable prices and will prove to be good investments in the fullness of time. We patiently endure the mood swings of our often-manic fellow market participants while we are comforted by generous, and likely increasing, dividend payments. TPS Portfolio shows trailing and forward P/E ratios of 13.1 and 11.8 and a 3.1% dividend yield. Stock prices will always be volatile, but we sleep well at night.

THE DEATH OF VALUE HAS BEEN GREATLY EXAGGERATED

Inexpensively priced stocks enjoyed a terrific September on both an absolute and relative basis. The Russell 3000 Value index (RAV) returned 3.64% and the S&P 500 Value index (SVX) advanced 3.67%, compared to -0.04% and 0.29% returns for their respective Growth counterparts. For a few weeks anyway, the outperformance of Value stocks quieted some of the vitriolic voices shouting about the demise of a historically lucrative style of investing.

Many of the sensationalistic headlines would lead folks to think that they might have lost money over the last decade investing in Value stocks. The data proves otherwise. Since September 2009 the Russell and S&P Value indexes gained 11.3% and 11.5% per annum, a terrific return (in dollar terms) relative to stocks around the world, not to mention bonds, commodities and U.S. Treasuries. The three-, five- and seven-year numbers all tell a similar story, with Value generally leading those same relative performance tables.

Given that data for the Russell 3000 Value and S&P 500 Value indexes do not go all the way back to the inception of *The Prudent Speculator* in March 1977, we utilize the Fama-French Value series as we look at returns over the last 42 years.

FIGURE 1

10-Year Index Returns

As of 09.30.19. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.

Index	YTD	3-Year	5-Year	7-Year	10-Year
Value Stocks					
Russell 3000 Value	17.5%	9.2%	7.7%	11.2%	11.3%
S&P 500 Value	20.0%	10.6%	8.5%	11.6%	11.5%
Global Equities					
MSCI ACWI	16.7%	10.3%	7.3%	9.5%	9.0%
MSCI ACWI excl. U.S.	12.1%	6.9%	3.5%	5.6%	5.0%
MSCI EAFE	13.4%	7.1%	3.9%	6.7%	5.5%
MSCI Europe	14.2%	7.2%	3.0%	6.3%	5.2%
MSCI Emerging Markets	6.1%	6.3%	2.7%	2.8%	3.7%
S&P/ASX 200 - Australia	18.7%	8.7%	5.5%	5.9%	6.8%
CAC 40 Index - France	17.8%	10.9%	5.5%	8.8%	4.7%
Deutsche Boerse - Germany	12.2%	4.7%	2.5%	5.5%	5.0%
Hang Seng - Hong Kong	4.2%	7.3%	6.2%	6.9%	5.8%
Ibovespa - Brazil	10.9%	11.8%	2.7%	-2.1%	-3.2%
Shanghai - China	14.8%	-1.2%	3.2%	5.4%	2.3%
Sensex - India	6.8%	10.7%	6.3%	7.9%	5.9%
Nikkei 225 - Japan	13.1%	9.6%	8.5%	10.5%	8.0%
FTSE 100 Index - U.K.	10.1%	4.8%	0.7%	3.7%	4.9%
Other Assets					
S&P GSCI Commodities	7.8%	3.5%	-6.8%	-6.9%	-1.4%
Bloomberg Barclays U.S. Agg Bond	8.5%	2.9%	3.4%	2.7%	3.7%
Bloomberg Barclays Global Agg Bond	6.3%	1.6%	2.0%	1.2%	2.3%
ICE U.S. Treasury 7 - 10 Year	9.8%	2.4%	3.8%	2.6%	4.4%
ICE U.S. Treasury 3 -7 Year	6.0%	2.0%	2.6%	1.9%	2.9%
ICE U.S Treasury 1 - 3 Year	3.1%	1.5%	1.3%	1.1%	1.2%

Interestingly, the Fama-French historical annual return rate of 14.1% over that period represents a premium of roughly eight percentage points to the 6.2% average yield on the 10-year U.S. Treasury since 1977. Given that this "risk-free" rate averaged only 2.4% over the past decade, we could argue that the nine-percentage-point RAV and SVX premium since 2009 has exceeded expectations.

FIGURE 2

Long-Term Returns

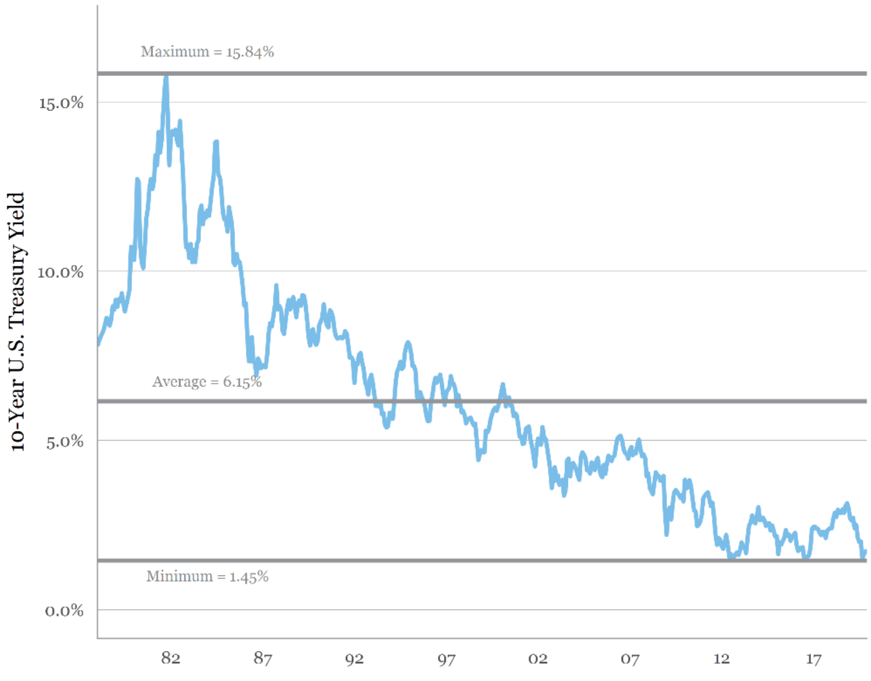
From 02.28.77 through 07.31.19. Low P/B Ratio (Value) and High P/B Ratio (Growth) portfolios are formed on Book Equity to Market Equity at the end of each June using NYSE breakpoints. Dividend payers are a weighted average of the top 30%, middle 40% and lowest 30% of dividend payers, rebalanced monthly. Non-dividend payers do not pay a dividend. Long-term Corp bonds use the Ibbotson Associates SBBI US LT Corp TR index. Long-term govt bonds use the Ibbotson Associates SBBI US LT Govt TR index. Intermediate term govt bonds use the Ibbotson Associates SBBI US IT Govt Total Return index. Treasury bills use the Ibbotson Associates SBBI US 30 Day T-Bill TR index. Inflation represented by the Ibbotson Associates SBBI US Inflation index. SOURCE: Kovitz Investment Group using data from Professors Eugene F. Fama and Kenneth R. French and Ibbotson Associates

Category	Annual Return	Standard Deviation
Value Stocks	14.1%	16.7%
Growth Stocks	10.8%	18.5%
Dividend Paying Stocks	12.1%	14.3%
Non-Dividend Paying Stocks	11.8%	22.2%
Long-Term Corporate Bonds	8.6%	9.6%
Long-Term Gov't Bonds	8.3%	11.0%
Intermediate Gov't Bonds	6.8%	5.4%
Treasury Bills	4.5%	1.0%
Inflation	3.5%	1.3%

FIGURE 3

Risk-Free Rate: U.S. Treasury

From 12.30.77 through 11.29.19. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.



Value stock performance has easily topped that of the average stock in the world. While we realize that Growth strategies have fared even better over the last decade, we think this adds to the case for Value today. The only other periods where Growth prevailed in the 10-year derby were in the aftermath of the Great Depression and the inflation of the Tech Bubble. Still, Value enjoyed superb ensuing relative returns in the 1940s and 2000s.

The divergence in price between the S&P 500 Value and Growth indexes is the same today as it was in March 2000.

FIGURE 4

Fama-French: Value less Growth

From 06.30.26 through 10.31.19. Growth stocks are half Fama-French small growth and half Fama-French large growth returns rebalanced monthly. Value stocks are half Fama-French small value and half Fama-French large value returns rebalanced monthly. The portfolios are formed on Book Equity/Market Equity at the end of each June using NYSE breakpoints via Eugene F. Fama and Kenneth R. French. Annualized total return. SOURCE: Kovitz Investment Group using data from Professors Fama and French

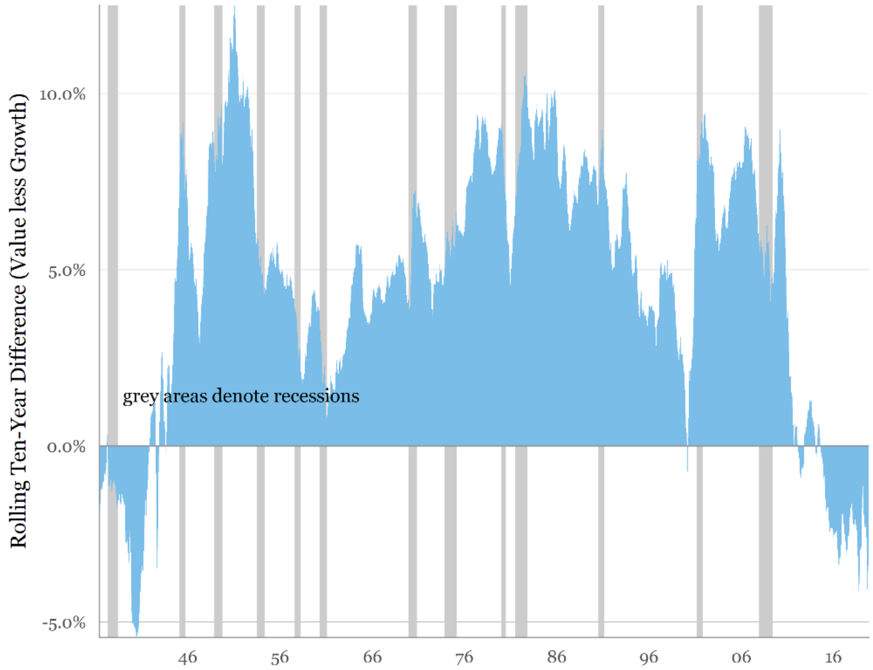
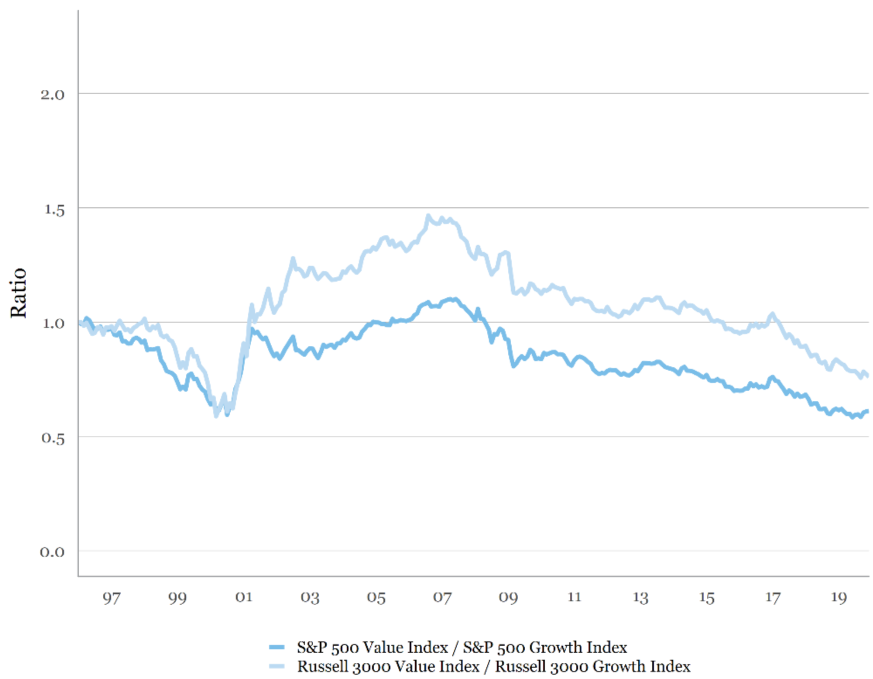


FIGURE 5

Value index relative returns

From 12.29.95 through 11.29.19. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.



While there's no guarantee that past is prologue, take a look at other valuation factors. Price to Book Value and P/E for the Russell indexes show that inexpensive stocks are below their averages and are at historically large discounts to their expensive rivals. As such, the tide may continue to turn toward Value in the absolute and relative returns races.

FIGURE 6

Value vs. Growth Valuations

From 05.31.95 through 11.29.19. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.

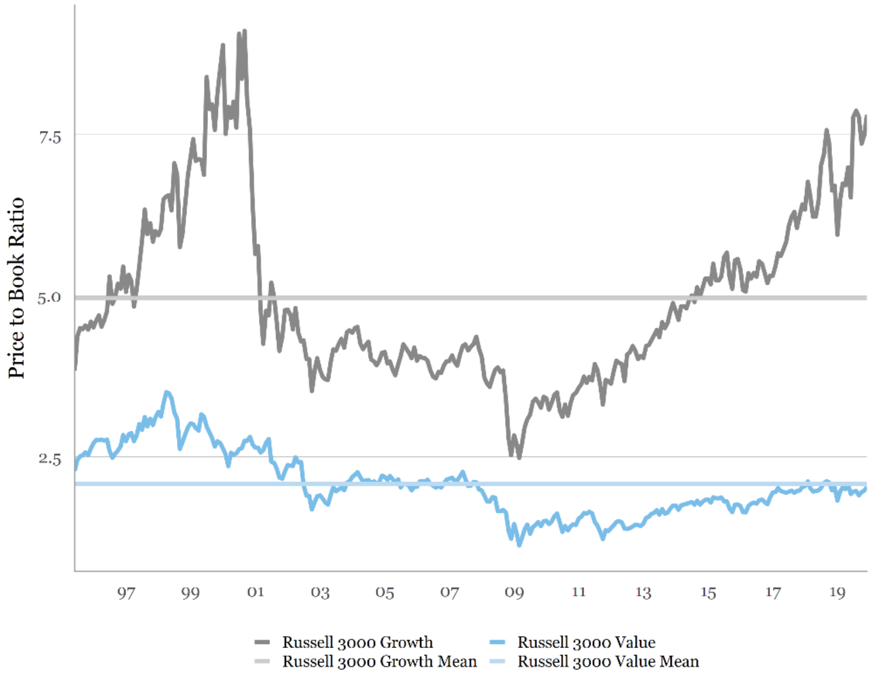
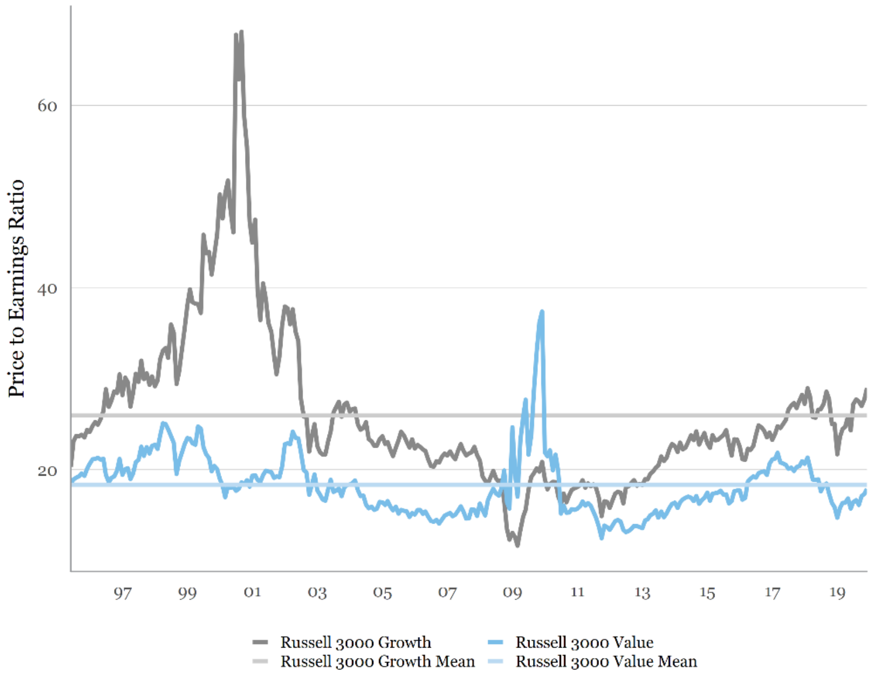


FIGURE 7

Value vs. Growth Valuations

From 05.31.95 through 11.29.19. SOURCE: Kovitz Investment Group using data from Bloomberg Finance L.P.



IMPORTANT INFORMATION

We screen potential investments primarily by their relative valuation metrics and our assessments of stock-specific risk. We recommend only those stocks we believe are undervalued along several lines relative to their own trading history, those of their peers, or that of the market in general. The prices at which we'll recommend purchases or sales of stocks incorporate a range of fundamental risks (e.g. credit, customer and competitive dynamic) that we believe the companies may face over our normal 3-to-5-year investing time horizon.

Past performance may not be indicative of future results. Therefore, you should not assume that the future performance of any specific investment or investment strategy will be profitable or equal to corresponding past performance levels. Investing involves risk, including possible loss of principal. Diversification does not protect against loss in declining markets. Payment of dividends cannot be guaranteed.

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The dividend-weighted portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into five groups: non-dividend paying, top 30% of dividend payers, middle 40% of dividend payers, bottom 30% of dividend payers and all dividend payers (weighted 30% of top dividend payers, 40% of middle dividend payers and 30% of low dividend payers). Non-dividend payers are stocks that do not pay dividends. Dividend payers are stocks that pay dividends. The capitalization and factor-based (book value-to-price) portfolio data is from Eugene F. Fama and Kenneth R. French. The dataset is broken into four groups: large value, large growth, small value and small growth. A large value stock is a type of large-cap stock investment where the intrinsic value of the company's stock is greater than the stock's market value. A large growth stock is a growth stock of a company with a market capitalization value of more than $5 billion. A small value stock is a value stock of a company with a relatively small market capitalization. A small growth stock is a growth stock of a company with a relatively small market capitalization. The total return values presented in Figure 1 from Morningstar's Ibbotson Associates are grouped into small- and large-capitalization stocks.

The Russell 3000 index measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The Russell 3000 Value Index measures the performance of the broad value segment of U.S. equity value universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 3000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values. A value stock is a stock that tends to trade at a lower price relative to its fundamentals (e.g., dividends, earnings and sales) and thus considered undervalued. A growth stock is a company whose earnings are expected to grow at an above-average rate relative to the market.

Large-cap stocks are represented by the Morningstar-Ibbotson Associates SBBI Large Stock Total Return index. Small-cap stocks are represented by the Morningstar-Ibbotson Associates SBBI Small Stock Total Return index. Short-term bonds are represented by the Morningstar-Ibbotson Associates SBBI U.S. 30-Day T-Bill Total Return index. Intermediate-term bonds are represented by the Morningstar-Ibbotson Associates SBBI U.S. Intermediate-Term Government Total Return index. Long-term bonds are represented by the Morningstar-Ibbotson Associates SBBI U.S. Long-Term Government Total Return index.

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