

April 7, 2018

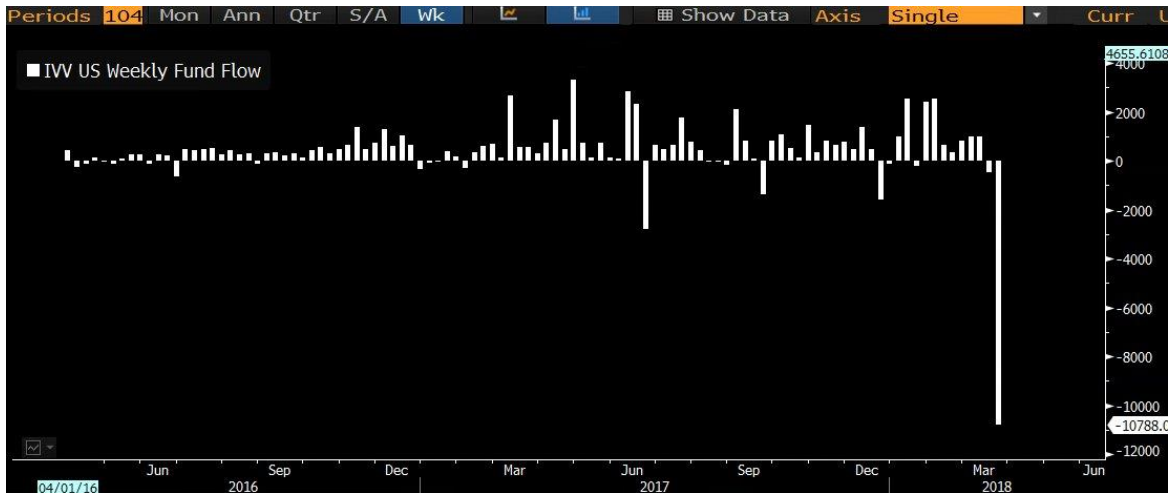
March 2018 - Performance Update

If you are an accredited investor, please contact us for performance information.

March was a volatile month for the market and our portfolio. Our results were dragged down by the several factors – all of which I believe to be transitory.

- Fears of trade wars dragged down stocks and had a particularly strong impact on shares in companies in the logistics and transportation sectors. We hold shares in Union Pacific and Canadian National railways – both of which were negatively affected. We view the threat of a trade war as grossly overstated, and more political theater than reality.
- Technology companies, which have long been the darlings of the market, declined due to the Facebook data fiasco and the prospects of tighter regulations on data privacy. We don't hold any shares that could be directly impacted.
- Consumer staples declined sharply, because of two factors: poor earnings and rising interest rates. We wrote about the threats facing CPG companies last year and we have avoided shares in such companies. Secondly, rising interest rates have pushed down prices for consumer staples stocks as many investors have been treating these companies as “bond proxies” and have fled them in the face of rising interest rates.
- Health care companies came under pressure after the Trump administration said it is considering suing companies in connection with the opioid epidemic. This led to sharp declines in two of our holdings: AmerisourceBergen and McKesson. As drug distributors, both companies could be liable for damages and both have in the past settled state lawsuits related to the distribution and tracking on opioid drugs. The threat of a federal lawsuit creates significant uncertainty, but does not threaten the business model of these excellent companies. The magnitude of the stock price declines is overblown and should reverse itself as fears subside over the coming weeks.

Combined these themes resulted in very negative sentiment leading investors to pull money from the stock market. Such “investor flows” can overwhelm any fundamentals in the short term. To illustrate how dramatic the selling has been, I looked at the flows into the IVV, the Vanguard ETF for the S&P500. As you can tell, March stands out as period of extreme negative sentiment.



At LRT we are focused on avoiding permanent losses – and to that end we seek to avoid companies whose businesses can be easily disrupted or permanently damaged by the economic cycle or change in the competitive environment. As such, we do not see any of holdings being permanently impaired by what happened in March. Market volatility can be annoying but it is also an opportunity to purchase stocks at bargain prices, which is exactly what we have done over the past two months. I believe we are well positioned to deliver portfolio performance in the months ahead.

Market Outlook

The current market sentiment is incredibly negative with high volatility, very high put/call ratios and an overall atmosphere of fear. It is the perfect time to make investments as any improvement in sentiment can led to an explosive rally. I continue to expect a modest rise in the overall market in 2018, with the S&P500 ending the year above 3,000 – a rally of at least 13% from current levels – driven by strong corporate earnings growth. Our portfolio currently contains many “coiled springs” – stocks whose price has declined over the past few months even as their businesses have continued to improve, margins expanded and share counts have shrunk.

Last year’s tax reform included provisions for the immediate depreciation of capital investments which is leading many companies to accelerate investment. Furthermore, the economy overall appears to be accelerating with very strong jobs growth. I believe that the upcoming earnings season, during which companies will report earnings for calendar Q1 2018, will be the most bullish since 2011. Companies will be reporting earnings reflective of the positive trends in the economy and it will be the first “clean” quarter under the new tax rates (in Q4 2017 many companies reported special one-time items relating the tax reform bill changes). Strong earnings combined with very weak market sentiment could lead to a strong rally in the market in the next few weeks.

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