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"You only find out who is swimming naked when the tide goes out."
—Warren Buffett

Q3-2019 Update
October 2, 2019

Dear Clients:

We're again pleased to report client equity portfolios continued to experience solid performance through the first three quarters of 2019, which also marked the ***first time since 1997 when the S&P 500 had a total return greater than 20% in the first nine months of the year.*** While we're grateful this year finally broke a streak of 21 straight years without a 20%+ total return for the S&P 500 through the first nine months of the year, we're even more encouraged the relative performance pendulum began to swing strongly from "growth" towards "value" in September, a trend we ***hope*** continues.

As we stated in our Interim Update on September 16, 2019, we always advise ignoring the stock market's short-term wiggles and focusing primarily on the long-term. Ben Graham, who was Warren Buffett's business school professor and mentor, famously said, "though the stock market functions as a voting machine in the short run, it acts as a weighing machine in the long run." What this means is fear and greed play important roles when votes are being cast, but fundamentals are what matter and eventually determine stock prices.

As you're well aware, the past five years in particular have been extraordinarily difficult for active, "value" investors like us. We believe to produce better-than-average long-term results, you need to own a portfolio that's ***different*** than the average. We evaluate companies as if we're buying the entire business. We look for stocks ***our*** analysis says trade at a reasonable discount to what that business is worth and have a future catalyst in sight to narrow that gap

While we firmly believe that strategy is sound, it has certainly not been rewarding recently. We've been frustrated stocks we buy at cheap valuations (i.e. could double in price and still be attractive) have struggled while stocks with absurdly high valuations (i.e. not profitable anytime soon and could be cut in half and still be overpriced) have soared. However, as shown in the table below, a shift in fortunes may have begun in September, as the S&P 500 Value index dominated the S&P 500 Growth index in September, leading to a solid outperformance by "value" in the third quarter.

	12/31/2018 - 9/30/2019	**6/30/2019 - 9/30/2019**	**8/31/2019 - 9/30/2019**
S&P 500	20.55%	1.70%	1.87%
S&P 500 -- Value	20.01%	2.83%	3.74%
S&P 500 -- Growth	21.06%	0.72%	0.29%

One good month/quarter for "value" obviously doesn't necessarily mean a good turn in fortune for "value" has begun and planning a parade is certainly premature. There have been false starts for "value" before. Still, a shrimp cocktail looks like a feast to a starving man and we're starting to see some cracks in the "growth at any price" fan base and a long-overdue return to sanity by investors.

Trouble in "FAANG"-land could mark a top for the mindless, passive indexing fad. Shares of Facebook, Apple, Amazon, Netflix and Alphabet (parent of Google), together the FAANG stocks, have enjoyed tremendous momentum of the upward variety. Their ever-increasing prices have led to continually higher capitalization-weights in indices like the S&P 500 (these five stocks are 1% of the stocks in the S&P 500, but account for a whopping 20% of the capitalization weight), which has in turn led to a constant flow of buying as the mindless, passive indexers deploy their increasing volume of inflows from investors attracted by the performance and misleadingly "free" cost of index funds. It's no coincidence Morningstar reported as of the end of August, passive index funds had overtaken actively-managed, stock-picking funds in assets for the first time, $4.27 trillion vs. $4.25 trillion. Further, in the past decade, passive index funds added $1.36 trillion in net flows, while actively-managed funds shed $1.32 trillion.

As we all know, trees ***don't*** grow to the sky and some issues have arisen that threaten to interrupt this fairy tale. Technology giants like Facebook and Google are targets of increased governmental regulation, as lawmakers worry about abuses that accompany these companies' growing power. The roster of companies seeking to eat some of Netflix's streaming lunch grows by the day. The upshot is Facebook ended the third quarter of 2019 down 18.1% from its high (7/25/18), Apple down 3.5% (10/3/18), Amazon down 14.9% (9/4/18), Netflix down 36.1% (7/9/18) and Google down 5.8% (4/29/19).

It's an interesting coincidence the very stocks that have powered the performance of index funds are stumbling just as index funds have surpassed actively-managed funds in assets. It will be equally interesting indeed to see what happens if/when the capital that has flowed into passively-"managed" funds heads for the exit and mindless buying turns into mindless selling, leading to even more mindless selling. At that point, "sell to whom?" will be the trillion dollar question. We'll bring the popcorn!

It's true they don't ring a bell at market tops (or bottoms), but we're pretty sure the "Unicorns" (privately-held technology companies, typically losing tons of money, but valued at $1 billion or more) are trying to tell us sanity is returning, which is positive for the health of the overall market and will hopefully benefit investors who focus on valuations and ignore the hype, like us.

Venture capital/private equity firms invest in private companies at an early-stage, with hopes they will be able to cash-out at a big profit when the private company goes public through an initial public offering ("IPO"). These investment firms succeeded in generating high returns (in founder/CEO –led firms like Amazon and Facebook) that weren't necessarily correlated to what was happening in the stock market, which was catnip to university endowments and other giant institutional investors, who responded by flooding the private market with $2 trillion of capital over the past decade. Indeed, the number of private equity firms has risen from about ***1,000 in 2000 to over 7,000 today***. During the same period, private equity assets under management have exploded from about $500 billion to ***$5.8 trillion.***

With this tsunami of cheap/free capital chasing too few good deals, the result is predictable. When investors ***compete*** to give their capital to private companies, you get standards that are lowered at the same time valuations are raised, a toxic combination. In other words, you get (former) shared office space wunderkind ***WeWork***, which may prove to be the "canary in the coal mine" that kills the hopes of other Unicorns who are long on captivating stories of how they're going to "disrupt" and dominate the world, but short on realistic plans for how they're going to make money doing it.

In its first or "A" round of financing in April 2009, WeWork was valued at $97 million. Fast forward 10-years to January 2019, when its "G" or 7th round of financing valued the company at $47 ***billion***, which illustrates how in a private financing with a relative handful of investors, the price is set by the most enthusiastic backer, without the public market discipline of short-sellers who can cast negative "votes" on a company's valuation.

WeWork's IPO bombed and has been shelved. Potential investors not only refused to give the company a valuation in excess of the $47 billion it last sold shares at privately, they balked at $20 billion and even $15 billion (WeWork's valuation at its "E" or 5th financing in 2015). In other words, public investors still wouldn't touch WeWork at a discount of ***two-thirds*** from what the private equity "Masters of the Universe" paid "way back" in January.

Turnoffs were many, including the fact the company that lost $690 million on revenue of $1.5 billion in the first half of 2019 and had no reasonable path to profitability, "risk factors" in the Prospectus for the IPO ran to 32-pages and revelation founder/(former) CEO Adam Neumann sold the rights to the word "We" to the company for $6 million.

Trust us, while this moment of clarity is clearly bad for WeWork (and Uber, Lyft, Peloton, etc.), it is healthy for the overall market and should be a great sign for us that fundamentals and valuation are once again becoming important for setting stock prices and separating attractive investments from the speculative flyers. We think the tide is indeed going out for those companies operating with a "land grab" mentality of growing without heeding cost/ profitability and will prove to have been "swimming naked." It appears blind faith is on the way out and fundamental analysis is on the way in!

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Summary

We're invested alongside you and are happy stocks had a strong first 9-months of 2019 and "value" stocks showed some long-overdue relative strength in September. According to Bespoke Investment Group, when the S&P 500 is up 20% through the third quarter, the fourth quarter is also up 86% of the time (by an average of 3.4% and median of 5.6%). That said, October is down 59% of the time (by an average of -1.2% and median of -0.9%). U.S. stocks have indeed stumbled hard out of the starting gate in the fourth quarter on the rekindling of fears of a weakening economy that shook stocks in August. It's impossible to predict the timing or depth of recessions, but we're keeping our eyes and ears wide open

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Under Securities and Exchange Commission Regulation S-P, KM is required to deliver its Privacy Policy Notice to each client prior to the establishment of an account and updates annually. We are delivering our 2019 annual update to each client account with this letter. In addition, given the increasing importance of protecting clients' personal information, we have implemented a policy whereby KM personnel will not release any information about a client's account without specific authorization from the client. If you would like KM to release information about your account to your CPA or other service provider, please contact Director of Client Service Matt Kirr (matt@kirrmar.com), Associate Director of Client Service Zach Greiner (zach@kirrmar.com) or Associate Director of Client Service Maggie Kamman (maggie@ kirrmar.com) by e-mail or at 812-376-9444 or 800-808-9444.

Regards,
Kirr, Marbach & Company, LLC

THE WALL STREET JOURNAL

STOCKS

Value Stocks Beckon Investors in Aging Bull Market

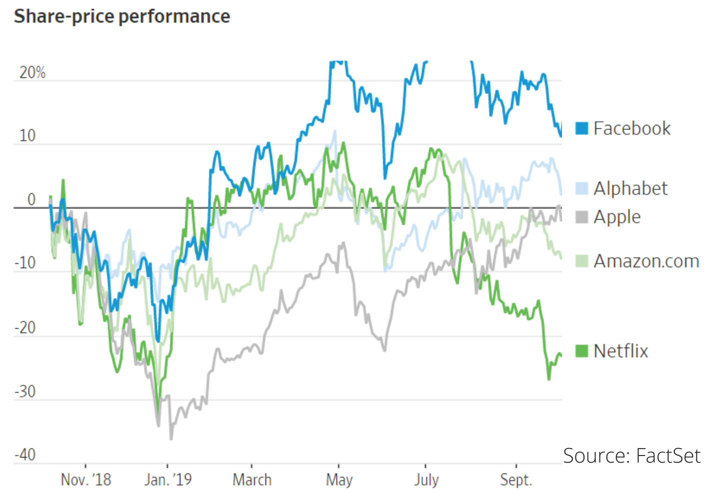
Positions pared in tech stocks, Treasurys and other assets that have generated big returns

By Ira Iosebashvili and Gunjan Banerji Sept. 25, 2019 8:00 am ET

U.S. stocks' September assault on record levels is prompting many investors to shift toward assets that have lagged behind in recent years, the latest bet that value strategies will regain favor.

Thin Returns

Investors who bought shares of popular tech companies that go by the acronym FAANG are sitting on slim gains over the past year



Assets under management for one of the biggest value-focused exchange-traded funds tracked by FactSet hit a record $50.3 billion in September. The ETF has advanced 5.1% over the past month.

Value stocks, often defined as companies whose shares trade at a low multiple of their book value, or net worth, saw the largest divergence in performance from their growth-focused counterparts this decade, according to a Bank of America Merrill Lynch study that looked at the first half of September.

Meanwhile, investors have pared positions in technology stocks, Treasurys and other assets that have generated big returns in recent years.

Funds tracking momentum stocks, those that investors are purchasing because they have been rising, recorded last week their first significant outflows since March of this year, according to Deutsche Bank. And one of the biggest momentum-focused ETFs has edged up 1.4% over the past month, underperforming the S&P 500, which has gained 4.2%.

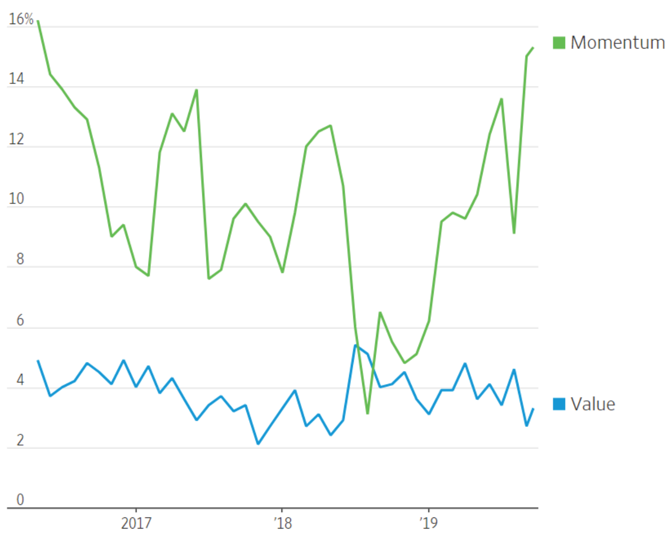
The moves are the latest sign of how a jumble of contradictory data has investors grappling with two divergent paths for the U.S. economy. A recovery from a soft patch in growth would, in theory, boost companies such as financials and energy companies, whose shares have underperformed broader markets over the years. But an economy weakened by protracted trade conflicts and slowing growth abroad would likely push the Federal Reserve to further ease monetary policy, providing a tailwind for Treasurys and growth stocks.

Many investors are opting for a nuanced approach. Hugo Rogers, who oversees $5 billion as chief investment strategist at Deltec International Group, said his fund this month trimmed positions in Treasurys and gold and picked up shares of oil drillers, including Halliburton Co. and Schlumberger Ltd. Shares of the S&P 500's energy sector have zipped past the broader index in the past month, gaining 8.5%.

"We are trading what we think are the early stages of a reversal, and watching out for a bigger reversal that can last for many years," he said.

A confluence of factors is driving the most recent shift. Many are worried that the world's biggest central banks are unlikely to loosen monetary policy much further. Rates in Europe and Japan are already at or near historic lows, while the Fed has signaled that its latest rate cuts are unlikely to be followed by a long easing cycle.

Measure of investor interest in trade



Note: Wolfe analyzes bearish interest on different sectors to gauge sentiment. For example: bearish interest in stocks that have historically been poor momentum plays versus the ones that have been good momentum bets. Figures through Sept. 17.
Source: Wolfe Research

That could spell bad news for the big, momentum-driven technology stocks, which have been a key engine for the market's gains in recent years. Some of the largest tech stocks have lost steam. Netflix Inc., for instance, soared 44% year-to-date through early May before giving up all of its gains and stumbling into the red for the first time on a year-to-date basis since November 2016. Some of these companies underperformed the broader market Tuesday, with Facebook Inc., Netflix and Amazon.com Inc. dropping at least 2% as the S&P 500 shed 0.8%.

Momentum stocks haven't been as widely held as they are now since 2016, according to Wolfe Research, as investors large and small have piled into winners. The firm analyzes bearish interest in different sectors to gauge sentiment.

The high concentration of bets in a comparatively small universe of names has sparked fears of a potentially chaotic unwind, especially because many investors have used leverage to increase their exposure, analysts at JPMorgan warned. That could lead to the type of jarring adjustments markets experienced in February 2018, when a surge of volatility wrong-footed scores of investors caught wagering that share-price swings would remain muted, said Marko Kolanovic, a quantitative and derivatives strategist at the firm.

Momentum trades "worked well until the rotation started, and now are in the early stages of a collapse," Mr. Kolanovic wrote on Sept. 16.

Still, plenty of investors are reluctant to part with assets that have been winners for years and sink money into those that have consistently underperformed during the current expansion. Many who have scooped up value stocks in recent weeks have retained large positions in Treasurys and technology stocks.

"It's going to take quite a while to have value regain its normal standing in the marketplace," said Bill Smead, chief executive of Smead Capital Management. "It's not as easy as just doing this dash for trash." Yet many say the shift is only getting started. Diane Jaffee, a senior portfolio manager running $3.7 billion in value-focused funds at TCW Group Inc., notes the spread between the trailing price/earnings ratios of growth and value stocks on the Russell 1000 index hasn't been this wide since the dot-com crash of 2001.

Her fund has received more inquiries from pension funds and endowments in the past several weeks than it has in years, Ms. Jaffee said. "A lot of people don't understand that value cannot die," she said.

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https://www.wsj.com/articles/value-stocks-beckon-investors-in-aging-bull-market-11569412801

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Study shows "behavior gap" continues to destroy investor returns

Mickey Kim
August 16, 2019

INVESTING
Mickey Kim

We clearly can't control trade wars, the markets or White House tweets, but our behavior is up to us.

Suppose you got spooked last December and sold your stocks as the market's collapse reached a crescendo on Christmas Eve. Who could blame you, with the talking heads screaming about the ***"Worst December Since the Great Depression"*** and the ***"Worst Year Since the Global Financial Crisis"***?

Perhaps you eased your pain over the holidays by telling yourself you'd jump back in the market once the bleeding stopped. That ***sounds*** like a reasonable strategy, but if you sat on your hands even a few days, you missed the ***"Best January for Stocks in 30 Years"*** and did yourself great financial harm.

Unfortunately, investors have an uncanny, destructive tendency to buy high (when they're feeling (over)confident) and sell low (when they're scared).

That's the message from DALBAR's 25th annual Quantitative Analysis of Investor Behavior (QAIB) report, which measures the effects of investor decisions to buy, sell and switch into and out of mutual funds. The effects are measured from the perspective of the investor, not the investments themselves, and show the average investor earns less (often ***much*** less) than fund performance reports would suggest.

According to DALBAR, "investor behavior is not simply buying and selling at the wrong time, it is the psychological traps, triggers and misconceptions that cause investors to act irrationally." The report identified nine harmful behaviors, most importantly:

- ***Loss aversion.*** Behavioral economists have shown the emotional pain of a loss is about twice the pleasure of a gain of the same amount. So, negative experiences will "weigh more heavily and for a longer period of time and be what predominately shapes the investor's behavior." Investors must fight their natural urge to panic and flea when stocks hit an inevitable rough patch.

- ***Availability bias.*** Investors' most recent experiences will have the most profound effect on their behavior, which is why things tend to go to extremes. During the technology bubble of the late 1990s, investors' recent experiences led them to see future gains as "being irrationally more probable," perhaps like today's "FAANG" stocks.

Successful "market timing" (i.e. jumping into and out of stocks) is an expensive fantasy. If you're going to have long-term success, you have to ride out the bad days to benefit from the good days.

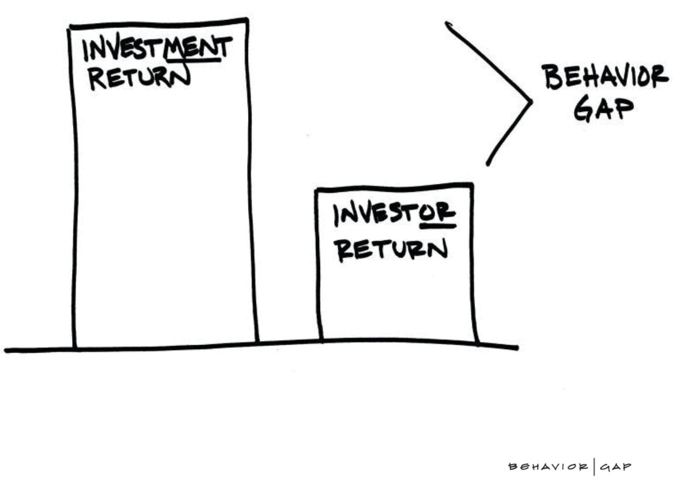
J.P. Morgan assumed a $10,000 initial investment in the S&P 500 Index (SPX) for the 20-years ending December 31, 2018 to determine the cost of missing the best days. Importantly, ***six of the 10 best days occurred within two weeks of the 10 worst days***. As you can see, ***missing just the 10 best days in the 20 years*** cut your return in half and ***you actually lost money if you missed the 20 best days***.

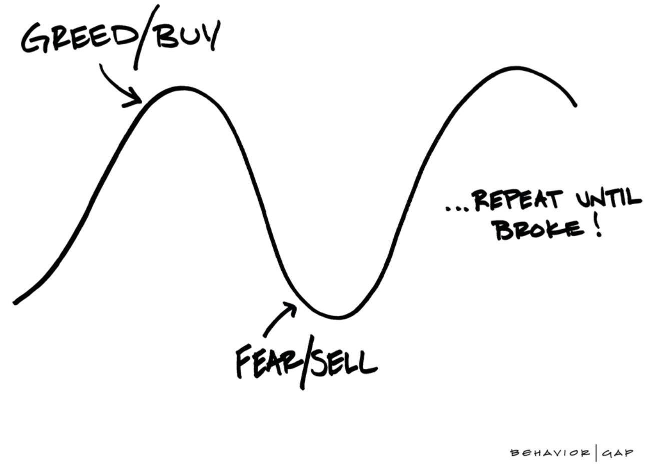
January 1, 1999 to December 31, 2018	$ Ending	% Annualized
S&P 500 Index (Fully Invested)	$29,845	5.62%
Missed 10 Best Days	$14,895	2.01%
Missed 20 Best Days	$9,359	-0.33%
Missed 60 Best Days	$2,144	-7.41%

Crandall, Pierce looked at the market timing issue a little differently, assuming you missed the ***single best day in each year*** for various periods. Assuming you made the same $10,000 investment in the SPX on January 1, 1969, stuck it in a drawer and forgot about it, you would have had $241,368 on December 31, 2018. If instead you tried to "time the market" and missed just the ***single best day*** in each of those 50 years, you'd have ***less than a fifth*** of that amount.

Periods ending December 31, 2018	10-Years 2009-2018	15-Years 2004-2018	25-Years 1994-2018	50-Years 1994-2018
S&P 500 (Fully Invested - $)	$27,754	$22,545	$53,743	$241,368
S&P 500 (Fully Invested - % Annualized)	10.7%	5.6%	7.0%	6.6%
Less Best Day Each Year ($)	$19,443	$12,990	$21,194	$42,599
Less Best Day Each Year (% Annualized)	6.9%	1.8%	3.1%	2.9%

My friend Carl Richards, CFP coined the term "behavior gap" to label the shortfall between investor returns and investment returns that occurs because rising prices attract us and falling prices scare us. Instead, take your cue from Warren Buffett, who said "lethargy bordering on sloth remains the cornerstone of our investment style."





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Past performance is not a guarantee of future results.

The S&P 500 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. market for large capitalization stocks. This index cannot be invested in directly.

The S&P 500 Value Index is an unmanaged, capitalization-weighted index that measures the performance of the value segment of the U.S. market for large-capitalization stocks. This index is a subset of the S&P 500 Index and cannot be invested in directly.

The S&P 500 Growth Index is an unmanaged, capitalization-weighted index that measures the performance of the growth segment of the U.S. market for large-capitalization stocks. This index is a subset of the S&P 500 Index and cannot be invested in directly.

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