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The Value Connection

Our mission is to be responsible stewards of our clients' financial lives.

O'KEEFE STEVENS
ADVISORY, INC.

Inside This Issue

OSA Annual Letter

Written by Justin Stevens

Each year, in the January issue of The Value Connection we publish our annual letter. It's divided into two parts. First, a review of the general principles of the philosophy which governs our investment advice. This is our opportunity to restate the foundational tenets of our philosophy as it relates to behavioral guidance, and our value investment philosophy. The second part of this update is a review of the economic/market phenomena of the past year from our vantage point. Publishing these market and economic remarks annually gives us time to digest what has happened and not get caught in the present-day crises as they unfold. More importantly, we think about the broader implications of world events and how they might, if at all, impact us personally as investors.

This year, we placed a different emphasis in the general principles section of the letter. The key attributes of our value investing philosophy are the focus of our quarterly calls. In fact, the core belief underlying the value philosophy is to be acting on a plan. Intentionality is the crucial element in the advice we provide our clients. Having a plan, acting consistent with that plan, and monitoring the situation to adjust the plan is even more important than the underlying investments that fund the plan.

Part One: General Principles

It is worth restating this every year. We are goal-focused and planning-driven, as sharply distinguished from an approach that is market-focused and current-events-driven. Long-term investment success comes from ***continuously acting on a plan***. Investment failure proceeds from ***continually reacting to current events in the economy and the markets.***

We are long-term, value oriented, equity investors, working steadily toward the achievement of your most important lifetime goals. We make no attempt to forecast, much less time, the equity market; indeed, we believe these to be fool's errands.

Continued on next page...

Since we accept that the equity market cannot be consistently timed by us or anyone, we believe that the only way to be sure of capturing the full premium return of equities is to ride out their frequent but ultimately temporary declines.

Looking back, there have been 15 "bear markets" in equities since the end of World War II – an average of one every five years or so. The average depth of these declines was something on the order of 30%. But in September 1945 the price of the forerunner of the S&P 500-Stock Index was about 16; the Index ended this past year at 3,230. Thus, at least historically, the permanent advance has triumphed over the temporary declines.

Our essential principles of goal-focused portfolio management remain unchanged:

(a) The performance of a portfolio relative to a benchmark is largely irrelevant to long-term financial success.

(b) The only benchmark we should care about is the one that indicates whether we are on track to accomplish our financial goals.

(c) Risk should be measured as the probability that we won't achieve our goals.

(d) Investing should have the exclusive goal of minimizing that risk.

Part Two: Current Observations

Two thousand nineteen was, in important ways, the mirror image of the previous year. Two thousand eighteen was a dramatically outstanding one for the American economy – and for corporate earnings and dividends – despite which the equity market couldn't get out of its own way and ended on a terrific downbeat (a 19.8% peak-to-trough decline through Christmas Eve.) This past year was the exact opposite: an exceptionally good year for the market, up nearly 30%, plus a couple of more percentage points for dividends – even though the economy slowed somewhat, manufacturing went into decline, and the earnings of the S&P 500 almost certainly ended 2019 down slightly year-over-year.

Without laboring the market's course over the entire year, it was a sequence of three important forays into new high ground. First, it made up all of 2018's drawdown, and broke out at the end of April. It then corrected sharply, about which we have more to say in a moment. Another series of new highs followed in June-July and consolidated into the fall. The third and most dramatic breakout took place at the end of October and continued straight through the end of the year without interruption.

These three successive waves of new highs seem to us to have attended upon a slowly growing realization that widespread fears of major disaster – trade wars tipping the economy into recession, a significant year-over-year downtick in earnings, and a constitutional crisis regarding impeachment – were overblown. This was particularly true, we think, with respect to the late October breakout and the virtual melt-up that followed. That upswing was ignited by a third quarter earnings decline that proved far milder than almost anyone had forecast, and not one but two successive blowout monthly job reports.

With all those rather dry facts out of the way, we'd like to return to the above-mentioned May-June drawdown, which lasted about a month, and took the S&P 500 down about 7%. Technically, this can't even be classified a "correction," as the Index didn't close anywhere near 10% down. It was, nonetheless, a full-blown panic attack, set off by one of President Trump's most belligerent tweets regarding China.

It is the way investors reacted to this relatively brief, relatively shallow drawdown which captured our attention, and which we commend to yours. Simply stated, net liquidations of U.S. equity mutual funds and ETF's – absolutely, and especially contrasted with bond fund inflows – soared to levels not seen since the Great Panic of 2008. We repeat: a one-month, 7% drawdown set off a flight from equities consonant with the greatest financial crisis of our time.

Set aside momentarily, if you can, the headline issues of the day: the trade situation, an aging economic expansion, impeachment/election uncertainty, and the like. These are not merely imponderable; they're irrelevant to long-term, goal-focused investors like us.

Instead, we invite you to focus on what seems to be the default setting of the investing public, which we would describe as pessimism verging occasionally into sheer panic. All our reading and experience suggest that very meaningful market setbacks have not historically occurred during huge waves of public pessimism and fear. Quite the contrary.

This is not to be taken as a market forecast. We plan, we don't prognosticate. It is simply an invitation, as we look into the new year, to take some comfort from the rampant fear abroad in the land, even after a decade and more of stellar returns. There will be plenty of time to begin worrying when the stock market once again becomes cocktail party conversation, and everyone around us is excitedly bullish.

Keep your spirits high. It is overwhelmingly probable, as financial journalism has been shrieking of late, that 2020 will not match the returns of the past year. Few years ever do; that is both manifestly true, and wholly irrelevant. The fact – or, more properly, the truth – is that we goal-focused, planning driven investors had an exceptional year in 2019. We did so not by forecasting this year's returns – nor by jumping into the market just in time to get them – but by patiently hewing to our long-term, value-oriented, equity discipline. That is the great lesson of this genuinely great year.

Thank you, most sincerely, for being our clients. It is an honor and a pleasure to serve you.

"Bull markets are born on grown on skepticism, mature on optimism and die on euphoria. The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell."

-Sir John Templeton

Going Green!

In January we announced our switch to paperless delivery of our Quarterly Performance Report. So far, this announcement was well received. We are happy to be making an improvement to our planet by limiting emissions and minimizing paper usage.

Please let us know if you still want to receive these documents in paper format. We can make the switch between paper and electronic delivery at your request.

If you're receiving your TD Ameritrade documents in paper format and would like to switch to electronic delivery, please let us know and we will make the adjustment.

Save the Date!

O'Keefe Stevens Advisory Value Conversation Investor Call

When: Wednesday, March 4th, 2020 at 4:00 PM ET

Details on how to join the call will be emailed to you at a later date.

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Please be advised that our disclosure document, Form ADV, is available upon request. As a reminder, always let us know if your investment objectives have changed.