Warnke/Nichols Ltd.
Investment Management

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PORTFOLIO NOTES **MAY 2022**

To our Business Partners:

- ***LONG-DURATION ASSETS.*** This is a fancy phrase for describing financial assets whose cash flows distributed to owners are generally well out into the future. This type of analysis was orignally applied to bonds as a measure of how much prices will react to given changes in interest rates. The longer the "duration" of a bond, the larger the reaction to interest rate changes. When interest rates rise, for example, the prices of bonds maturing in, say, 20-30 years get clobbered … much more than short-term bonds.

  Without getting too far into the weeds, the same concept can be applied to stocks. The longest of the long duration assets these days are mostly tech companies thought to be "disruptors" or "innovators" with seemingly bright future prospects. Unfortunately, most of these companies are barely or un- profitable, and their cash earnings are expected many months or years in the future. The stocks of these companies are extremely volatile, and it becomes nearly impossible for the analyst to determine the true value of the company. The longer it takes the companies to generate cash earnings, the more uncertain they become as investment candidates.

  Much of the carnage we've seen in recent months in the stock market has come from those companies with great promise, huge sales growth, but little or no profitability. The price declines since February 2021 have been breathtaking. Many of these "disruptors" are down as much as 90% off their highs! Many (most?) of them might never see a dime in profit.

  This is why we want to widen your margin of safety by owning companies with established records, recurring cash earnings now, NOT in the future, high profitability, and sound financials. Their values are also more predictable. While all stocks are susceptible to changes in the economic environment, the "shorter duration" stocks you own tend to hold up better under the stress of overvalued and emotional markets.

- ***PORTFOLIO VALUATION.*** While our group* of portfolio stocks is still quite expensive, more high quality companies are showing up on the radar screen. We have rightly held cash through the collapse in the popular averages since November/December (see below), which we're willing to spend as stocks go on sale in the marketplace – those coveted 50-cent dollars!

- ***RECENT RESULTS.*** Stock market indexes, after rebounding in March, sold off sharply again last month. The tech-heavy NASDAQ dropped the most, over 13%, while the other indexes we monitor suffered declines of 8-10%. The Dow Jones Industrials fared a bit better, down around 5%. Market returns are decidedly negative year-to-date. For the first four months, declines range from 21% for NASDAQ, to 10% for the others. Year over year performance has also gone negative with declines ranging from 1% for the S&P 500 to 12% and 17% for the small-cap Russell 2000 and NASDAQ, respectively. Our equity composite* performance compares favorably with all the popular market indexes.

Steve Nichols, CFA　　*Bill Warnke, CFA*

The group of "portfolio stocks" -- our Equity Composite for the purpose of evaluating investment performance -- consists of 19 stocks that are held in our clients' accounts. Portfolios might hold some or all of these stocks, depending on investment guidelines unique to each client, the timing of purchases and sales, and start dates of accounts. The performance of this group of stocks is a good proxy for our equity performance but might vary widely among accounts. Of course, past performance is not necessarily indicative of future results.

We hereby offer to deliver to you without charge a copy of our current Form ADV Part 2, in accordance with the U.S. Securities and Exchange Commission's "Brochure Rule." Please contact us if you would like us to send you a copy.

Investing with a margin of safety.™

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