Warnke/Nichols Ltd. INVESTMENT MANAGEMENT
WILLIAM R. WARNKE, CFA / STEVEN R. NICHOLS, CFA / ANDY P. RAMER, CFA

PORTFOLIO NOTES **SEPTEMBER 2022**

To our Business Partners:

- ***FORECASTING.*** At the risk of contradicting ourselves (we talked about likely future stock market returns last month), we're going to address the practice of making forecasts about the economy and the stock market. We are prompted by a recent article by Howard Marks, the cofounder of Oaktree Capital Management and a very thoughtful and excellent writer. He started out his missive with a quote from famed economist John Kenneth Galbraith: "There are two kinds of forecasters: those who don't know, and those who don't know they don't know."

  He goes on say just how impossible a task it is to make an accurate forecast and why they are rarely helpful in the investment process. The economy (and most companies) are far too complex and subject to a myiad of inputs to make forecasting any more than guesswork. One wrong assumption in an economic or industry sector forecast from the "top down" can have disastrous effects on investment results.

  A much better approach is to work from the "bottom up," analyzing economic and investment prospects on a company-by-company basis, relying on what is knowable, overlaid with the all-important valuation analysis and a significant margin of safety. While there is always some guesswork involved in every investment process, we are very much aware of the dangers they present and keep them to a bare minimum along with a healthy dose of convervatism.

  Even though we follow the U.S. economy and stock markets with much interest, we honestly couldn't care less about what the pundits think is going to happen. We'd rather be laser-focused on owning a small group of good companies at reasonable prices, much like a business owner who acquires attractively-priced assets to earn a satisfactory return on his/her invested capital.

- ***PORTFOLIO VALUATION.*** Markdowns continue in the prices of companies in the marketplace. Unfortunately, our group of portfolio stocks* is priced at 78% of value, which is still a bit high. HOWEVER, our list of buy candidates is growing so, over time, we'll be committing more cash to cheap stocks, while continuing to reduce holdings in companies that are still quite pricy. Note that one important element of our sell discipline is to own around 20 stocks in a typical equity portfolio. If we build positions in two or three new stocks, we'll have to sell two or three (fully-valued or unattractive holdings) to make room. Note also that, in taxable accounts, harvesting gains like this in long-held stocks results in long-term capital gains. While we hate to pay taxes as much as anyone else, this is the nature of the investment business.

- ***RECENT RESULTS.*** Stock market indexes retreated in August after their July advances. Most of the indexes experienced declines of 3-4%, with the larger cap indexes with slightly larger losses. Year-to-date returns remain negative, with the NASDAQ down over 24% and most of the other indexes showing declines of 14-17%. For the trailing twelve months, declines cover a broad range of 11-22%, with the NASDAQ experiencing the greatest decline. Our group of portfolio stocks* continue to compare favorably to the averages over all three periods discussed above.

Steve Nichols, CFA   Bill Warnke, CFA   Andy Ramer, 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.

Investing with a margin of safety.™

440 WELLS STREET, SUITE 203 DELAFIELD, WI 53018 262–303–4113
E-MAIL: VALUE@WARNKENICHOLS.COM WEBSITE: WWW.WARNKENICHOLS.COM