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Dear Clients and Friends:

Some first quarter and some month to date! As we sit to write this report in the first week of April, the Dow Jones Industrial Average is down over 600 points on the day. Reviewing some of last quarter's statistics, we find that there were 3 days when the single day swing in the Dow Jones Industrial Average was more than 1,000 points (more than 4% each time) and on February 5 the swing was more than 1,500 points or 6.7%. It is now five days into the second quarter and we have already seen three days with swings of more than 700 points.

Yet, as you can see from the statistics below, looking at the quarter as a whole it doesn't seem that much happened in the stock market. Start to finish stock returns were modestly negative. Also visible below is the fact that rising interest rates have started to take a toll on bonds returns. Money funds were one of only a limited number of safe harbors.

Your performance for the first quarter may be found at the end of your asset appraisal.

Benchmark Index Returns	3 Months Ending 3/31/2018
Lipper Balanced Fund Index	-1.1%
S&P 500 Stock Index	-0.8%
Russell 1000 Value Index	-2.8%
High Yield Div. Aristocrats	-3.4%
Money Fund Average	0.3%
S&P-7-10-Year-US Treas. Bond Index	-1.2%
S&P- Twenty Year+ US Treas. Bond Index	-3.3%

If volatility is now the watch word, it also seems that many have become desensitized to large moves in the market averages – not totally surprising as this has now been going on for some time. Of course, volatility within individual stocks, even those of high quality and little news, has been much higher. Uncertainty breeds volatility and vice versa and the economic/political situation has provided plenty of uncertainty for the market to chew on. Daily individual stock price moves of greater than 10%, which historically have been limited to lower quality securities, have now spread to many higher quality holdings. For instance, this past quarter Intel, AbbVie, Polaris, and VF Corp, good companies all, experienced at least one daily move greater than 10%.

In addition to an unusual amount of economic/political uncertainty, we also attribute much of the volatility to a concentration of money in both broadly and narrowly focused index and sector funds used by both institutions and individuals. It is much easier and less emotional for someone to push the sell button on a fund than it historically has been on an individual stock someone is emotionally committed to – we hate to part with winners. If this analysis is correct, we can expect more volatility in the future, even if the political situation calms down after midterm elections.

This would seem to provide investors with an opportunity to take advantage of these major moves, but there is always a grain of truth (though generally overdone) in the ostensible reason for a decline. This makes it very difficult to sort fact from fiction on a short-term basis. And it is why we continue to focus on the long-term when good analysis is generally rewarded.

The economy continues to move steadily higher and we expect this to continue as job growth starts to feed on itself bringing more consumers off the sidelines with new wages to spend. This, of course, creates increased demand requiring the expansion or acquisition of plants and equipment leading to more workers to be hired and we are off on the virtuous circle of growth. We think this can go on for some time and while it is happening, it provides a favorable backdrop for equity investment.

We hope (and believe) that trade disagreements with China will result in more favorable trade terms with the Chinese after years of trade movement favorable to them at our expense. As many trade agreements are coming under fire it should be remembered that most of the existing multilateral agreements are quite old and also, in many cases, were political rather than purely economic in orientation. With the passage of time, some renegotiation is always necessary to reflect economic reality as times change. We believe that as a country we have historically not taken advantage of the fact that we have the largest and most attractive consumer market in the world. The current issues with China will be a real test of this thesis as we are one of their largest trading partners. Also, none of the past agreements have dealt with the problem of patent theft which has been a major issue for years.

Nonetheless, the green light stays on for the economy.

But these factors also mean the yellow light remains in place for the stock market. While returns were slightly negative last quarter, the return gap between value, growth and income oriented securities narrowed significantly versus what they have been recently. Since the market peaked in early March, the tech sector of the S&P 500 in its entirety has underperformed the broader market by about three percentage points. This represents quite a change from what has been experienced over the past several years.

While tech is expected to continue to do well, questions are starting to arise relative to some of social media's power in the market place and the business models being used. This is the subject before Congress this week with Facebook's Mark Zuckerberg being grilled on their selling of customer data. We believe more regulation down the road is eventually inevitable and the profitability of these companies in particular could suffer.

Finally, interest rates are likely to continue rising as the economy gains steam. Bond returns will continue to be either lackluster or negative. Higher interest rates are generally not good for higher stock prices either. Thus we have a conflict between a strong and growing economy, the foundation for long term positive stock returns, and rising interest rates which raises questions on the appropriate valuation to place on those earnings. This doesn't necessarily mean a bear market but it is cause for continuing caution or at least the expectation of flat markets while it all gets sorted out.

Top twenty holdings

Once again there was little turnover in our top holdings. We purchased small positions in Hanesbrands Inc. which brought it into our top 20 holdings. It knocked out Tupperware, which fell due to poor performance. We went into some detail in our last letter about why we like Hanesbrands – the stock price is cheap, the company is financially strong with solid cash flows and dividends, and we like the company's recent pushes into online sales and premium products.

So instead of rehashing Hanesbrands we thought we would spend time on Tupperware which has been a poor performer, down about 20% in the first quarter. Because the stock is down it is not unusual to receive questions from clients about whether we still "like" Tupperware. The answer is that we do still like the company and believe it continues to be quite a bit undervalued, although clearly we wish we had purchased it at a lower price.

But before digging into Tupperware, we should note that the company's decline last quarter was pretty much fully offset in our aggregate performance by the return from Tapestry (formerly Coach) another top twenty stock. Tapestry was up 19% over the first quarter, but not too long ago, it too went through a swan dive not much different from Tupperware's. This is the nature of portfolio management in today's market and another manifestation of the volatility discussed above.

The key to Tupperware is to remember that 75% of its sales are overseas with a heavy emphasis on emerging markets. In addition to the plastic containers that come to our mind when we think of the Tupperware brand, the company also sells beauty and skincare products, kitchen appliances and microwave products, and children's educational toys. While Tupperware parties may be old fashioned for the U.S. market, they remain extremely popular in emerging markets where access to these items through stores or the Internet is often limited. From that standpoint, it appears to be a relatively low risk, high yielding participation in emerging markets which will also benefit if global growth continues to pick up.

While the fundamentals remain intact, Tupperware has had a difficult run since our initial purchases a few years ago. Since we first bought the stock, the company has done about what we thought it would do… at least in local currency numbers and unit volume. However with so much of its business outside the U.S. and the dollar generally rising over this period, the results look poor when translated back to U.S. dollars. As a result year over year comparisons have not looked good and the stock has not performed well.

We still like Tupperware as we look ahead towards its prospects for the future. Tupperware is in the process of restructuring, mainly focusing on lowering costs and pricing. The company has also announced that its COO, Patricia Stitzel, will take over the CEO position in May. She will replace the individual who has led the company for the last 26 years. A fresh view often leads to changes and she will be anxious to show improvements over the next few years.

So what do we like about Tupperware now? It appears the dollar has started to level out vis-a-vis a number of foreign currencies. Historically TUP has not hedged currencies as a matter of policy due to the ongoing expense, particularly in emerging markets, but a new CEO may bring a new perspective. Over time, Tupperware should benefit from the changes in tax laws, as it has significant assets held overseas. But like many other companies, there will be a hit to earnings this year based on earnings accumulated overseas on which taxes have not yet been paid and this may be why the stock is down so much. With the decline in price the stock appears to be very cheap. It currently trades at less than ten times expected earnings, meaning that the stock is at a substantial discount to the overall market. Financially Tupperware is strong with a reasonable amount of debt, and we get to collect a healthy 6% income yield based on the current prices. The dividend is reasonably covered by relatively stable cash flows. While it may still be a bit early for a big Tupperware turnaround, we generally prefer to stick with the stock as there is little that has changed fundamentally about the company. Historically each stock has its time to perform as long as our judgement on the fundamentals proves correct. That was the case for Tapestry and there is no reason to believe it won't also prove true for Tupperware.

Cybersecurity

As a result of all the data now held in the cloud, hackers are getting better and better at creating authentic-looking ways to gain access to your information. And over time we have seen an increasing number of attempts to get directly into client data, often through hacked email accounts or accounts that look legitimate. Of course you probably know the usual advice is to change your passwords regularly and not to use the same password across multiple sites. We agree, but beyond that, the best advice we can give to clients is to never click through to a website directly from an email. Whether you are trying to log into Schwab, your 401(k), or a bank account, we recommend you always go to the website directly rather than clicking a link in an email no matter how legitimate it looks. This will protect you from most phishing scams in which hackers try to gain access to your logon information.

Of course, we cannot do our job if we cannot keep your data safe, so here are just a few of the steps we take internally to avoid issues. Whether your accounts are held in Schwab or elsewhere, most logins from us require a multi-step process to ensure a legitimate entity is accessing *your* data. For instance, Schwab provides us with a random number generator which we must use along with our normal id and password each time we log on to the site. We also take steps to make sure that the data we hold for you internally cannot be accessed, including frequent audits of our own systems and an external security service to see all protections are up to date continuously.

Of course technology will continue to evolve (along with our internal systems) as fingerprint and facial recognition technology become more commonplace and we will need to evolve with them.

Money transfers are one of our greatest concerns. In recent years we have received emails from clients requesting transfers of funds to accounts in the Caribbean, France, and China. Only one of these requests turned out to be legitimate. Transfers are relatively easy when the funds are moving to known accounts with the same registration as the client, or we are asked to send a paper check to the client at their known home address. In these cases the risk of fraud is extremely low. However the risks increase when funds are moving from the custodian to an unknown entity. This is often the case for large purchases like a house or car and occasionally charitable gifts or inheritances. We take several precautions to mitigate risks: in addition to double and sometimes triple checking the information, we require your signature authorizing the transfer, and we also require verbal confirmation for each transfer. As we take pride in knowing all of our clients, we do not believe that anyone would be able to fake a verbal confirmation with us. All these extra steps serve the purpose of ensuring your financial security.

Just let us know if you have any security questions or concerns not dealt with above.

Summary

In spite of all the economic and political noise that now surrounds us, the economy continues to grow, and corporate earnings still look generally good. While a major decline can happen at any time we believe that continued volatility without a meaningful direction to the market is the most likely case going forward, at least for a while. Interest rates will likely edge higher but there doesn't appear to be any reason for a major move in either direction. We don't anticipate any major portfolio changes though the recent decline has uncovered an increasing number of interesting possibilities.

As always, just give us a call if you have any questions or thoughts to share.

Sincerely,

Loudon Investment Management, LLC

DML/ELS/JSS/LO