



2019 Year-End Commentary U.S. Equity Value Model Portfolio January 13, 2020

Our U.S. Equity Value Model Portfolio (EVMP) increased 10.3% during the fourth quarter versus 7.4% and 9.1%, respectively, for the Russell 1000® Value (R1000V) and S&P 500® indices. For the full year, our EVMP increased 29.6% versus 26.6% and 31.5% for these indices (excluding fees)¹. Excluding cash (which averaged 6.6% for the year), our equity investments increased 11.4% in the fourth quarter and 33.0% for the year¹.

2019 marked my third consecutive year of outperformance versus the R1000V since leaving Equity Investment Corporation’s investment team on October 1, 2016. The cumulative gain has been 53% versus the R1000V benchmark’s 40.8%, or a 30% investment growth differential in 3 ¼ years.

Barksdale Portfolio Results Since October 1, 2016 ¹			
	<u>BI&R</u>	<u>R1000V</u>	<u>S&P 500</u>
Q4 2016	8.0%	6.7%	3.8%
2017	18.0%	13.7%	21.8%
2018	-7.6%	-8.3%	-4.4%
2019	<u>29.6%</u>	<u>26.6%</u>	<u>31.5%</u>
Cumulative	53.0%	40.8%	59.1%
Annualized	14.0%	11.1%	15.3%

Few active investment firms and teams add value versus passive indices, and the 4-P’s (People, Philosophy, Process, Performance) are critical determinants of assessing investment qualifications. After investing (and losing much of) my paper route money in high school, my investment approach took shape in 1977 after reading an article by a relatively unknown investor at the time – Warren Buffett². In 1986 I launched Equity Investment Corporation (EIC) to implement this valuation framework. During the 30 ¾ years that I was responsible for the firm’s investment decisions (from 1986 until September 30, 2016) our All-Cap Value results exceeded Russell’s large/mid/small growth and value indices (as well as the S&P 500’s), with an annual “alpha” of 2.5%, and a 72% downside capture ratio³. Moreover, each of the firm’s investment strategies outperformed its passive benchmark. Since then, as shown above, my investments have continued to outperform. BI&R now offers my investment approach via lower-cost model delivery.

2019 Review

As occurred in the post-Volker 1980’s, many value managers have failed to appreciate the increased *value* of capital creation when inflation is low and have held too much cash for years. It was important to make purchases during 2018’s fourth-quarter double-digit decline to minimize cash levels before 2019’s strong start. We began the year with about 2.5% in cash.

We had no exposure to energy, the market’s worst-performing sector, but continue to look for opportunities. Energy is a volatile, high-risk commodity business, with little growth and new competitive suppliers (fracking, gas, wind, and solar). This makes these investments difficult to value.

There was a great deal of internal market volatility in 2019. During the summer, trade war tensions reduced prices of industrial, technology and communications companies and sent investors to “safer” consumer staple and utility firms. We did the opposite: adding MSC Industrial Direct as its price reflected slowdown-fears; and maintaining our positions in Apple, Intel, Google, Qualcomm, Taiwan Semiconductor, and Facebook despite political attacks. On the other hand, as prices for consumer staples stocks rose, we sold our positions in Hershey and General Mills, as well as our lone utility holding, National Grid. By year-end, our technology and communications holdings were the most significant contributors to our returns, while our consumer and staples investments increased 37% versus 26% for those comprising the R1000V index.

Model Portfolio Changes

During the quarter, we added a new position in CBS, which subsequently merged with Viacom to become ViacomCBS. Both stocks had fallen in price due to investor fears about increasing content competition from Netflix, Amazon, Disney, AT&T, and Apple, as well as concerns about “cord-cutting” in favor of “streaming.” However, Viacom and CBS each have significant customer franchises, have produced high returns on capital, and have invested capital well for shareholders. While the outcome of these battles is impossible to predict, ViacomCBS’ price decline reflected a very pessimistic view of its competitive position. It thus offered a reasonable margin of safety to protect against potential business erosion.

We increased our investment in Cigna Corporation. Health insurance companies have faced considerable political uncertainty, and Cigna is no exception. Cigna acquired Express Scripts in 2018 at an attractive price, and it has contributed significantly to the firm’s earnings. However, Cigna’s stock price has languished due to understandable concerns about needed health care reform. Again, we cannot predict the future, but barring a full-fledged implementation of the Medicare-for-All proposals, Cigna’s price today offers tremendous value.

In December, we trimmed our positions in Apple and Taiwan Semiconductor, which had risen 83% and 66% during the year, respectively. While market volatility in 2018 and 2019 presented many buying opportunities, today’s market offers “slim pickings,” and our cash at year-end rose to 13%.

Looking Forward

I am pleased that two former colleagues from EIC have agreed to assist me in launching Barksdale Investment & Research. Joyce Michels was my right-arm during her 28-year tenure at EIC, developing and overseeing the internal processes that supported the firm’s growth from \$30 million to \$5.6 billion. Jessica Griner worked with me to create and manage four socially responsible thematic product extensions to accommodate investors wishing to balance their social and investment objectives, leading to her interest in corporate responsibility and active proxy voting.

I often said during my time at EIC that my investment goal was a 50-year track record. 2019 marked my 34th year. A dollar invested when I started in 1986 has now grown to \$47.78, versus \$33.08 or \$30.83, respectively, if invested in the S&P 500 or Russell 1000 Value indices (excluding fees)⁴. That’s a good start. Jessica, Joyce, and I look forward to serving you and your clients in the years ahead.

To learn more about BI&R’s investment services, please visit www.BarksdaleInvestment.com.

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Founder, President, & Chief Investment Officer
 Equity Investment Corporation (12/31/85 to 9/30/16)
 Barksdale Investment & Research (8/1/19 to present)

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Disclosures

¹ From October 1, 2016, until December 31, 2018, results are those of a socially-restricted portfolio over which Jim Barksdale acted as a sole portfolio manager at Equity Investment Corporation. From December 31, 2018, until December 31, 2019, the results are those of an unrestricted U.S. Equity Value account whose holdings and weightings follow BI&R's recommended U.S. Equity Value Model Portfolio. Cumulative results include reinvestment of dividends and are gross of management or administrative expenses. Equity-only figures are from Standard & Poor's attribution analytics. Past results do not imply nor guarantee future results. Barksdale Investment & Research publishes model portfolios, does not tailor investments to client circumstances, and is not a Registered Investment Advisor. Subscriber results may vary depending on the individual implementation of published model portfolios. All investing involves risk, including the risk of loss.

² Warren Buffett, "How Inflation Swindles the Equity Investor," Fortune Magazine, May 1977, <https://fortune.com/2011/06/12/buffett-how-inflation-swindles-the-equity-investor-fortune-classics-1977/>

³ Source: Morningstar, monthly data, gross of fees, versus the Russell 3000 Value benchmark, as reported by Equity Investment Corporation (EIC), All-Cap Value strategy. Jim Barksdale served as Chief Investment Officer with sole veto and decision authority over all of EIC's investments from January 1, 1986, until September 30, 2016. He was assisted by three additional investment team members who joined his firm in 1999, 2003, and 2005.

⁴ The 34-year growth of \$1 since 1986 links the results detailed in Disclosures 1 and 3 above.



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