"In the midst of chaos, there is also opportunity", SUN TZU

2018 Review and Commentary

The final quarter of 2018 was similar to the first quarter when the markets made new highs followed by a sharp 10% correction. The recent quarter followed new market highs in September that quickly turned into a rout as declines cascaded into a free-fall. While there was a brief respite during the last few trading days of the year, the quarter saw the S & P 500 Index decline by 13.5%. For the entire year, the S & P 500 Index declined 4.38% while the Russell 1000 Value Index fell 8.69%. The MVP domestic value portfolio retreated 15.8% as indiscriminate selling pummeled the portfolio. Significantly, 2018 witnessed the first full year market declines since 2008. For the entire year, the best performing sectors were health care, utilities and information technology while the worst performing sectors were energy, materials and financials. In fact, according to Empirical Research Partners, there were significant ETF inflows in December in traditional defensive sectors such as healthcare, utilities and consumer staples. Once again, growth stocks outperformed their value stock brethren.

The carnage was not limited to U.S. equities as the MSCI EAFE index lost 13.32% for the year while the MVP International Value portfolio lost 21.96%. The sole relative bright spot was the MVP Dividend Income account that declined 7.91% for 2018 while the benchmark DJ Global Select Dividend Index fell 12.71%.

Despite the disappointing returns primarily due to the sell-off in December, MVP adhered to its process and took advantage of the chaotic events by adding to existing holdings and purchasing new names with greater discounts for the three strategies. Additionally, our process allowed us to lock in gains on holdings that reached our intrinsic value such as Sprit Airlines, American Express, and Citigroup while allowing us to trim existing positions such as Nokia, Fossil, and others in order to redeploy capital into deeper discounted names. Unfortunately, it is the annual dreaded year-end report card that did not reflect what we did throughout the year to add value to clients' capital. Simply put, short term performance can make value managers look less than intelligent; however portfolio decisions made during chaotic periods can only prove to be right or wrong by Mr. Market over a 3 to 5 year holding period, if not longer. Also remember that our decisions are often contrary to the general market because as contrarians, we focus on valuation work and business fundamentals rather than daily stock prices.

Certainly, anyone involved in the equity markets during 2018 lived in a stressful environment that was worldwide. According to Bloomberg, global equity markets had a peak market value of $87 trillion in early 2018 and less than eleven months later had a market value of $67 trillion, a decline of $20 trillion or 23%. Looking closer at the U.S. equity market, in the fourth quarter, among the Dow Jones Industrial Stocks the worst performers were Apple, Goldman Sachs, IBM, United Technologies, Exxon Mobil and Home Depot. All of these stocks were in different sectors with no apparent theme linking these stocks together. As a matter of fact, up until

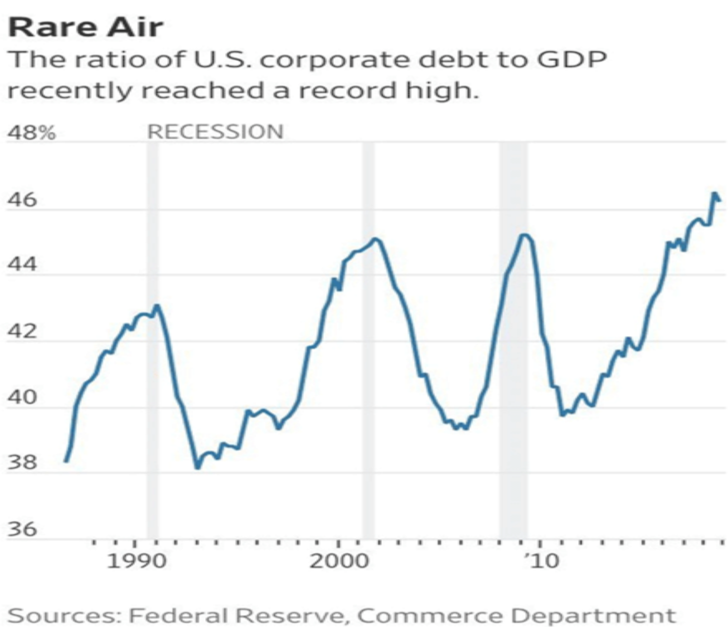
December Apple had been performing well while IBM had been struggling. In essence, more than one market commentator concluded there was no place to hide from the carnage. This quote brings to mind a comment from my boss in the mid-1970s when I made the exact same remark regarding the 1973-74 market meltdown. His response was that I just didn't understand a simple truth: ***When the paddy wagon backs up to the door, they take the good girls along with the bad***. Lastly, after the seemingly endless love affair with the "FAANG" stocks, those stocks did not escape unscathed. Amazon, Apple, Alphabet (Google), Facebook and Netflix saw declines from 13.4% to 30.6% during the fourth quarter. When all was said and done, December was the worst December for stocks since 1931.

In reviewing the events that contributed to the declines, there was no shortage of issues. Among the more important factors were higher short term interest rates, the Federal Reserve's tightening monetary policy, increased trade tensions between the U.S. and China, slowing growth in China and around the globe and falling oil prices. In addition, according to Lipper, U.S. stock mutual funds and ETFs experienced more than $46 billion of outflows between December 5 and 12. The need to raise cash to fund these redemptions very likely contributed to the market decline. This recent action shows one of the weaknesses of ETFs in that when redemptions rise, the ETF managers must sell portions of every stock in the ETF to maintain a desired balance in the ETF portfolio. Lastly, a discussion of recent market action would not be complete with mentioning the increased activity of algorithmic trading. Algorithmic trading is generated entirely by computers based upon criteria designed to limit market losses. Since there is no human input, trading is implemented when certain "support" or "resistance" levels are reached. This type of trading can exaggerate market swings made even worse by reduced liquidity within the financial system.

As we turn our attention to 2019, most of these problems persist while there are several more to add to the list of concerns. Some of the issues garnering investor attention is the Brexit divorce scheduled to occur in late March and its implications for trade disruptions, a German economy that is teetering on the brink of recession, France dealing with social unrest in reaction to new policies implemented by President Macron and a rising populist sentiment in Italy that seems to be challenging the dictatorial regulations of the EU. As if this was not enough, the EU will elect a new Parliament in the spring, the EU will elect a new President in the summer and there will be a new head of the European Central Bank in the fall. This is the first time in history that so many institutions will see change within the same year. If nothing else, it will create uncertainty over the future direction of fiscal and monetary policy while global growth slows. Surely, with all this change in the offing, risks are probably higher now than at any point in the last several years.

Here is the U.S., economic growth is expected to moderate as the benefits of the 2017 tax cuts work their way through the system. Along with this moderating growth, corporate profits are expected to slow rather dramatically following strong growth in 2018. Current forecasts expect S & P 500 corporate profits to increase 6 to 8% in 2019 following growth of approximately 24% in 2018. Politically, the U.S now has a dividend government with the opposition focused on an obstructionist approach that will likely include various investigations of the President, his staff and his policies. The acrimonious nature of Washington politics is currently on display as the partial government shutdown continues without any noticeable progress towards a compromise agreement to end the impasse.

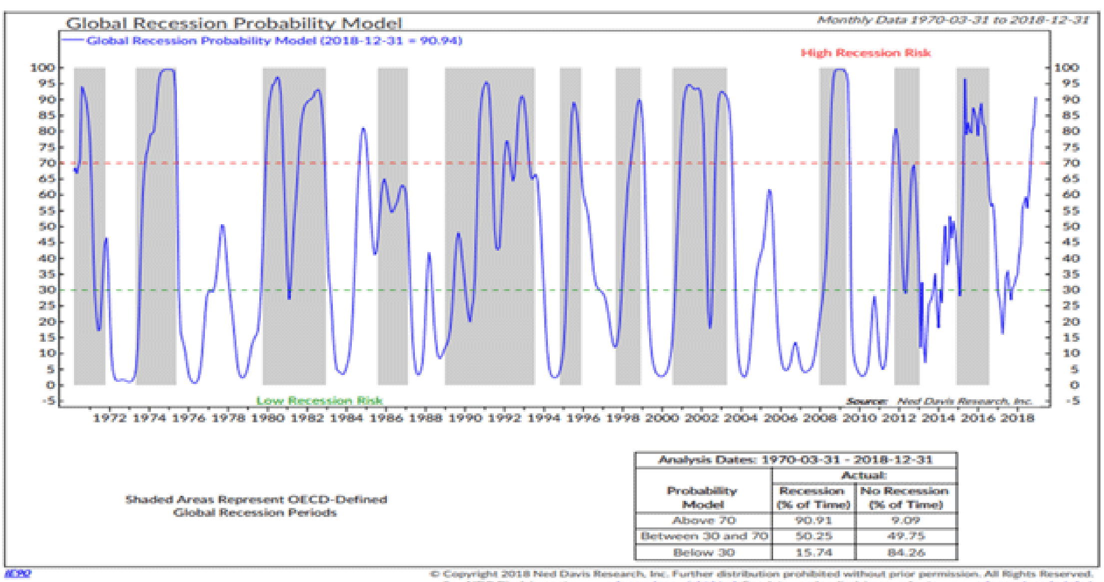
As discussed in previous reports issued during the fourth quarter, there is increasing concern about rising corporate debt in U.S. companies and the fact that almost 50% of the debt is rated BBB, the lowest investment grade. Unfortunately, corporations issued more debt in the last ten years in order to buy-back company stock, unfortunately at levels significantly higher than current prices. To be specific, there was ***$9.6 trillion*** in outstanding corporate debt at the end of the third quarter of 2018. This amount is 75% higher than the ***$5.5 trillion*** outstanding 10 years ago. Importantly, Moody's has described the amount of investment-grade debt as ***"riskier now than it was prior to each recession since 1981 and possibly all downturns through late 1940."*** In addition, yield-seeking investors haven't helped as these investors accepted corporate bonds with the now-common "covenant light" provisions that do not offer the same level of protection as in the past. These mistakes are somewhat reminiscent of the 2005 to 2007 period that did not end well for investors. Indeed, it would not be surprising if the trigger for the next market downturn originated within the fixed income area. As a result of this foolish behavior, U.S. corporate debt as a percentage of GDP is now at a record high as shown in the following chart:



Source: Wall Street Journal

From the above chart, it is easy to see that current corporate debt levels are at a point that has been associated with previous recessions in the U.S. Obviously, this fact alone does not assure a recession is in the offing but it should be clear that the risks of a recession are increasing. Despite the increasing leverage driven by investors dilemma, we are seeing businesses led by great management teams within the portfolios acting the opposite by deleveraging their balance sheets (Century Link, etc) and selectively borrowing to invest in the future (General Mills' acquisition of Blue Buffalo, etc). Also, we tend to stay away from highly leveraged businesses such as utilities.

Since we are talking about the possibility of a recession, it is important to examine a chart provided by Ned Davis Research that shows the probability of a global recession. In the following chart, it is again clear that we are currently at levels that have *always* been associated with recessions. At the very least, everyone in the investment business should be paying close attention to the economy and major economic reports as 2019 unfolds.



Source: CMG Capital Management

Since Wall Street strategists continue to express confidence that the U.S will likely avoid a recession in 2019, it is instructive to examine what could go right this year that will postpone a recession, at least for a while. Among the more important factors could be a relatively peaceful conclusion to current negotiations between the U.S. and China concerning a variety of trade issues. In addition, the Federal Reserve could exercise patience with respect to further increases in short-term rates, relieving a big worry on the minds of investors. And, if the Federal Reserve slows down the rate at which it is shrinking the Fed's balance sheet that would also provide a big boost to investor and consumer confidence. Needless to say, lower oil prices can also provide a much-needed shot of support to consumer spending that would, in turn, aid economic growth and corporate earnings. Lastly, a reasonably constructed compromise to the partial government shutdown would be beneficial to the near term mood. Obviously, a less contentious Washington environment could do wonders for the investment environment. Should the U.S. muddle through the morass of issues confronting it, more reasonable valuation levels combined with corporate profit growth of 6 to 8% could result in the equity markets returning mid- to high-single digit returns for the year. However, while valuation levels are more reasonable than during the last year, present levels cannot be considered "cheap" by any historical metric.

Regardless of how events unfold in 2019, Metis Value Partners will adhere to our well-defined investment process and strategy. We remain committed to the identification, evaluation and purchase of companies that offer exceptional value while incorporating a margin of safety for our clients. We believe in knowing what we own with a focus on the long-term potential of each stock in our three concentrated portfolios. The past year was a difficult one for virtually all investors but we remain confident that our portfolios will perform well with holdings trading below our estimated value and valuations significantly below their respective benchmarks. We greatly appreciate the confidence you have shown in our management of your valued clients' assets and stand ready to assist you in growing your business in the coming years.

Stephen Kent, Jr.

Stephen K. Kent, Jr., CFA
Founding Partner and CIO
Metis Value Partners, LLC
January 21, 2019

DISCLOSURES:

Past performance is not indicative of future results, which may vary. The value of investments and the income derived from investments can go down as well as up. It shall not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities mentioned here. While MVP seeks to design a portfolio which reflects appropriate risk and return features, portfolio characteristics may deviate from those of the benchmark.

Nothing herein should be construed as a solicitation or offer, or recommendation to buy or sell any security, or as an offer to provide advisory services in any jurisdiction in which such solicitation or offer would be unlawful under the securities laws of such jurisdiction. The material provided herein is for informational purposes only. Before engaging MVP, prospective clients are strongly urged to perform additional due diligence, to ask additional questions of MVP as they deem appropriate, and to discuss any prospective investment with their legal and tax advisers