Dear Partners,

Is the marathon runner worried when a sprinter enters the race and takes an early lead?

The rhetorical question just posed reflects our relative underperformance of the S&P 500 during the most recent twelve month journey around the sun. The marathon metaphor also reflects my confidence that we're in the right race, and that I have partners who believe in allowing results to materialize. For that, I am very grateful.

If this letter is a little long, it is because of my decision to focus on Mead Capital full time in 2020. I will be seeking new client partners that share our long term, business owner-oriented investment philosophy.

You can be sure to receive the same level of dedication as in past years. In fact, far from a negative, I fully expect a benefit from these new relationships. Mead Capital was never founded to become the biggest enterprise. What I have sought, however, is a conscious approach to seeking business-minded clients. I've found each new relationship brings a new perspective on the world, whose experiences in business and in life make our investment program that much better.

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What we own and why we own it:

Let us begin with a recap of our major positions and some of the reasons why I've chosen to make the commitments of our capital. Understanding *why* we own certain companies is just as important as the what. It should help clients old and new understand my reasoning and approach.

Comfort in Concentration – Berkshire Hathaway

Across all accounts Berkshire Hathaway represents the largest holding—in some instances reaching well into the double digits percentagewise. Considering this concentration, I feel it is worth putting down in words my thoughts on why:

a) such a concentration is not as risky as conventional measures might suggest, and;

b) why I believe Berkshire, at current prices, to represent a high probability of outperforming the market plus my management fee.

Is Berkshire Hathaway one stock? Yes and no.

Yes, if you consider the parent company, Berkshire Hathaway, Inc. as one investment—full stop. But what about the other stocks Berkshire itself owns?

What about the dozens of companies it owns, including companies formerly traded on an exchange? Does the fact that Burlington Northern Santa Fe, one of the largest Class I railroads in the country, now no longer reports as a stand-alone public company make it somehow less of a stock because it's inside Berkshire? As you might imagine, I fall firmly in the second category. Berkshire is a conglomeration of many different businesses. To consider it one company is to ignore reality.

Most know that Berkshire Hathaway is a conglomerate, but the extent of its diversification, and the advantages of its structure, are less well understood. Here's an overview of Berkshire's after-tax earnings for the twelve months ended 3Q-2019 (the full year 2019 report will come out in mid-February):

	Oct. 1, 2018- Sept. 30, 2019	
Berkshire Hathaway After-Tax Earnings	*($ millions)*	
Insurance - underwriting	$957	*4%*
Insurance - investment income	5,248	*22%*
Railroad	5,429	*23%*
Utilities and energy	2,754	*12%*
Manufacturing, service and retailing	10,446	*45%*
Other	(1,392)	*-6%*
Operating earnings, after tax	**$23,442**	***100%***
Investment and derivative gains/losses	$4,617	*20%*
Net earnings (loss)	$28,059	*120%*

Even this table does not show the full extent of Berkshire's wide-ranging activities. (Additionally, that $1.4 billion loss in Other is largely due to the write-off at Kraft-Heinz; true operating earnings are closer to $25 billion.)

Digging deeper into insurance (its main line of business, and an incredible generator of earnings and low-cost leverage) Berkshire owns two excellent reinsurance companies headed by perhaps the most valuable man in the business, Ajit Jain. It also owns the entirety of GEICO, a low-cost vehicle insurer familiar to most people, as well as a slate of other "primary" insurers offering products ranging from Directors and Officers insurance to workers' compensation, to other specialty lines.

These insurers, at quarter-end September 30, 2019, collectively provided Berkshire with $127 billion of negative-cost money. Say what? Because insurance premiums are paid up front, and in the case of a reinsurer can take decades to be paid out, Berkshire can invest the funds for its own benefit. And because the insurance companies have, over a long period of time, underwritten prudently, Berkshire makes a profit on top of it all. (The technical term for this cost-free money is negative cost float – an insurer is paid to hold funds, a situation better than borrowing.) These funds, along with a gusher of cash coming into Omaha, is put to work in some other wonderful, publicly-traded investments such as American Express (19% owned by Berkshire), Coca-Cola (9%), Wells Fargo (9%), Apple (6%), and Bank of America (11%), in addition to many others.

As stated above, Berkshire owns a railroad – yes, an entire Class I railroad – Burlington Northern Santa Fe, that possesses meaningful long-term competitive advantages in hauling freight across a growing country (the USA). While BNSF is utility-like, Berkshire owns actual utility businesses, too. Berkshire Hathaway Energy – formerly known as MidAmerican Energy, owns pipelines and other distribution assets in the US and the UK, electrical generation and wind power businesses, and, probably most known to the layperson now, Berkshire Hathaway Home Services (yes, it is the utility business that in turn owns the real estate brokerage).

Berkshire's Manufacturing, Service, and Retailing businesses are, simply put, a collection of gems. Some names familiar to all, especially in the Northeast, are: Jordan's Furniture, Benjamin Moore, Dairy Queen, Shaw Carpet, Business Wire, McLane, MiTek, NetJets, Oriental Trading Company, Pampered Chef, Brooks Shoes, Duracell, Garan, and many, many more.

Within Finance and Financial Products (now included as part of the MSR segment) is one of the largest manufactured home builders in the country, Clayton Homes (included as a finance company largely due to its significant finance arm), XTRA, a

trailer leasing business, and Berkadia, a joint-venture finance operation. Last year this operation was consolidated for reporting purposes with the MSR businesses above.

In short, Berkshire owns over a hundred wonderful businesses. They are all owned by one parent, Berkshire Hathaway. As a result, we all have a large investment in "one stock". But can that "one stock" really be so risky when its component parts are so diverse and well-run? My answer is a resounding no.

It should be said that Berkshire has one attribute that makes it potentially riskier, and that is its no dividend policy. In effect our capital is trapped and will compound internally until Berkshire pays a dividend (its recent stock buybacks are actually a return of capital to shareholders, but unless we sell, we will not receive cash). In the hands of a poor or even mediocre manager, a no dividend policy can destroy value. My strong feeling is that the existence of buybacks, which are value-add to remaining shareholders, are a precedent-setting example of good behavior. Buffett's successor, and the Berkshire board of directors, are highly-likely to treat shareholders well for many, many years.

Valuing Berkshire

As wonderful as any company is it is never worth an infinite price. And as deep as my admiration is for Berkshire, I have, at times, stayed away from purchasing shares when the price was too high, even when sitting on cash. I am aware of the potential for subconscious bias in my long admiration for Berkshire and Buffett – even penning these words cannot bring 100% confidence that it won't negatively alter my thinking in the future. But I'll continue to do my best to stay rational.

There are a number of different ways to go about valuing Berkshire. One is a sum-of-the-parts analysis that goes through each major operating segment, places a value on each, and adds up the totals. Another method is to capitalize an amount representing normalized earnings plus cash. Yet another might use a multiple of book value. Rather than go through each method, for this letter I'll use the negative approach—inversion if you will.

What is the market currently saying about Berkshire's value, and where might it be wrong?

As the table below indicates, the market is valuing Berkshire at about $560 billion.

Breaking down Berkshire Hathaway's market value
What do we get for our money?

($ millions)		*% market cap*
Market capitalization on January 21, 2020	$560,000	*100%*
Balance sheet totals as of September 30, 2019:		
Insurance cash & Treasuries	$124,442	*22%*
Equity securities	220,051	*39%*
Equity method investments	17,535	*3%*
Fixed maturity investments	19,172	*3%*
Subtotal cash & investments	$381,200	*68%*
Implied residual value of operating businesses	$178,800	*32%*
After-tax earnings (12 mo. 9/30/19):		
BNSF Railroad	$5,429	
Utilities & energy	2,754	
Manufacturing, service, and retailing	10,446	
Subtotal - after-tax earnings	$18,629	
Value assuming 10x	$186,290	*33%*

Assumes:
1. Equity & debt securities are fairly-valued.
2. Breakeven insurance underwriting ($1bn profit not included above).
3. Normalized earnings power of non-insurance businesses.

But what do we get for our money?

- A full 22% of the market cap is represented by the cash Berkshire has on the books. Is this good? Bad? Something else? It depends what you think Berkshire will do with the money. Berkshire hasn't found much as of late. But it's late in the cycle. Having that much cash makes Berkshire anti-fragile—market disruptions *strengthen* its prospects. I would like to have seen more share repurchases over the last few quarters, and something will have to budge

at some point, but at the moment this cash cushion provides a huge war chest to enter the next recession *when* (not if) it and/or some other market disruption comes.

- Almost 40% of Berkshire's market cap is made up of its portfolio of stocks. With two-thirds of that concentrated in five companies its very easy to observe there does not exist the froth seen in other areas of the stock market. A full 10% of the market cap of Berkshire today is represented by Apple. Every ten shares of Berkshire gets you one share of Apple on a look-through basis. These holdings are very real and serve once again to provide diversification via our "one stock".

Berkshire Hathaway investment portfolio - select data

		$220.1	*$560.0*
	$bn	% equities	% market cap
American Express	$17.9	8%	3%
Apple	$57.0	26%	10%
Bank of America	$27.8	13%	5%
Coca-Cola	$21.8	10%	4%
Wells Fargo	$20.2	9%	4%
	$144.7	66%	26%

- Another 6% of Berkshire's market cap is represented by its investments in fixed maturity securities (bonds) and equity method investments (Kraft Heinz, Pilot Flying J, and Electric Transmission of Texas).

We add these items up and come to 68% of the total of Berkshire's market cap. That leaves 32% unaccounted for. We still haven't considered the many, many, many businesses Berkshire owns. Again, using inversion, if we assume the after-tax earnings from the three major segments of non-insurance businesses are worth ten times their earnings (a ridiculously-low valuation considering their attributes) we arrive at about one-third of Berkshire's market cap.

This doesn't even take into account:

1. **Earnings from insurance underwriting.** In the twelve months analyzed Berkshire's insurance companies earned close to $1 billion. They've historically earned a profit, but we're not considering it at all. It assumes the investments and cash are funded by a breakeven insurance operation.

2. **Growth of the operating businesses**. Berkshire may own some decidedly boring businesses, but they are very good ones. Some are great but do not grow; others have growth potential. Even a small amount of incremental growth provides a margin of safety at current prices of Berkshire.

So what does this tell us?

It tells us the market is mis-judging Berkshire. What could be the reasons for a large, informed, and intelligent market (sometimes the market goes haywire but in general there are smart, rational people assessing businesses) missing Berkshire's true worth?

1. **Buffett's age.** Market participants might judge the risk of Buffett's importance to Berkshire as very high. In reality the business is operated in a very decentralized manner. Conversely, it might be thought that when Buffett is no longer in the picture that the stock will fall precipitously. (If it does, Berkshire might repurchase shares; or, we could—win-win.)

2. **A focus on tech or growth companies.** The businesses Berkshire owns are decidedly low-tech (in most cases). With companies like Tesla sporting both exciting products and exciting stock prices, Berkshire is comparatively unexciting (I like it that way).

3. **Misunderstanding key attributes.** One of Berkshire's key advantages is its conglomerate structure and low-cost funding. The insurance operations provide free or less than free capital for Omaha to put to work. That $127 billion of float costs Berkshire *nothing*. Companies make money by how much their assets earn minus how much their liabilities cost. Low cost funding allows for good returns with average-earning assets. The conglomerate structure allows this capital to flow freely between subsidiaries, and the large tax base allows Berkshire Energy to take advantage of tax incentives other utilities can't.

Buffett has said an investor should be able to distil his/her investment thesis into one paragraph. Here's mine:

> Berkshire Hathaway is a unique conglomerate that has assembled a collection of competitively-advantaged businesses operated in a highly-decentralized manner. Those businesses, and significant investments in other publicly-traded businesses (stocks), are funded by low-cost capital provided by world-class insurance operations. The balance sheet is rock-

solid with over $100 billion of cash ready to be deployed into opportunities that might arise from market disruptions. The market is currently placing a price on the collection of assets that appears to be meaningfully below its true worth, as conservatively estimated.

Cimpress

Cimpress is in the mass-customization business. You might be familiar with its largest operating segment, Vistaprint. In fact, several years ago the company was called Vistaprint and changed its name to accommodate a growing suite of related businesses. Understanding Vistaprint will help you understand what the rest of the business does.

Vistaprint is probably best known for its business card product. A business owner can go online, design a business card using online tools and resources, and order a small number of them (as few as 100) at highly-competitive prices. Other, related products, such a stationary, pens, signs, etc., are available for purchase too. How can Vistaprint accommodate such low volumes and still make a profit? Answer: mass-customization.

Vistaprint operates a few selectively-placed operations centers across the world that use technology to aggregate batches of small orders. Once an order is placed online it is combined with many others, much of which is automated, and produced at a low cost. It is classic economies of scale enabled by technology.

Vistaprint has gross margins that local printers could only dream of. Having seen first-hand some of these local printers struggle with the competitive dynamics in the industry I can tell you the advantages Vistaprint has are real. Even the spoke-and-hub model employed by some local print shops (many print shops sharing one central printing facility) cannot compete with Vistaprint. As scale grows, so does Vistaprint's margins and profits.

Cimpress's other businesses are related. An offshoot of the customer-upload model is the upload-and-print model where designers working with business owners use the company's facilities to produce their products. It all drives volume through the Cimpress facilities, increasing economies of scale.

In recent years Cimpress has made some major investments. Some worked out, some didn't. You have most likely seen pens from Cimpress-owned National Pen Company. They recently purchased BuildASign, another company with some name recognition. But the company is not immune to mistakes. It made some investments

that did not pan out, both on the acquisition front and from ground-up startup-type operations.

What's encouraging is the fact that management readily admits its mistakes. The company is run by founder-operator Robert Keane, who has shown a willingness to be forthright and honest with shareholders. The company is in tune with the key capital allocation practices that drive shareholder value, including selectively repurchasing shares when advantageously-priced.

In short, Cimpress is demand-aggregator employing technology to drive down costs and provide value to customers and shareholders alike. It's a business I've personally owned since 2014. While the stock price sees frequent gyrations due to the evolving nature of the business (and shortsighted market participants), its core competitive advantages appear built to last a long time.

Copart

Copart is the undertaker of the car world. It's a simple and essential business, if relatively unexciting.

When a vehicle is totaled or reaches the end of its useful life it must be disposed. Copart operates a network of yards that temporarily store vehicles in locations all around North America (and some locations in Europe) and connect buyers and sellers of vehicles and parts. Copart combines two advantages that creates a moat around the business.

1. NIMBY. Short for not in my back yard, Copart's locations are largely irreplicable. Just like no one likes a new landfill near their home, Copart's competitors face a high hurdle to move into an area already occupied by Copart.
2. Network effects. Once vehicles are in Copart's yards the company connects buyers and sellers through its online network. It's a classic case of more vehicles on the platform = more interested buyers = more vehicles that are able to go through the platform, and so on.

In short, Copart provides an essential service to the economy. Insurers and vehicle owners can easily dispose of an unwanted vehicle; and buyers can more easily find vehicles and parts via its wide network. For its part Copart takes a fee for providing its services.

Opportunities abound in Europe which has an even tougher regulatory and approval process. What this means for Copart is its advantage will be solidified that much further when it's in the door, rewarding its significant upfront efforts.

Copart's management, led by CEO, Jayson Adair, understand the key drivers to the success of this simple business and appear shareholder friendly.

Hingham Institution for Savings

Hingham is a small bank located in – surprise – Hingham, Massachusetts. Its advantage stems from sticking to what it knows best and keeping costs down.

The Bank is run by the Gaughen family who have operated the bank since the mid-1990s. They act like owners because they are owners; in total one-third of the bank is owned by management.

Hingham focuses on real estate. And when I say focus, I mean almost 100% of its loan portfolio is in commercial and residential real estate. This focus means Hingham gets to know its markets very well. Consequently, its loan loss ratio – perhaps *the* most important metric for a bank – has been close to 0% over the cycle. Bank managements can defer loan losses temporarily; but they always show up over time. Most banks have policies spelling out the conditions under which management can borrow from their bank. Not Hingham. Rather than manage the risk they've eliminated it by banning Reg O loans altogether. This move should be emulated.

What Hingham lacks in funding costs (it has average-cost deposits plus Home Loan Bank borrowings) it makes up in efficiency. At 30% (lower is better; the big banks typically target the 50s) Hingham sports one of the best efficiency ratios I've ever seen. Even its Community Reinvestment Act or CRA costs are minimized, as the bank makes an investment in a fund that takes care of a normally time-consuming and expensive task.

Even the investment portfolio is different at Hingham. Most banks hold about 20% of assets aside in an investment portfolio for liquidity purposes to fund the rest of the balance sheet. Since Hingham is regulated like other banks it must have a portion of assets in investments. But Hingham sees its investment portfolio for what it is: ownership of other companies. It states the portfolio is not for liquidity but for long-term commitments in good businesses.

Hingham has earned a return on average equity of around 15% over time and without undue leverage. The trend is likely to continue but the bank faces some challenges. For one, its Boston-centric business is reaching some limits. For this reason, the bank

has identified Washington, D.C. as a similar-type market for careful expansion. Such a capital allocation decision is not without risk.

The team at Hingham has demonstrated its ability to navigate cycles and changes in the past, and I'm confident we've partnered with an able and honest management team that will safeguard our investment into the future.

Synchrony Financial

Synchrony was formerly a unit of GE Capital that spun out as a stand-alone entity. The company owns the popular CareCredit program whereby patients of medical practices can pay for their services overtime. It also provides private label and co-branded credit cards and related financial services such as installment loans and loyalty programs. The bulk of Synchrony's business is conducted via it's FDIC-insured online bank.

Synchrony finances its roughly $100 billion balance sheet, including its $90 billion portfolio of receivables, with $66 billion of interest-bearing deposits, $12 billion of securitizations, $10 billion of debt and $15 billion of equity capital.

Unlike Hingham Institution for Savings, Synchrony's business is built on managing expected credit losses that are sure to materialize. Its credits are substantially in the strongest FICO categories, but these still come with loan losses. It anticipates these losses and just like a credit card company charges an interest rate that compensates it for the risk.

Synchrony's management team, led by CEO, Margaret Keane (no relation to Cimpress CEO, Robert Keane), has demonstrated it is a good steward of shareholder capital. In just the first nine months of 2019 the company returned $2.7 billion or over 10% of its market cap in combined dividends and stock repurchases. It's a trend I'd like to see continue as the market price of the stock has lagged.

Trupanion

Trupanion is a pet insurance company. What's unique about Trupanion is it does not operate as a traditional insurance company. Its business model is setup like an insurer such that the very lucky pets (those whose owners pay policies but do not incur much in claims) subsidize the unlucky pets. Those in the middle generally pay for themselves. Trupanion makes a profit for providing the service.

Unlike a traditional insurer (pet or human), Trupanion has no payout limits and covers 90% of veterinary visits. It targets a 70% payout ratio. Instead of operating

with the traditional model of pricing every procedure, Trupanion pays claims quickly. It seeks to understand costs over the life of the pet and simplify the process. The company breaks down costs of pet veterinary care by breed, location, and many other cost factors. They then price their policies accordingly.

Trupanion is a growth company with a market that appears very large. Pets have increasingly become family members alongside human children. The percentage of insured pets in North America has room to grow from its current 2% penetration ratio to match that of the U.K., which is somewhere around 25%.

Our investment in Trupanion is relatively small compared to other commitments but I've judged the risks as worthwhile. And there are risks. Trupanion was founded by its CEO, Darryl Rawlings, who is first and foremost a pet person. He aspires to the best capital allocation practices and operates with an "Outsiders" mindset. (The Outsiders is the title of a book by William Thorndike that chronicles eight outsider CEOs that bucked the trend and created large value for shareholders.) There's risk growth doesn't materialize as fast as predicted and that the valuation of the company is currently too optimistic.

I'm willing to take these risks as presently situated. Trupanion's management team not only has shareholders in mind but really cares about the value delivered to the end consumer. Companies putting customers first with a great value proposition and a runway for growth usually have fortune on their side. Time will tell.

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What is the market going to do?

When I tell people what I do for a living one of their first questions is usually a prediction of the future. Here's my answer: I don't know. There's a quote I sometimes borrow from James Pierpont Morgan. When asked what the market would do, he answered, "It will fluctuate." So much for predictions. But there was a lot of wisdom in that quip. We know the market will fluctuate, and as a bottoms-up investor all I can do is appraise the worth of companies I understand and wait for business results to translate into financial results. We know the market will fluctuate; we just don't know when and in which direction.

That said, we can assess *in general* where we stand. This is a technique Howard Marks, Chairman of Oaktree Capital Management, laid out in his book *The Most Important Thing*.

In his excellent book, Marks explains his approach to assessing the markets for their degree of attractiveness. Rather than plug in numbers to a formula that provides him with a number, Marks looks for an undefined but not unimportant *feel*.

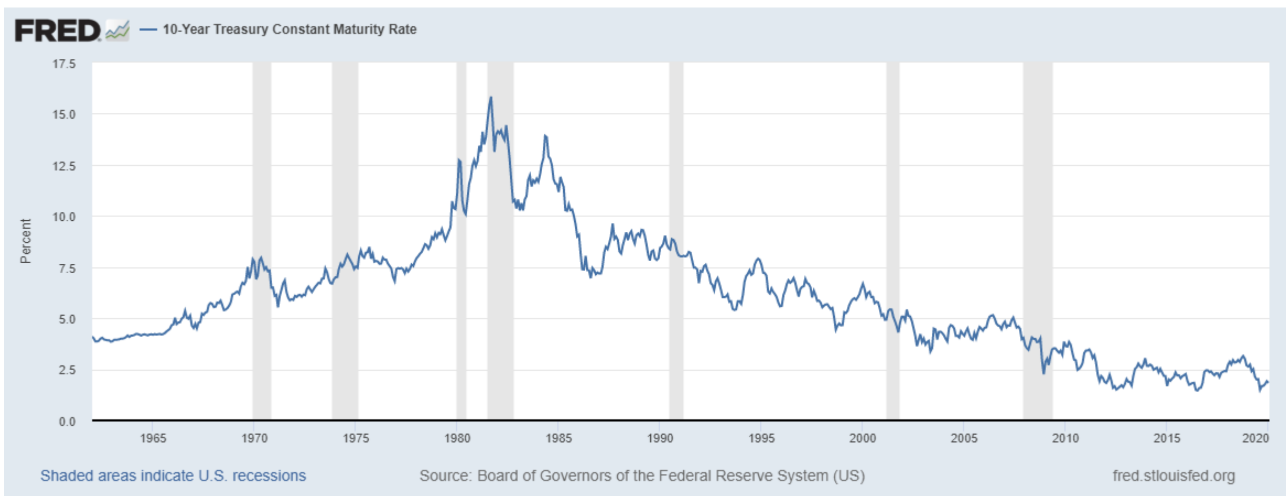
- What are investors' attitudes generally: are they nervous, excited, neither?
- Are credit markets accommodative, tight, somewhere in between?
- Where are interest rates, are they high or low historically?
- What do valuations look like relative to long-term earnings?
- Where are we in the business cycle?

Marks' approach is one of taking the market's temperature and looking to see if many metrics point to the same conclusion. My conclusion is there is little to buy today that will carry reasonable prospects of above-average returns. Using Marks' general approach here are my reasons why:

1. ***What are investors' attitudes to the market, generally?***
   While it seems the ever-increasing market points to exuberance, the severity of the 'Great Recession' of '08 and '09 still lingers in the minds of investors. Still, going on a decade since the last major market upheaval would tend to dull investors' minds to the pain they then experienced, and include those who didn't live through it. The Bitcoin/cryptocurrency mania of a year ago (and a mania is what it was), and the sky-high valuations of companies with no profits, would be strong check mark for some degree of speculative fever. This is on top of the fact that "accommodative" central banks appear at the ready to put out the fire of economic disruption with a firehose of printed money; a fact some investors assume means they can ignore the risks of a recession.

2. ***Are credit markets accommodative, tight, somewhere in-between?***
   The graph below charts the spread between high-yield (read: junk or risky) debt and US Treasuries (essentially risk free). It is the premium investors demand to step away from a riskless option. While not close to the trough of around 2.50% seen in 2007, today's spread is low at 3.38%. Coupled with the fact that covenants – generally, protections put in loan documents to protect the lender – have been easing or in some cases eliminated altogether, and my assessment must be one of accommodation. Considering the mass of BBB bonds hanging on the precipice of downgrade to junk, things could get interesting.

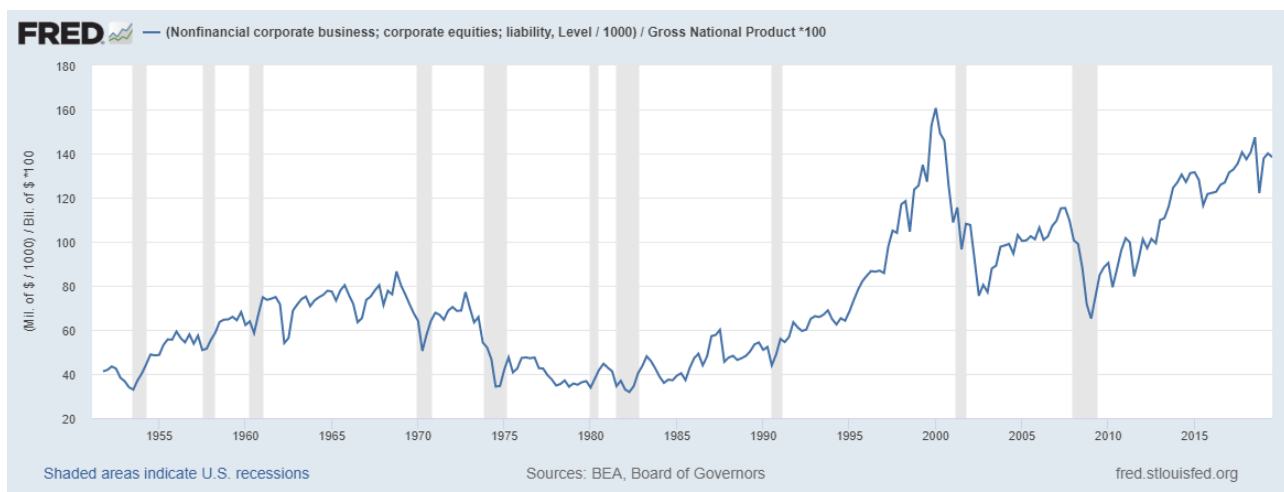
3. ***Where are interest rates, are they high or low historically?***
   Not much to say here. Interest rates are low historically-speaking. All things being equal, lower interest rates mean higher valuations. It is anyone's guess as to what the flood of negative-yielding debt in the global system (currently around $10 *trillion*, yes with a "T") will do. Borrowings by US companies in the Euro market are an evidence of capital flows continuing to come into the US. What the ramifications will be we cannot know for sure.



4. ***What do valuations look like relative to long-term earnings?***
   While I don't condone the practice of charting, there are certain fundamental relationships within the economy that hold over longer periods of time. One of those is the stock market's valuation relative to the output of the economy. Since stocks are businesses and businesses produce the nation's output, measuring the relationship between production and the cost to own that

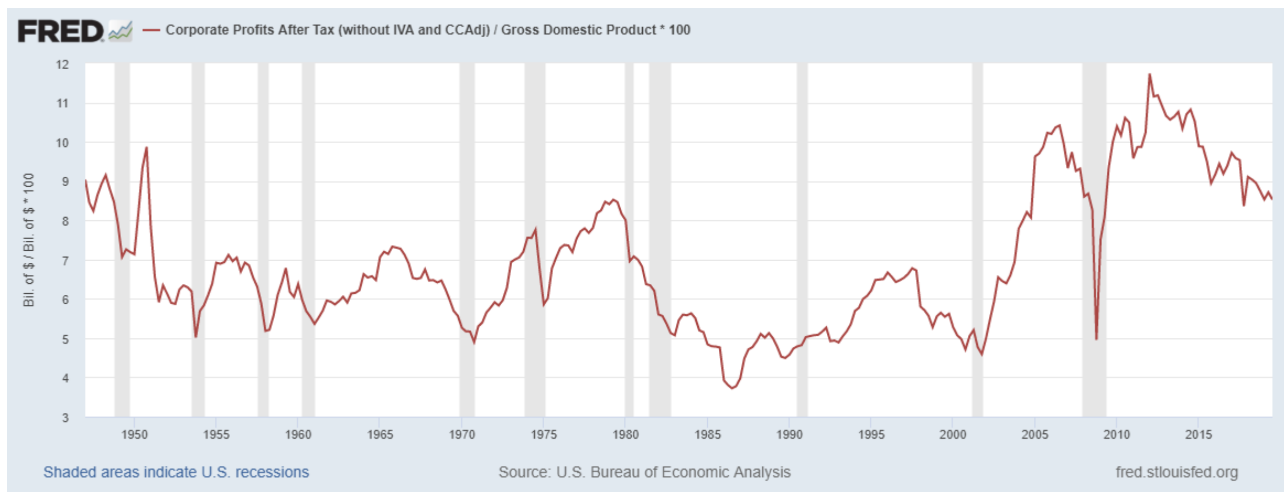
production makes sense for a broad-based valuation perspective (similar to a price/earnings ratio).

As can be seen clearly below the only other time markets were this expensive was the 'dot-com' boom of the early 2000's. Of course, *if* interest rates are fundamentally stuck at a lower absolute level then the higher valuation of stocks relative to their earning power would be a more rational outcome and not necessarily indicate speculation. Still, looking at the graph below it's not unreasonable to conclude that valuations are high. And if you adjust for the fact that the market continued to go up after yearend, the ratio of around 140% starts to feel closer to that speculative range.



5. ***Where are we in the business cycle?***
   While I'd never venture to call the top, it certainly feels like were at or near a top. Low unemployment, high profit margins (see below), high valuations and a very positive outlook are all signs of it being good times.

6. ***Where are corporate profit margins?***
   Corporate profit margins are down from their high of over 10% but remain at or near the highest they've ever been, historically. With a tight labor market and the prospects of higher inflation in other areas generally, margins likely don't have much higher to go from here.



7. ***A closer look at the S&P 500…***

   The Standard and Poor's website provides some interesting raw data on the index, open for anyone to see. These include operating earnings, net earnings, dividends, buybacks, and data on book value, among many other data points. A closer look is very illuminating.

   - Between 2012 and September 2019 the index compounded at 11.52% per year, and investors received an average of 2.32% in dividends, for a total return of 13.84% per annum.

   - The underlying return on the index (excluding dividends) was comprised of 7% from underlying earnings growth and 4.2% from multiple expansion. Said another way, investors were willing to pay more for the same level of earnings (which is consistent with lower interest rates).

   - Net debt increased at a rate of 18% per year. Related, the debt-to-equity ratio of companies in the index rose from 40% in 2012 to 66% as of September 2019.

   Where does this leave us? A few generalized statements:

   1. The index as presently situated is trading at about 20 times earnings or a 5% earnings yield. Investors probably shouldn't expect more than that over the course of the next decade. You can't have your cake (stock price gains in excess of underlying fundamental business growth) today

and expect it to be around tomorrow. Each new milestone ahead of underlying earnings growth is borrowing from future returns.

2. If inflation and/or a return to “normal” interest rates occur, returns may well be negative over the next ten years as multiples revert. This may happen in spite of underlying earnings growth.

3. It seems highly improbable that total returns in the future match those of 2019. For that to happen would require a large upswing in earnings (unlikely) and/or a valuation change. For the index to return 25% from its point in September 2019 the multiple would have to increase to 25 times (a 4% yield). I’m not saying it can’t happen (anything can happen in markets over the short run) only that it’s unlikely. We’ve entered an area of the curve that’s asymptotic (approaching zero)—it’s inherently unstable.

4. Compounding the valuation risk above is the balance sheet risk. The companies in the index are collectively more highly leveraged than six or seven years ago.

In short, the trends in the index over the past half-decade or so are unsustainable. Trees cannot grow to the sky.

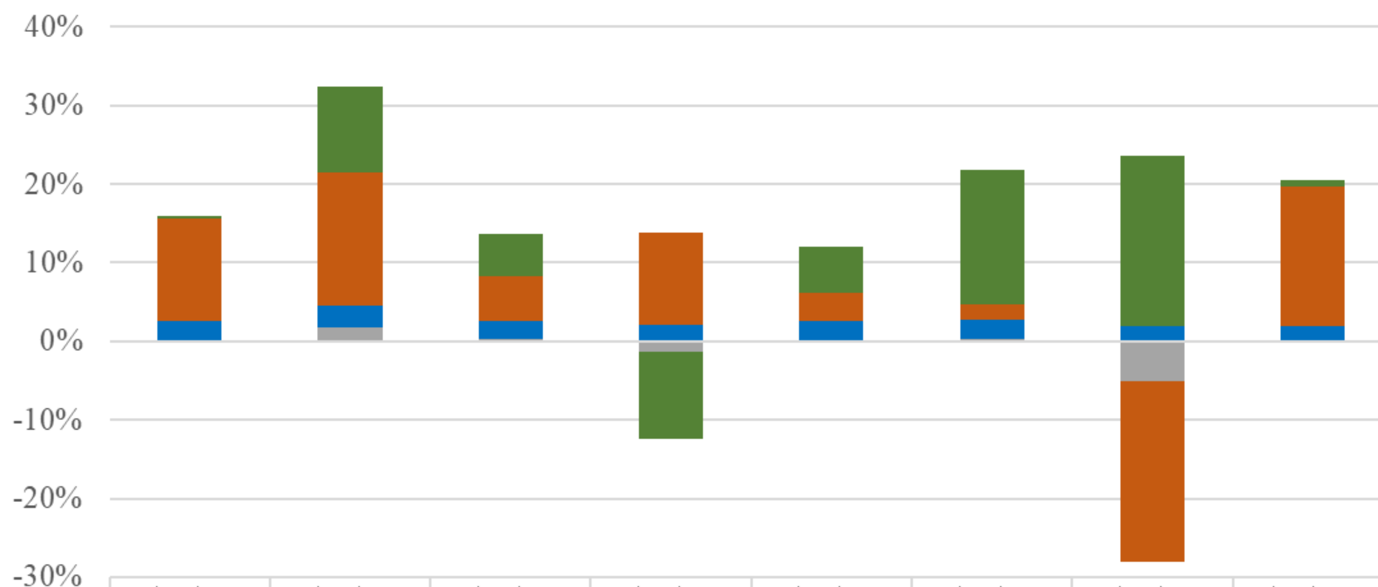
Continued on next page…

S&P 500 Per Share Analysis

	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018	9/30/2019
S&P 500 Index	$1,426	$1,848	$2,059	$2,044	$2,239	$2,674	$2,507	$2,977
Price return	*13.41%*	*29.60%*	*11.39%*	*-0.73%*	*9.54%*	*19.42%*	*-6.24%*	*18.74%*
Dividend %	*2.60%*	*2.78%*	*2.30%*	*2.11%*	*2.42%*	*2.41%*	*1.85%*	*1.81%*
Total return	*16.00%*	*32.38%*	*13.69%*	*1.38%*	*11.96%*	*21.83%*	*-4.39%*	*20.55%*
Operating EPS 12mo	$97	$107	$113	$100	$106	$125	$152	$153
Multiple	*14.7x*	*17.2x*	*18.2x*	*20.3x*	*21.1x*	*21.5x*	*16.5x*	*19.5x*
Book value per share	$667	$716	$727	$740	$769	$827	$852	$903
Debt per share	$270	$327	$366	$426	$430	$456	$500	$593
Cash per share	144	174	184	192	203	228	196	210
Net debt per share	126	153	182	234	227	229	305	384
Debt-to-equity	40%	46%	50%	58%	56%	55%	59%	66%
Debt-to-total cap	29%	31%	33%	37%	36%	36%	37%	40%

Sources: S&P Indices data on S&P 500, and author's calculations.

S&P 500 Components of Total Return



	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018	9/30/2019
Change in Operating EPS %	0.39%	10.82%	5.33%	-11.12%	5.78%	17.17%	21.76%	0.90%
Change in multiple %	12.96%	16.94%	5.75%	11.70%	3.55%	1.92%	-22.99%	17.68%
Dividends	2.60%	2.78%	2.30%	2.11%	2.42%	2.41%	1.85%	1.81%
Compounding effect	0.05%	1.83%	0.31%	-1.30%	0.21%	0.33%	-5.00%	0.16%

Compounding effect Dividends Change in multiple % Change in Operating EPS %

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Conclusion:

While our benchmark the S&P 500 is no easy competitor, its attributes have, in my view, worsened over the past year. When I look at the S&P and see the level of true earnings, its high and increasing degrees of leverage, buybacks on high-priced shares, etc., I feel confident that our group of businesses, carefully selected, will do modestly better than the S&P 500 over the coming five years.

There are many indicators pointing to an unfavorable investment climate at present, but as the sage said, "this too shall pass," and I'll be ready.

That doesn't mean I'm sitting around, however. Quite the contrary, my investment process has continued unchanged – and it won't change no matter what the stock market does. That process is one of building a roster of excellent companies that I know and understand deeply, regardless of price, and waiting for them to go on sale. I know full well that we may never get to purchase all of them at prices that provide a high probability of satisfactory returns with a built-in margin of safety. But some eventually will meet all my criteria, and I'll be ready. There is little to buy today at current prices, but much to do to prepare, to expand the roster of great businesses, and deepen my knowledge of those already on the list.

To conclude I will recall the marathon/sprinter analogy from the opening of this letter. The past year saw a sprinter (the S&P 500) put distance in front of us. But that sprinter is at present tired, dehydrated, and undernourished. We have a long race ahead of us.

Thank you for your continued faith and trust in me with your hard-earned capital. I look forward to reporting to you in another year.

Rationally yours,

January 22, 2020

Important Disclosures:

Mead Capital Management, LLC is a registered investment adviser based in Derry, New Hampshire. Adam J. Mead is its principal, CEO, Chief Investment Officer, and managing member.

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Past performance is not indicative of future performance.