CM Market Update

Summary

- The fundamentals of the companies in our portfolios are by-and-large doing well as of the third quarter, with most providing positive guidance looking forward.
- We believe the overall economy is in good shape, and we do not see a recession on the horizon.
- We believe this market correction is largely due to fears of a slowing market and economy as a result of trade issues.
- We believe that stocks, overall, are entering a fair value zone, and have largely priced in a slower economy that has yet to arrive, and stocks are materially cheaper than bonds.
- We continue to believe that oil and energy-related stocks are in a long-term bull market.

While many headlines may create fear and uncertainty, it is important to remember that the media tends to accentuate fear, as fear sells better than positive news. While it is always important to review facts, it is even more important during times of extreme uncertainty.

The facts are that there has never been a major bear market without a recession. However, there are normal corrections, which typically range between 5% and 15%. But major bear markets, like the one in 2008/2009, historically have happened only during a major recession.

The overall effect of the world economy slowing, the unresolved issues between the US and China, and the overall uncertainty relating to trade and regulations, indicate that the US economy could slow from its current 3% growth rate to a range of 2.25% to 2.50% growth. At the recent Schwab Impact conference in Washington D.C on October 30, Janet Yellen was quoted as saying if she had to write down a number, her forecast for US GDP in 2019 would be 2.7%.

The markets have been adjusting to this potential for slower growth. However, when you consider that during the last 9 years since the recession (September 2009 through September 2018) the US economy had an average growth rate of 2.3%, and even if you include the 0.46% potential negative impact on the US economy if all the proposed tariffs went into effect (see chart), US GDP would still be growing at a faster rate than the past 9-year average.

Tariff	Value	% of US GDP	Status
Steel & aluminum	$0.76b	0.00%	Imposed
25% on $50b goods	$12.5b	-0.06%	Imposed
10% on $200b goods	$20b	-0.10%	Pending
Add 'l 15% on $200b goods	$30b	-0.15%	Pending
10%-25% on $267b goods	$47b	-0.24%	Potential
25% on auto imports	$90b	-0.46%	Potential
Source: Charles Schwab & Company.			

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Our research shows that, on average, stocks currently have a higher earnings yield when compared to AAA and BAA bonds. This scenario makes stocks very attractive relative to bonds today. While psychology and fear tend to cause markets to overreact, we believe that, overall, the stock market is in a fair value range at this point.

We will monitor these macro situations closely and will alert you if there is any material change in our thinking that would cause us to revise the strategies in our portfolios.

Specific to the stocks in our portfolios, by-and-large, the fundamentals are doing well. For example, during the third quarter series of earnings releases in October/November, roughly 68% of the companies in our portfolios beat the consensus estimates in year-over-year sales growth, and approximately 84% of them beat the consensus earnings estimate for the third quarter.

After reading the earnings releases and listening to managements' conference calls to the analyst community, together with our one-on-one calls with management, our takeaway is that most companies are positive about the fourth quarter, as well as forecasting into 2019. Some companies did have a "we are not quite sure what will happen with trade" commentary, but even with that, most are positive in their projections for the coming year.

Company	Closing Stock Price 11/9/2018	Bloomberg Consensus 11/9/2018 12-Month Target	Consensus 12-Month Price Target Return Potential from 11/9/18 Closing Price
WTI Crude	$60.19		
Apache	$37.08	$49.90	**34.6%**
Ardmore Shipping	$7.20	$10.09	**40.1%**
Devon Energy	$33.01	$50.41	**52.7%**
Era Group	$11.34	$15.00	**32.3%**
Ensco	$6.98	$8.98	**28.7%**
Halliburton	$34.98	$49.10	**40.4%**
Murphy Oil	$30.99	$36.14	**16.6%**
Pioneer Energy	$2.84	$3.53	**24.3%**
Schlumberger	$50.40	$72.25	**43.4%**
Unit Corp	$22.50	$30.00	**33.3%**
Transocean	$10.53	$14.27	**35.5%**
Centennial Resource DVP.	$18.54	$27.05	**45.9%**
DMC Global	$37.77	$53.00	**40.3%**
Colfax	$28.09	$35.06	**24.8%**
Atkore	$19.83	$30.25	**52.5%**
Granite Construction	$52.80	$65.14	**23.4%**
Manitowoc	$19.12	$28.32	**48.1%**
Allegheny Technologies	$27.12	$35.00	**29.1%**

Source: Bloomberg. Consensus is based on the analysts that report their research to the Bloomberg data base. Numbers have been rounded. Returns cannot be guaranteed. Data in this chart is subject to chage.

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To give you an independent view of our more heavily weighted sectors, energy and industrials, the table above lists the names of companies that are in our portfolios or that are on our watch list. Shaded in gray is Friday's closing stock price. Shaded in green is the Bloomberg Consensus (a repository/collection of leading bank and brokerage firm analysts) 12-month price target. Shaded in blue is the potential return from the Friday, November 9, 2018 closing stock price should this 12-month consensus price target be reached. This does not include dividends. Our estimated numbers are generally higher as we are looking out two and three years versus just 12-months.

While nothing is guaranteed, we wanted to show what the most current independent thinking is on some of the stocks that are in our portfolios or on our watch list. **The bottom line is this: the fundamentals of these and many other companies in our other portfolio sectors are doing very well, despite their short-term fluctuations in price**.

Although all of these independent individual analysts can be wrong on any one stock, when we take this consensus view across a portfolio of stocks, we have found them to be fairly consistent. The table below illustrates that the consensus from independent analysts remains optimistic with regard to the companies in our CM Value I composite.

One more viewpoint to share is to look at the valuation metrics both in the absolute sense, as well as compare them to the S&P 500, our proxy for "the market". Remember, lower suggests cheaper and better values.

	CM Value I Composite	S&P 500 Index
Price to Sales	0.84	2.06
Price to Cash Flow	9.31	12.09
Price to Earnings (forward)	12.51	15.59
Price to Book	1.32	3.06
Source: Bloomberg. Numbers have been rounded. As of September 9, 2018		

The light at the end of the tunnel is this. We believe the fundamentals for the basket of stocks in our portfolios are on solid footing today. And, if the US economy continues to grow at 2.25% to 2.50% or more, we believe they should perform well. Moreover, until we see the US economy actually contract, not just slow down, we do not see a recession and therefore do not see a major bear market.

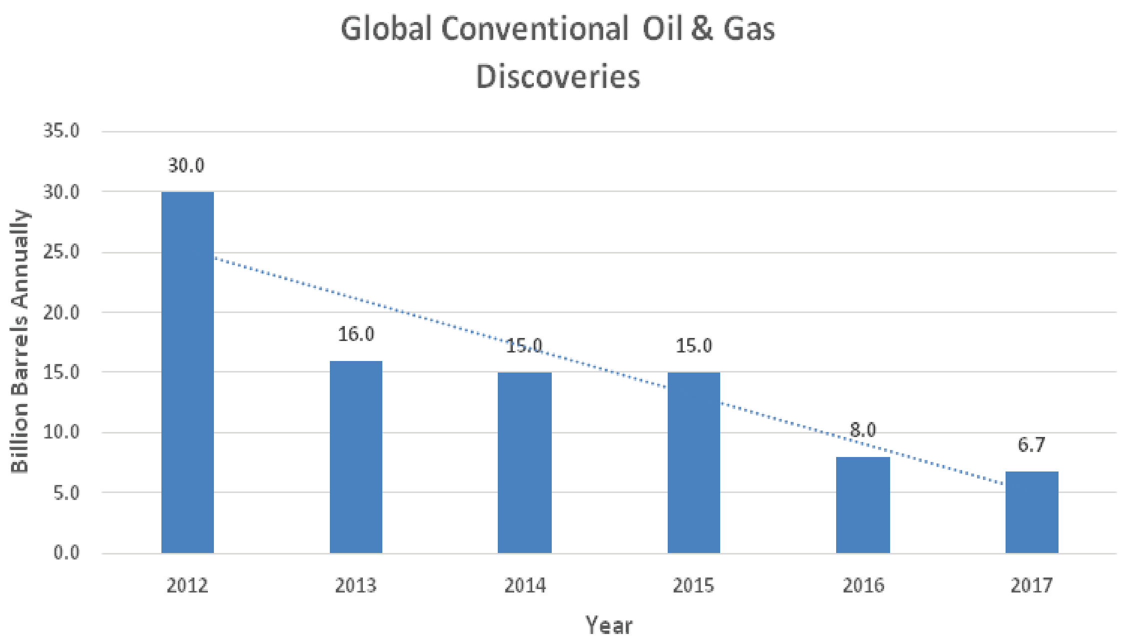
Energy

With regard to the record-setting selloff in the price of oil (a proxy for energy-related stocks) over the past six weeks, we continue to remain long-term bullish and believe several undeniable facts support our line of thinking.

Summary

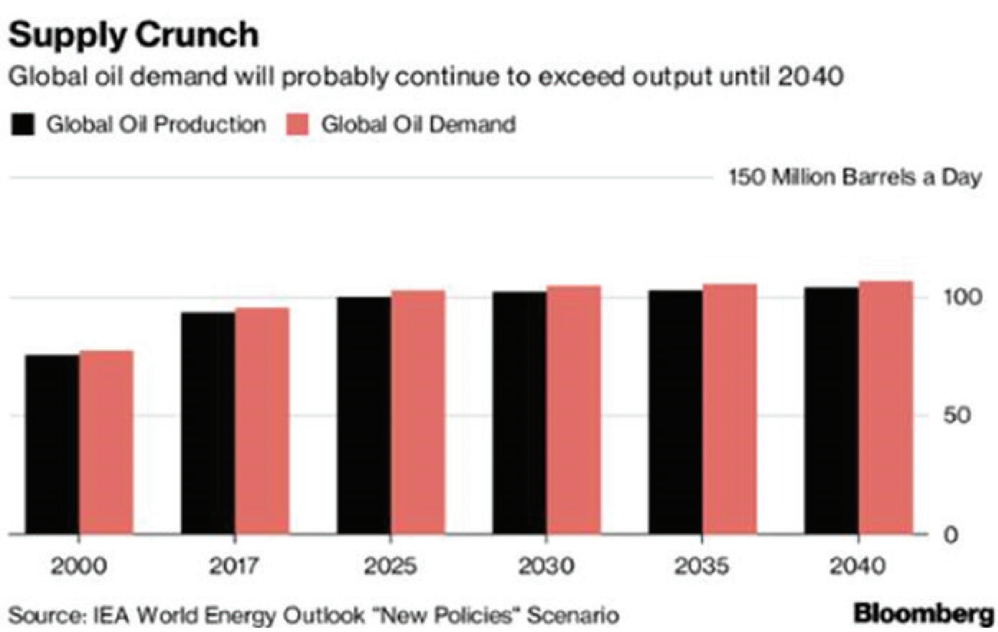
1. **Depletion from existing wells is roughly 3 million barrels per day.**
2. **Worldwide demand for oil and oil products continues to increase.**
3. **Lower capital expenditures have led to the lowest discoveries since the 1940's.**
4. **Saudi Arabia needs at least $88 per barrel of Brent oil to balance their budget.**

Due to the depletion from existing wells, coupled with growth in demand, the world needs to replace approximately 4 million barrels or more of oil per day. This would amount to 20 million barrels a day in 5 years. The US, Russia, and Saudi Arabia produce about 10 million barrels of oil per day, each. **In other words, the world will need to add the equivalent of another Russia and Saudi Arabia over the next 5 years!**



Source: Rystad Energy UCube and Rystad Energy research and analysis

According to the International Energy Agency (IEA), global oil consumption is currently more than 35 billion barrels annually. On top of this, our research shows that when you add to this the 4 million new barrels that will be needed per day, the world is not finding enough new discoveries to keep up. Compare this to the average discoveries over the past 6 years of 15 billion annually or 6.7 billion in 2017. Because capital budgets have been constrained due to lower cash flows in recent years, projects have been delayed or canceled. As a result, global discoveries of oil and natural gas in 2017 totaled only 6.7 billion barrels of oil equivalence, a level last seen in the 1940s. Since 2014, exploration expenditures fell more than 60 percent due to low oil prices and low cash flow. If this climate persists, we believe there will be an oil shortage sooner rather than later.



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To directly quote the IEA in their just released World Energy Outlook, "against this backdrop, it would appear risky to rely on tripling of US tight oil production, from today's level, by 2025. There is a real prospect of a damaging price spike and increased price volatility." Even the IEA is concerned of an oil shortfall.

Saudi Arabia's National Budget

Disclosed Planned Expenditures (Bln $)	$240
Legacy welfare programs carried over	$65
Asssumed total budget (Bln $)	$305
Projected Oil Exports, Bln bbls	2.81
Projected non-oil income (Bln $)	**57.2**
Oil income revenue (Bln $)	**248.1**
Implied per barrel revenue	**$88.26**

Source: Cornerstone Analytics 9/27/2018

Essential to the price of oil is that many OPEC countries need much higher oil prices just to balance their budgets, as oil revenues are their primary source of income. For example, as you can see on the chart above, Saudi Arabia requires roughly $88 per barrel of Brent oil to just balance their budget. When prices are lower than this, Saudi Arabia and other OPEC countries must dip into their cash reserves or sell assets, which they have been doing. We believe the desire to maintain their social programs and standard of living will be a key support for higher oil prices in the future.

Conclusion:

In closing, we believe this market sell-off over the past six weeks is partially due to a slow-down in the economy. However, we believe a larger reason is due to the fear and uncertainty of the trade issues. One thing the market is not discounting is the potential for improvement in the economy if some of the trade issues get resolved, as was the case with the renegotiation of NAFTA. We believe this recent decline is more reminiscent of a bull market correction, driven more by fear and uncertainty than by facts. We continue to believe that our portfolio of stocks is fundamentally doing well and that the stocks should deliver positive returns as we look into the future.

See Disclosures on Next Page

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