ST. JAMES INVESTMENT ADVISORS

COMMITTED TO VALUE INVESTING

INVESTMENT ADVISER'S LETTER

JANUARY 2019

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FOURTH QUARTER LETTER

*MARK*ET DISCUSSION

In 2018, the stock market had its worst year in a decade with appreciable losses across all asset classes, except cash. Unfortunately, we were right in calling for an increase in market volatility for 2018, primarily because the Federal Reserve continues to raise interest rates, which is impacting the amount of liquidity within the financial system.

The more the real economy became dependent on the asset economy, the tougher it became for the Federal Reserve to break the dependence on easy access to money via low interest rates. Until recently. Predictably, the current equity market pullback has left many talking heads concerned that the Federal Reserve will continue its current normalization campaign for interest rates.

Recently, the Federal Reserve raised the central bank's benchmark interest rate to a range of 2.25 to 2.5 percent.

This was the fourth-rate hike of 2018 and the ninth increase since the Fed began raising rates from near-zero three years ago. In addition to boosting the federal funds rate, the central bank provided updated economic projections. Their insights suggest there could be fewer rate hikes next year than originally anticipated.

It is important to keep emotions from dictating your actions. It is understandable to be concerned about market declines, however, market downturns provide a patient investor the opportunity to pick up stock market bargains as indiscriminate selling pushes down the prices of good companies.

One of the best ways to keep your emotions in check is to have sound rules that guide your purchase and sell decisions.

OUR APPROACH TO INVESTMENT RISK

The question you may be asking yourself is how do we at St. James approach this current investing environment?

The short answer is no different than we always do.

But let's take a closer look at some guiding principles that greatly influence our long-term investing approach. Our guiding principles are based on many years of investing and also contributed by notable investors such as Warren Buffett, Charlie Munger, Doug Kass, and Bob Farrell.

Evolution has hardwired investors towards "group think" or safety in numbers which leads many investors to buy what is popular instead of buying what is cheap.

The financial world is complex, and Mr. Market is often unpredictable. There is no quick answer or special formula to capture the holy grail of investment results. Instead it takes hard work, common sense and the ability to navigate the noise. To us it is impossible to avoid investment risk - but we do attempt to alleviate investment risk.

GUIDING PRINCIPLES

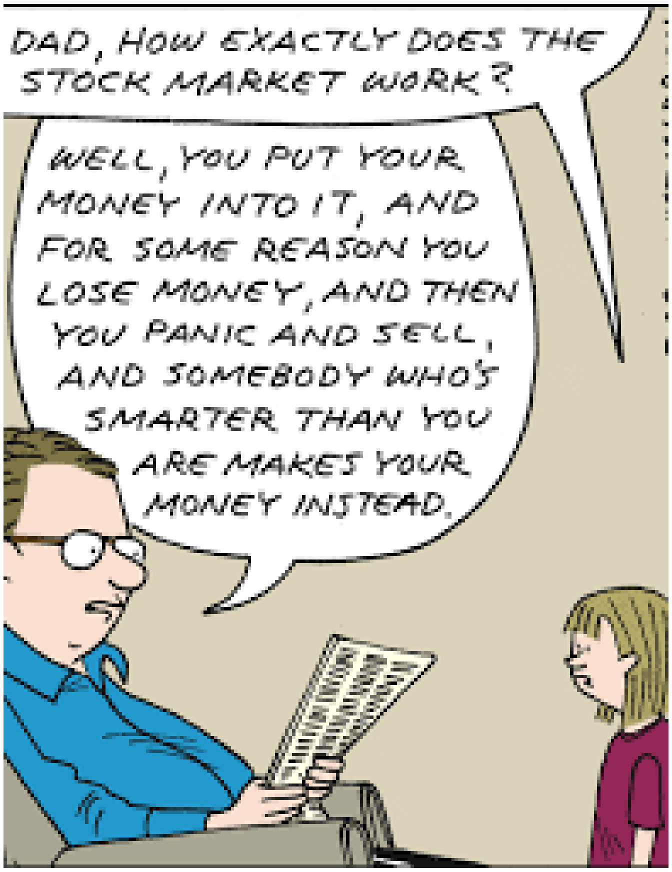
"This time it is different" is perhaps the most dangerous phrase in investing.

There are no new eras in investing and excesses are never permanent. There will be a hot group of stocks every few years, but speculation fads do not last forever. Over the last 100 years we have seen speculative bubbles involving various stock groups. Autos, radio and electricity powered the roaring 20s. The nifty-fifty powered the bull market in the early 70s. The dot-com bubble in the late 90s, and recently Bitcoin and FANGs.

"A lesson I learned early is that there is nothing new in Wall Street. There can't be because speculation is as old as the hills. Whatever happens in the stock market today has happened before and will happen again." - Jesse Livermore

Markets tend to return to the mean over time and excesses in one direction will lead to an opposite excess in the other direction.

Do not let emotions cloud your decisions or affect your long-term plan.



Fear and greed are stronger than long-term resolve.

The public is most bullish at market tops and most bearish at market bottoms. The survey from the American Association of Individual Investors is often cited as a barometer for investor sentiment.

In theory, when the public is aggressively buying risky assets warns of a market top, and conversely when the public is excessively selling warns of a market bottom.

"Volatility does not measure risk. The whole concept of volatility is useful for people whose career is teaching, but useless to us." - Warren Buffett

When all the experts and forecasts agree, something else is going to happen. <u>A contrarian investment strategy usually rewards patient investors.</u>

Stay in your circle of competence. Know the edge of your own competency. It is not a competency if you don't know the edge of it.

Maintain a Margin of Safety. Buy assets at a bargain so your investing results can be financially attractive even if you make a mistake. Price is not always the same as value.

Great companies are not always selling at great investment prices.

Be skeptical of unanimity of investment opinion.

"In a high wind, even turkeys can fly." - Eugene Kleiner

Do not automatically follow well known investors.

Even the greats make mistakes – look no further than Warren Buffett's Berkshire Hathaway which has lost more than $20 billion on Apple's shares from its peak price four months ago.

"If a stock falls in the market and no one's around, does it really lose its value?"

Do your own homework and study history.

"You are neither right or wrong because the crowd disagrees with you. You are right because your data and reasoning are right." - Benjamin Graham

Avoid big mistakes.

Think Independently. Markets and crowds are not always wise.

"Common sense is not too common." – Voltaire

Keep it simple.

Apply common sense when solving a problem or when doing an analysis of an opportunity. Think more and calculate less. Avoid false precision and unnecessary transaction costs. Try not to interrupt interest that is compounding. Focus on being a business analyst, not a macroeconomic forecaster. Pay attention to the business cycle, but don't try to predict it.

Be smart by not being stupid.

Accept Change. Avoid master plans since change is the only constant in life. Adapt. Understand arguments from all sides. Admit when you are wrong.

Keep Learning. Be a learning machine. Never stop reading. Be curious. Surround yourself with smart people. Set aside time to read and think.

"I read everything: annual reports, 10K's, biographies, histories, five newspapers a day. On airplanes, I read the instructions on backs of the seats. Reading is key. Reading has made me rich over time." - Warren Buffett

<u>Buy equity interests only in high quality businesses.</u> We only invest in companies whose businesses are understandable to us and where there exists fully documentary disclosure, including audited financial statements.

Buy Cheap. The definition of "cheap" for St. James in acquiring common stocks in the vast majority of cases is investing in companies at prices that reflect substantial discounts from readily determinable fair value.

St. James places particular effort into buying well-managed businesses with stable, but clearly superior management.

"Think like Main Street, not Wall Street." - Marty Whitman

St. James does not knowingly acquire the common stock of any company unless that company enjoys a super strong financial position.

St. James is not influenced by market volatility. Fluctuations in market prices are mostly a random walk with changes in market prices not in any way a measure of long-term investment risk, or investment potential. Most competent control investors, like Warren Buffett, ignore market volatility in that little or no weight is given to daily, or even annual pricing for portfolio holdings.

"In the short run the market is a voting machine. In the long run the market is a weighing machine." - Benjamin Graham

Value investing has a long and successful history. Most investors cannot follow a value investing discipline because there are periods, sometimes long periods, where you will be out of sync with the crowd.

Buy growth, but don't pay for it. We strive to buy a stock before the financial community agrees with us. Investment markets are a constant re-evaluation of individual businesses, and the market collectively. There are opportunities to invest in stocks that offer tremendous value, but that might not be realized for years.

"It gets late early out there." - Yogi Berra

St. James is a buy-and-hold investor as long as we believe the business has reasonable prospects that it can, over the long run, continually increase our fair value assessment at an attractive multiple and where we do not believe we made a mistake. Mistakes are measured by a belief that a permanent impairment has occurred in the underlying value or financial position of a company. St. James adheres to a strict sell discipline.

CONCLUSION

Obviously, an investment by you with St. James does entail investment risk, however we are doing our best to try and minimize investment risk.

As global investors have suddenly awakened from their risk aversion slumber, we thought a discussion on our approach to market risk is timely.

At St. James we will continue to invest as we always have, and always will, using our disciplined investment philosophy, a philosophy centered around avoiding investment risk and raising the odds of a favorable outcome.

Thank you for your continued support. We look forward to writing you again shortly.

Sincerely,

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St. James Investment Advisors

St. James Investment Advisors

We are professional portfolio managers Committed to Value Investing.

We are an independent, fee-only, U.S. Securities and Exchange Commission registered investment advisory firm, providing customized portfolio management services to individuals and their financial advisors.

Our investment methodology blends a combination of fundamental analysis, discipline and patience with the goal of creating long-term returns based on the time-proven principles of value investing.

As thoughtful value investors, our sole focus as a firm is to manage private investment accounts for individuals and financial advisors throughout the United States.

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