



ST. JAMES INVESTMENT ADVISORS

COMMITTED TO VALUE INVESTING

INVESTMENT ADVISOR'S LETTER

OCTOBER 2020

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THIRD QUARTER LETTER

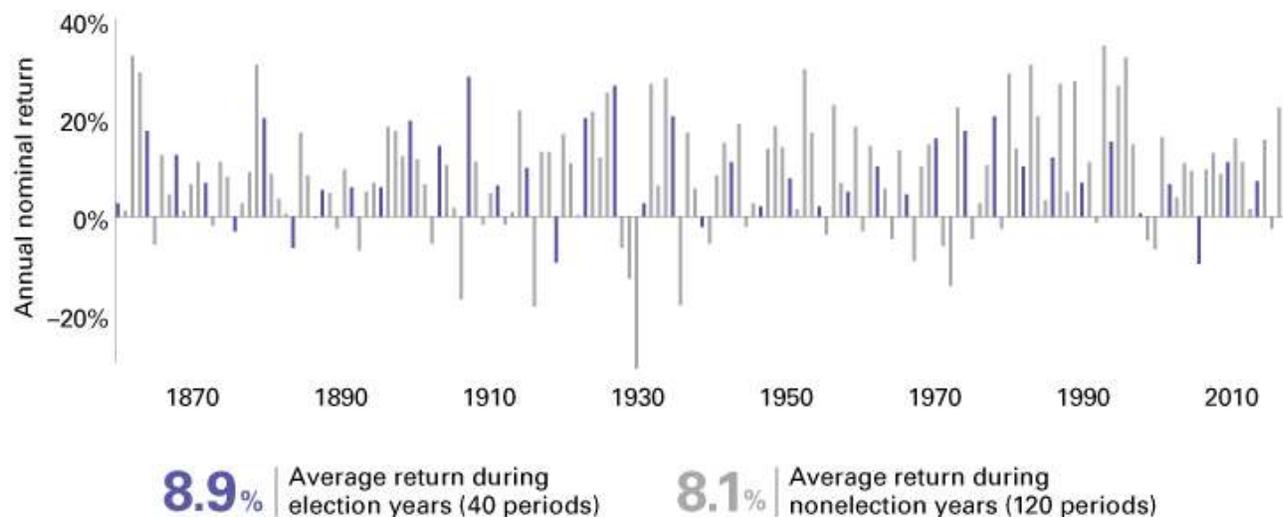
PANDEMIC AND ELECTION DISCUSSION

As we head into the fourth quarter of 2020, we continue to see the current market outlook dominated by the pandemic and the upcoming Presidential election.

Importantly as investors, our focus continues to be on the year 2021 and later. However, we acknowledge your concerns with the results from the upcoming election and political uncertainty.

From a recent study published by Vanguard, decades of research demonstrate that election years have no statistically significant impact on market returns or, for that matter, volatility.

Vanguard compared election years versus non-election years and a portfolio consisting of 60% stocks and 40% bonds showed no significant statistical difference in returns.



Vanguard also analyzed the volatility of the stock market in the months closest to an election.



You may be thinking that this election is different, and I am reminded of a famous quote from a legendary investor.

“The four most dangerous words in investing are: ‘this time is different.’” – Sir John Templeton.

Long-term investing success requires the discipline to remain focused on the long-term and not make short-term emotional decisions.

Patience and persistence are essential to long-term investment success. We encourage our clients to take a similar view.

VALUE INVESTING – WE THINK THE NEXT FEW YEARS WILL BE DIFFERENT

The S&P 500, and most growth stocks, are positive for the year. However, most value stocks are negative.

From a recent article published by First Pacific Advisors¹ the Standard & Poors ("S&P") measures value stocks using three factors: the ratios of book value, earnings, and sales to price. The S&P 500 Pure Value index is a style-concentrated index designed to track the performance of stocks that exhibit the strongest value characteristics.

The chart below shows how much worse their Pure Value Index has performed year-to-date versus the more popular S&P 500 Value and S&P 500 indexes.



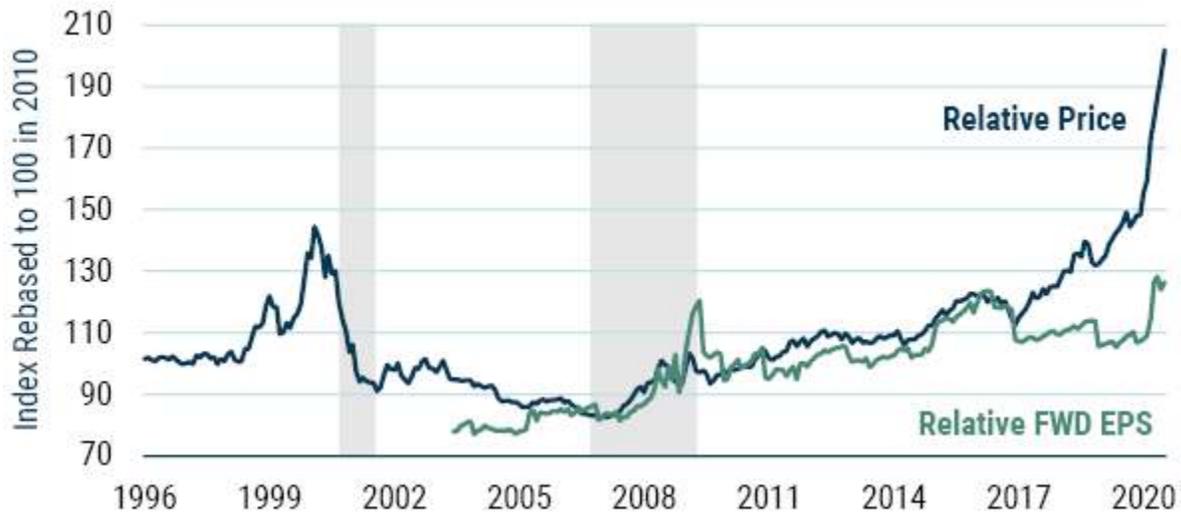
First Pacific Advisors is not alone in their assessment that value investing style is currently attractively priced.

From Matt Kadnar of GMO², we see another discussion on value investing’s current attractiveness.

¹ Are “Value” Stocks Finally Poised For A Comeback?, First Pacific Advisors, FPA Insights, www.fpa.com

² Matt Kadnar, GMO, 2Q 2020 GMO Quarterly Letter, <https://www.gmo.com/americas/research-library/2q-2020-gmo-quarterly-letter>

GROWTH OUTPERFORMANCE EXCEEDS FUNDAMENTALS

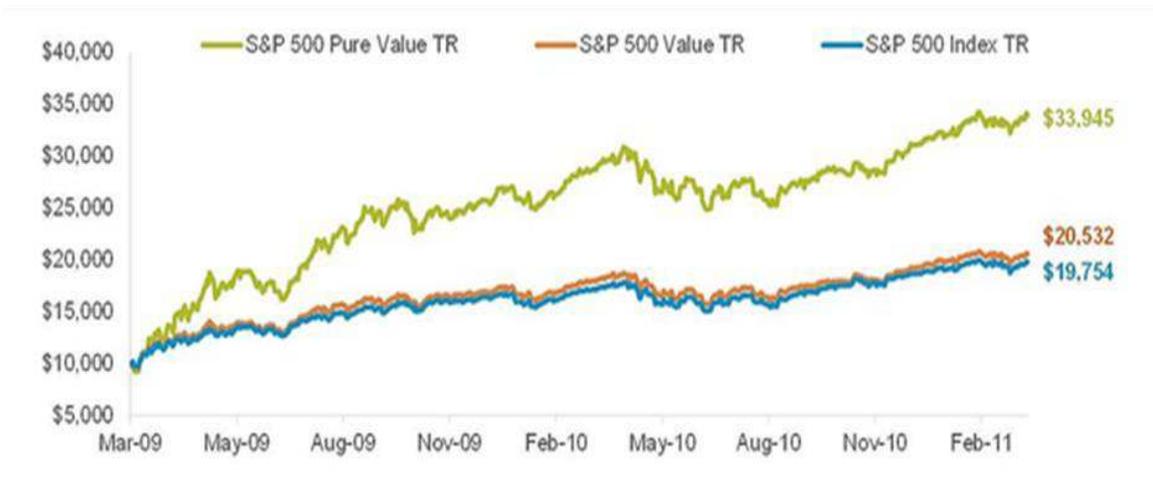


The result of this activity is that there is an opportunity within Value stocks, which are in the top decile of attractiveness worldwide.



First Pacific Advisors (FPA) also asked the question, “Why have value stocks performed so poorly recently?”

“One reason is that their valuation metrics have diverged sharply from other stocks - P/Es have risen or stayed flat for some of the largest companies in the S&P 500, and they have fallen for many value stocks.”



We agree with FPA that if history is any guide, the next few years for value stocks will differ from the last few years.

Investors may be very tempted to reach for yield in today’s low-interest rate environment. Due to the Federal Reserve’s action, it has become harder and harder to find attractive levels of income for investors.

“More money has been lost reaching for yield than at the point of a gun.” - Raymond DeVoe, Jr.

We agree with Mr. DeVoe, and reference once again the excellent article written by Matt Kadnar of GMO³. Not only does he have a very favorable view over the next several years on investing in value stocks versus the overall market, but he also discusses the benefits value investing has on lowering the overall duration of your portfolio. Duration measures a bond portfolio’s price sensitivity to interest rate changes.

“Value tends to have a higher dividend yield, so you get more of your return earlier than with Growth stocks, where you are more dependent on cash flows further into the future. How much Value lowers your effective duration is a more complicated issue because you also need to make assumptions on the changes in the discount rate, the return rates on invested capital (as the discount rate changes), changes in payout rates, etc....The duration difference between Value and Growth can be quite significant.

THE SENSITIVITY OF EQUITY TO CHANGING DISCOUNT RATES

	<i>Equity Duration¹²</i>	<i>Dividend Yield</i>
High Growth Equity	33-51	0.9%
Normal Equity	26-33	1.9%
Value Equity	10-22	2.7%

³ Matt Kadnar, GMO, 2Q 2020 GMO Quarterly Letter, <https://www.gmo.com/americas/research-library/2q-2020-gmo-quarterly-letter>

Value provides more current income, a cheaper and therefore more resilient asset, and lowers the duration of your equity portfolio.”

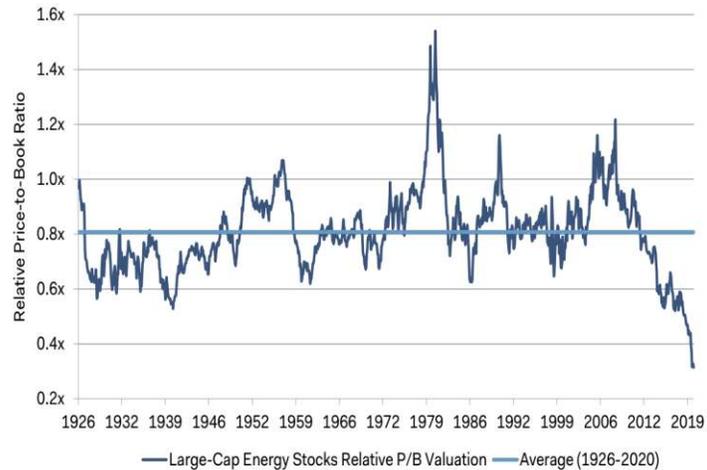
CONTRARIAN CASE FOR ENERGY STOCKS

According to SentimenTrader, energy stocks now represent the most hated stock market sector of all time!

According to Merriam-Webster the definition of a contrarian is anyone who thinks that most of what the public believes is wrong. Consider us contrarians when it comes to energy.

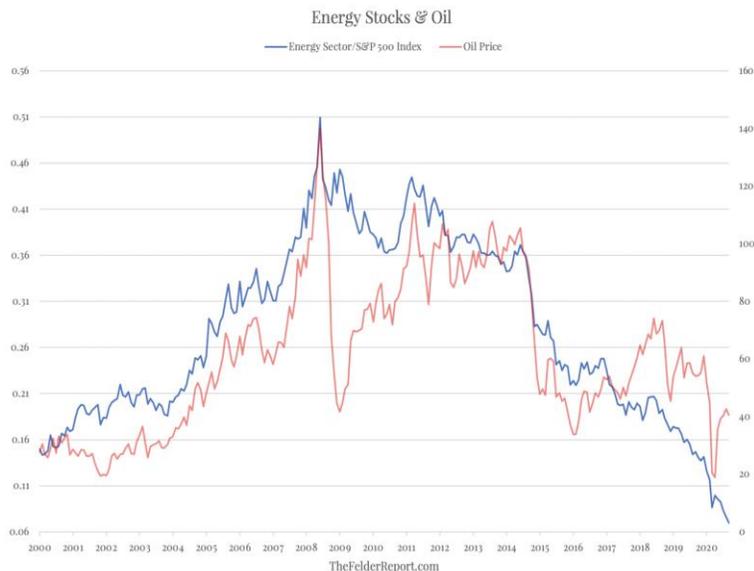
We believe the current inventories of oil will likely draw down in the later part of 2021, and possibly sooner, which would be very positive for the price of oil.

Figure 5: Energy Valuations Relative to the Overall Equity Market



A recent article by Dodge & Cox⁴ discussed the opportunities within the energy sector. “Energy companies are currently trading at low multiples relative to history and the broader market on a price-to-book basis. We believe that the fear and uncertainty dominating the headlines have driven valuations to extreme levels that already price in significant downside risks. This type of environment can create a long-term investment opportunity for value-oriented investors.”

From the Fielder Report⁵, “If we look at the relationship between the relative performance of energy and the oil price, there is a massive gap



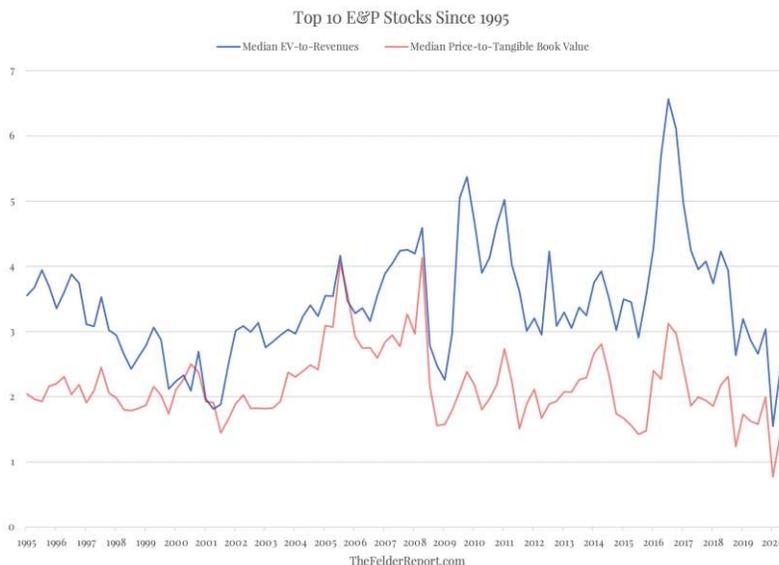
⁴ Investment Perspectives, Re-evaluating the Opportunity in Energy, July 2020, Dodge & Cox, www.dodgeandcox.com

⁵ This Sector Is Seeing The Sort Of Screaming Buy Signals That Only Very Seldom Arise, September 28, 2020, The Felder Report, www.thefelderreport.com

right now pointing to a potential surge in the former. There may be no better visual representation of the extent of the hatred toward the energy sector we are witnessing today.

This leaves the potential for a massive reversion trade that could see energy stocks outperform the broader market to a very significant degree going forward.”

Furthermore, Felder analyzes the top 10 exploration and production companies’ median valuation dating back to 1995.



Looking at their enterprise value-to-revenues and price-to-tangible book value, these companies are trading near or at their cheapest in history.

INVESTMENT PHILOSOPHY

“One of the best rules anybody can learn about investing is to do nothing, absolutely nothing, unless there is something to do... I just wait until there is money lying in the corner, and all I have to do is go over there and pick it up... I wait for a situation that is like the proverbial ‘shooting fish in a barrel.’” -Jim Rogers, Market Wizards

In the financial markets, frustration usually results from being emotionally or financially committed to a specific short-term outcome, which does not manifest itself. The majority of mistakes investors make are because they feel the need to do something, and be proactive, rather than waiting patiently for an attractive investment opportunity.

Historically, successful long-term investors remain focused on the fundamental considerations that drive their investment decisions, avoiding any expectations regarding how markets will perform in the near-term. Even if this means doing nothing!

“Common sense is not so common.” - Voltaire, A Pocket Philosophical Dictionary

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

Sincerely,

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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