# Comus Investment, LLC

Dear Partners,

March 30th, 2019

In the first quarter of 2019 our investments experienced a total return of 5.80% before fees and 5.17% after fees, versus 13.65% for the S&P 500 index.

Given our performance in 2018, particularly in the second half of it, this was quite a lackluster quarter for us. I believe our position now is much better than it was a year ago, and as long-term investors we should always appreciate price declines, but it is fair to categorize our performance over the past twelve months as poor. This is particularly the case for those who did not experience our early gains, and who were unable to reinvest to take advantage of the 2018 declines. I expect years as we just had to be blips which will often allow us to find some opportunity and improve our results, however as you can see from our performance compared to that of US indices this quarter, there is no guarantee we won't underperform or look silly in the short-run.

We haven't sold a stock for a profit in about a year now, and I can't say when we will. As usual, I believe what we own is worth much more than what the market has appraised it at, and regardless of what happens in the short-run, I believe this difference remains quite large.

I speak little publicly of our portfolio and my investment process, which is unique to the investment industry, but I am reserved because I value our methods and results more than publicity and attention. Publishing the companies we own and my reasoning for why we own them would be akin to a professional cards player telling his opponents at the table how he is beating them and letting them know what mistakes they are making. If we ever buy a large, great business I would likely disclose it, but not our bread and butter. Most investment managers do it to attract a following and I imagine it helps sales and AUM quite a lot, but I have no interest in it. As partners you are always free to ask whatever questions you like and I'll be happy to answer them.

This quarter marks the end of Comus' third full year and over this period, Comus' portfolio has compounded at 22.16% per annum, for 19.56% after fees, versus 13.60% for the S&P 500, for an 82.31% cumulative return before fees and 70.90% after fees versus 46.59% for the S&P 500. Admittedly, we had very few clients in the first year, so few will have achieved those results. Our returns over the past 12 months have hit our average quite a bit, while the returns of the S&P 500 over the past quarter has dramatically improved its average. It is difficult to say how the respective average returns of each will differ in the future but suffice it to say that US indices will not compound annually anywhere near 14% long-term (say nothing of 14% a quarter).

These three years have included one in which international markets have slumped- which isn't anything particularly unique and as you all know, I expect much worse years for all investors in the future. It has however, included the US Tax Cuts and Jobs Act passed in Dec 2017, granting a significant decrease in taxation for the average US public corporation. This perpetuity granted to the private sector has permanently increased corporate earnings, and therefore has permanently increased the value of most public companies in the US. This increase in value has been a boon to stock prices over the past few years (expectations of tax cuts were implied in prices even before the law passed). While the benefit to corporate earnings is permanent, it was a one-time non-recurring boost to US stock prices that should have improved the results of indices over this period, as the market's estimate of the present value of that perpetuity was added to the total US stock capitalization.

To attempt to explain short-term results such as ours over the past few quarters would require insight into the mind of the market and that of most investors. By actively investing, we are attempting to profit from the mistakes of most investors, and so the implicit assumption is that changes in valuation over short periods will often make little sense. By having a “who cares” attitude to most stock-market related events, you will be more enlightened and less prone to making mistakes than those who are of the opinion that the value of businesses are actually changing daily, weekly or monthly (they aren’t). Given that I don’t want you to care about macroeconomics, price swings or whatever average opinion is thinking, the rest of this letter is optional reading and will include some random thoughts and speculation on these topics- feel free to skip or ignore it.

While it doesn’t matter to us much, US market behavior recently has been odd (down 14% in 2018 Q4, up 14% in 2019 Q1 for the best quarter since 2009) and could probably be summarized simply as the market’s reaction to changes in monetary policy. You would have to survey the typical professional investor to determine what exactly the rationalization is, but generally speaking, the market reacted poorly to expectations of increasing interest rates coupled with worsening economic data last quarter. Economic data hasn’t changed much, but US performance this quarter seems to be mainly propelled by the recent announcement that interest rates will not rise further, meaning they have reached this cycle’s peak.

So while investors likely have skewed expectations of the future in that I expect the majority of them to be too optimistic in estimating future earnings and therefore current value, the price swings have likely just as much to do with changes in required returns. What this means is that when Treasury bonds offer a 4% annual yield, investors couldn’t rationally accept a 3% return from stocks, and so when interest rates rise, stock prices must fall as fixed-income offers a more competitive return. The past two quarters then are the result of investors expecting that fixed-income will offer a more competitive substitute return, and then being told that it won’t. With 30-year Treasuries offering 2.8%, and knowing that this rate will not rise any more, many investors are happy to accept lower returns than they otherwise would and therefore work to push stock prices up dramatically in the short-term.

Whatever the future holds, it isn’t good for equity investors that interest rates (fed funds rate) have peaked at 2.5%, for a few reasons. Firstly, this is the lowest interest rate peak in the past 70 years. I can’t find reliable data before 1950, but I would be surprised if interest rates ever peaked at a lower number. That the Fed believes the economy as well as fixed-income and equity investors cannot withstand a higher long-term rate means that the neutral rate is lower than it has ever been and that we all require ‘easy money’ in order to keep things chugging along. It also means that investors of this era are destined to receive lower returns than investors of prior eras. When interest rates are at 7%, it is pretty easy to achieve 10% annual returns from equities, but when interest rates are at 3% that is a fantasy for most.

Lastly, the neutral rate being so low means that monetary policy likely will be less effective in the future than it has been in the past. Historically, from the trough to the peak of every cycle, interest rates increase from their lowest to their maximum and the pendulum is wide, allowing policy-makers quite a range to properly move the levers as appropriate. The fed funds rate was nearly 0% from 2008 to 2015, which is a record, and now apparently under the best economic conditions, the upper-bound is deemed to be 2.5%, meaning the interest-rate pendulum is very skinny. The US is better off than most, but many countries are facing this position in which they are in a permanent liquidity trap- the neutral rate is so low that monetary policy is never effective and permanent ‘easy money’ is needed. Couple this with record high government + private sector debt in these countries, and you also have an unwillingness and difficulty implementing any fiscal stimulus. I expect many countries to remain in this skinny see-saw as they are not growing quickly enough to render stimulus unnecessary, but have no practical means to counter their conundrum.

With interest rates held at historic lows, stock prices should likely be permanently higher. In a world with 3% long-term interest rates, stock prices will always be at a much higher level than they would be in a world with 6% rates. Frankly, if long-term rates were 6% stock prices could plausibly be cut in half, which speaks to the willingness of everyone to accept lower returns in this era in which we operate. This could help explain much of the froth in tech and venture capital. It could also potentially explain froth in miscellaneous consumer and industrial sectors. One example of many to choose from would be Coca-Cola. An 130 year old company with declining revenues and increasingly forced to diversify from its primary product, it is currently trading at a market capitalization of $200B versus earnings of $7B, for a 3.5% earnings yield and it gets worse if you actually attempt to value it and subtract its net-debt position from a reasonable present value of its operating earnings. Something like this is difficult to explain. I imagine shareholders are looking more towards its dividend plus share buyback yield rather than focusing on the firm's potential future earnings and the fact that it is taking on debt to dish out this unsustainable return of capital. It could also be shareholders are fine with the marginal returns they will likely receive from a stock like this- I honestly don't know which one it is but either way it makes little sense to me.

All of this is to illustrate that I expect substantial differences between the short and long-run and that the short-run will often mislead. Unfortunately, markets are cyclical. As much as we all wish that economies and stocks could grow in a linear and moderate manner, it is unlikely to happen because it never has. Due primarily to speculation, debt, the efforts of the financial sector and the need to always push things to their limits, markets will always experience dramatic ups and downs. Rarely is there moderation, it is always feast or famine and I think for some time now investors have been happily feasting away.

As always, if you have any questions or concerns please reach out and I would be happy to talk.

Best,

Aaron J. Saunders

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