



*“The dumbest reason in the world to buy a stock is because it’s going up.”*

*—Warren Buffett*

July 26<sup>th</sup>, 2018

## **A Look Back**

Stocks were all over the map during the first half of 2018, with January a precursor of the stock market volatility we have experienced since then. You may recall that the Dow Jones Industrial Average reached an all-time high on January 26, but only one week later, the index had fallen ~4%. The S&P 500, despite having ended the 2nd quarter with a 2.65% gain had at one point, declined by ~10% from its 2018 high. From a historical perspective, this intra-year drop is not unusual: according to JP Morgan Asset Management, the average intra-year decline for the S&P 500 since 1980 has been 13.8%.

The market’s volatility was caused by many factors, including the potential for a trade war, which many pundits predict would negatively impact the economy. There is some evidence of such an impact already, as a number of CEOs report tempering capital expenditures until they can determine the magnitude of the situation. Uncertainty about the future direction of interest rates also played havoc with the stock market. The 10-year Treasury started the 2nd quarter yielding ~2.75% and was yielding ~3.12% by mid-May. However, approximately two weeks later, it was back to 2.76%, and it ended the quarter at 2.85%.

A rising interest-rate environment negatively impacts the multiple that investors will pay for stocks. Investors (all else being equal) will pay a lower multiple when the 10-year Treasury yields 3% than when it yields 1%. The S&P 500 currently sells for about 16.5x forward earnings (the multiple) versus a year ago, when it sold for 23.8x. With S&P profits expected to increase by about 20% in 2018, an argument can be made that the stock market is reasonably valued. However, now that the multiple has contracted from ~23x to ~16.5x, we see an outside chance of a multiple expansion over the short term (barring an all-out trade war).

While people may be nervous about investing in the stock market in a rising interest-rate environment, it is worth noting that according to JP Morgan Asset Management, since 1983, when the yield of the 10-year Treasury was below 5% (it is currently ~2.94%), increasing interest rates have historically been associated with rising stock prices. So, if history is any guide, we have a long way to go in terms of rate hikes before stock market performance is negatively impacted.

Mega cap technology stocks are still doing the heavy lifting when it comes to generating stock market returns (as measured by the S&P 500). David Kostin, chief U.S. equity strategist at Goldman Sachs, estimates that *more than 100% of the S&P 500's total return of 2.65% in the first half of 2018 is attributable to just 10 equities*. Amazon alone was responsible for roughly 36% of the benchmark gauge's advance. Amazon, Microsoft, Apple, and Netflix in the aggregate accounted for 84% of the index's gain.

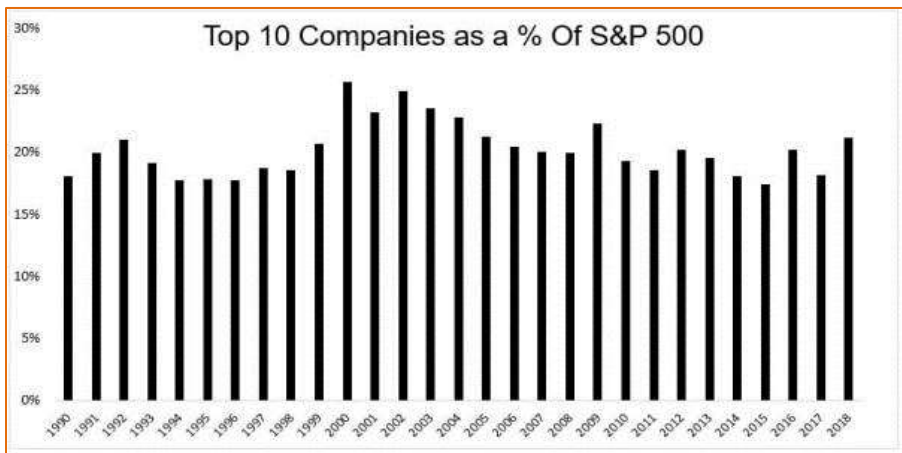
**Exhibit 3: 10 Stocks have contributed more than 100% of S&P 500's YTD return**  
as of June 28, 2018

Ticker	Company	Cons. 2019E sales growth	Total return	Mkt cap weight	% of SPX Return
<b>AMAZN</b>	Amazon.com Inc.	23%	45%	2.1%	<b>36%</b>
<b>MSFT</b>	Microsoft Corp.	10	16	2.9	<b>18</b>
<b>AAPL</b>	Apple Inc.	4	10	3.8	<b>15</b>
<b>NFLX</b>	Netflix Inc.	24	106	0.4	<b>15</b>
<b>FB</b>	Facebook Inc.	27	11	1.9	<b>8</b>
<b>GOOGL</b>	Alphabet Inc.	18	7	2.8	<b>7</b>
<b>MA</b>	Mastercard Inc.	12	31	0.6	<b>7</b>
<b>V</b>	Visa Inc.	11	17	0.9	<b>6</b>
<b>ADBE</b>	Adobe Systems Inc.	19	37	0.4	<b>5</b>
<b>NVDA</b>	NVIDIA Corp.	14	25	0.5	<b>5</b>
<b>Top 10 contributors</b>		16%	20%	16%	<b>122%</b>
<b>S&amp;P 500</b>		5	3	100	<b>100</b>

Source: FactSet, Goldman Sachs Global Investment Research

The narrowness of stock market leadership, however, has us concerned. History has shown that for a stock market advance to continue, the leadership cannot be limited to a small number of companies. Furthermore, the current leaders are among the most expensive when measured by their P/E ratio. Amazon, for example, sells for a whopping 109x forward earnings, and Netflix sells for 99x next year's earnings.

Equally concerning, according to John Authers's July 18th article in the Financial Times (citing Bianco research), if Microsoft were added to the FAANG grouping of stocks and these companies were their own sector, these six companies would comprise 17% of the S&P 500 in terms of market capitalization and would be the largest sector in the S&P 500. In the same article, (citing research by Michael Batnick), Authers reported that the market capitalization of the five biggest companies in the S&P 500 currently equals the market cap of the smallest 282 S&P 500 companies.



Source: Financial Times

Everyone seems to be jumping on the high-flying technology stock bandwagon. According to Jeff Cox of CNBC.com, fund managers who responded to the July Bank of America/Merrill Lynch fund managers survey (which polls 231 professional money managers who manage a total of \$663 billion in assets to find out what they are buying/selling as well as their views on the market) identified the FAANG+BAT trade (this refers to a basket of popular technology stocks, including Facebook, Apple, Amazon, Alphabet, Netflix, Baidu, Alibaba, and Tencent) as the most popular trade for the sixth consecutive month. This bet has paid off handsomely, as the FAANG stocks alone have advanced by over 40% through mid-July.



However, we doubt that the managers placing these trades are patient long-term investors (and we suspect that many, not wanting to underperform their benchmark, are buying these stocks simply because they are the stocks increasing in price) and anticipate that they will sell their shares at the first sign of trouble. We saw a sneak peak of what could occur on July 16th, when Netflix reported disappointing earnings and its stock dropped 14% in after-hours trading (the stock has since recovered a small portion of its losses). In addition, on July 25 Facebook provided disappointing sales and profitability forecasts and the stock plunged more than 20% in after-hours trading. Whether these were one-off events or a preview of more trouble is impossible to say for certain, but our best guess is that at some point, investors in many of these high-flyers will lose a great deal of money.

## Performance

The last day of the second quarter was indicative of the first six months of 2018. Stocks ended the quarter on a sour note as the major indexes went south in the last few minutes of trading. The Dow had traded 293 points higher earlier in the day, but the mood suddenly reversed course after selling pressure picked up, leaving the DJIA in the green by about 44 points.

A \$3.4 billion sell order that was entered toward the end of the day typified the mood that prevailed for the first half of the year. There were many days where the market experienced substantial gains up until the last half hour of trading, only to see those profits diminish sharply—or evaporate entirely.

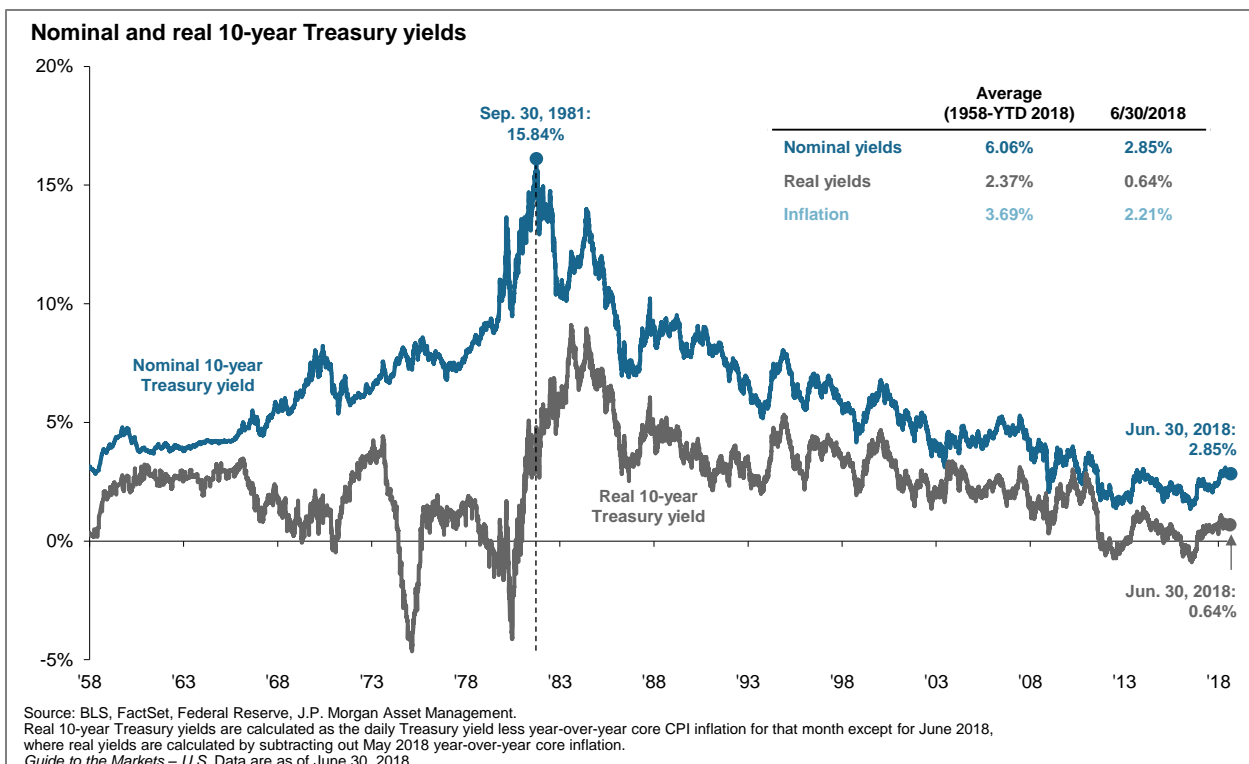
Every account at Boyar Asset Management is treated individually, so we always have a wide degree of performance dispersion, depending on the client's individual mandate. However, for the most part, our accounts did reasonably well for the first half of 2018, especially given our total lack of FAANG exposure.

## Some Thoughts About the Market

During the short term, the U.S. stock market could experience some turbulence. Midterm congressional elections are just around the corner. Historically (with rare exceptions), stocks have corrected prior to the event, only to rally once Election Day has passed.

We have seen a significant spike in the price of oil over the past six months. So far, consumers have ignored it and continued to spend. The recently enacted tax cuts have more than offset the price increase. However, if oil prices continue to increase, this could certainly prove to be a headwind.

Although interest rates have increased materially over the past year, they remain quite low from a historical perspective. If the Federal Reserve becomes more aggressive, this could cool the economy. However, with the 10-year Treasury under 3%, for the moment, we believe that this outcome does not present a problem.



Earlier in this letter, we commented that the market leadership has narrowed, noting that four stocks contributed, in aggregate, ~85% of the gain in the S&P 500 for the first half of 2018. All of these companies are technology stocks, a sector that represents over 25% of the index. Furthermore, these businesses have valuations that are among the highest of all listed U.S. stocks. (Currently the average trailing P/E ratio for technology companies within the S&P 500 is ~27x earnings.)

Conversely, money center banks such as JP Morgan, Bank America, Citigroup, and Wells Fargo were among the poorest performers during the first half the year, and yet in our opinion, they are among the cheapest publicly traded companies, utilizing any acceptable valuation technique. They are also currently very much out of favor. According to the previously mentioned Bank of America/Merrill Lynch survey, manager allocation to bank stocks has dropped by 33% over the prior two months.

**Bank of America**



**JPMORGAN  
CHASE & CO.**

In addition, these banks are overcapitalized and will continue to return significant amounts of money to shareholders. Just recently, JP Morgan increased its quarterly dividend to \$0.80 cents per share, up from \$0.56. The current yield is over 3%. It also announced it would buyback up to \$20.7 billion in stock. Bank of America raised its annual dividend by 25% to \$0.60 per share and announced that it will repurchase \$20.6 billion of its common shares. The bear case for these stocks is a flattening yield curve that would negatively impact earnings. However, at their current valuations, we believe that much of this is already priced into these stocks.

### **Could the Passive Equity Investing Rally Be Breaking?**

In the U.S., passive investing has gone from ~10% of all equity assets to ~40% since the late 1990s. But could that trend be reversing? And what would that mean for U.S. equities? According to Morningstar, the first half of 2018 saw a 44% reduction in inflows into U.S. passive investment vehicles from the prior year. Of particular interest, BlackRock (the world’s largest money manager and a major provider of passive investing products) saw institutional investors withdraw \$21 billion from passive stock funds but experienced \$7 billion of inflows into passive bond funds. This trend was not limited to professional investors, as retail investors withdrew \$1.6 billion from BlackRock’s passive stock funds and increased their exposure to passive bond funds by \$6 billion. This reaction could be a sign that investors are getting nervous and embracing the perceived safety of bonds. If this trend away from passive equity investing continues, it could create significant selling pressure on “popular” stocks that are components of major indexes and ETFs.

### **Is This 1999/2000 Revisited?**

While the stock market, as measured by the S&P 500, is nowhere near as expensive as it was in 2000 (as of the end of June, it sold for 16x forward earnings, compared to 27x for March 2000), we are beginning to see some interesting similarities between the two periods. In 1999, superstar value investor Julian Robertson’s fund lost 19% as technology shares reached absurd levels. Not surprisingly, his investors fled and withdrew \$7.7 billion, according to Tae Kim of CNBC.com. After losing almost 15% in the first two months of 2000, Robertson closed his fund, right before the technology-heavy NASDAQ lost 46% of its value from April through the end of the year. Perhaps David Einhorn, once a high-flying value investor, is this generation’s Julian Robertson. Einhorn, after having amassed one of the best records in the investment business, has been struggling. His fund declined by 19% for the first half of 2018, compared to a 2.65% gain for the S&P 500. This decrease follows a rough 2017, when his fund gained a mere 1.6% compared to a 19% gain for the S&P 500. While we admittedly may be grasping at straws looking for signals of value investing’s reemergence after a prolonged period of hibernation (as far as we know, Einhorn has no plans to close his fund), it is worth noting that almost immediately after Robertson threw in the towel, value investing staged an incredible comeback and richly rewarded those who had been willing to endure the pain of being a value investor in a market that rewarded only growth investments.



*Julian Robertson*



*David Einhorn*

Longtime market strategist Jim Paulsen of The Leuthold Group has pointed out another similarity between the current investing climate and 1999/2000. In an interview on CNBC, he noted that for the past five years, excluding technology shares, the rest of the S&P 500 has consistently underperformed the rest of the market—almost exactly as long as the last period (1995-2000) when technology shares led the market to stratospheric heights. He went on to say that the current “character and attitude of the marketplace” are similar to the belief that “tech can’t lose.” Paulsen continued, “I just wonder if it might end similarly . . . not to the same magnitude, but similarly.”

### **Some Value Investors Are Changing Their Stripes (But We Won’t)**

It has been a lonely time for value investors. *The Russell 1000 value index has underperformed its growth counterpart for 10 of the past 11 years*, according to Michael Wursthorn’s June 4 article in the *Wall*



*Street Journal*. This result has naturally led some pundits to declare value investing dead, arguing that value investing principles are not suited for this new technology-driven age (almost identical pronouncements were made in 1999/2000). This view has led some value investors to embrace the stocks of high-multiple-growth companies, like Amazon or Netflix—with even Warren Buffett owning Apple shares. We give Mr. Buffett a pass, however: with a cash hoard of over \$100 billion to deploy, his investible universe is much smaller than that of most investors, and Apple arguably does have some traditional value characteristics. While it has been painful for us to watch high-flying growth stocks like Amazon gain 56% this year, we have no plans to change the investment style that has served us so well for so long. At some point (hopefully sooner rather than later), value investing will come back into vogue, and many of the value investors who abandoned their style to keep up with a benchmark will regret their decision.

**Below please find excerpts from a recent article, and a previous quarterly letter we thought you would find to be interesting.**

We thought you would enjoy the follow excerpt from an article that appeared in The New York Times on May 6, 2018 written by Corey Kilgannon. The article has some similarities to the story of our long-time client Norman Kissler (albeit Mr. Kissler's tale did not have such a happy ending) which we wrote about in our 2003 Q4 quarter letter (which we have reprinted and added an update to in this letter).

Even by the dizzying standards of New York City philanthropy, a recent \$6.24 million donation to the Henry Street Settlement on the Lower East Side was a whopper — the largest single gift from an individual to the social service group in its 125-year history.

It was not donated by some billionaire benefactor, but by a frugal legal secretary from Brooklyn who toiled for the same law firm for 67 years until she retired at age 96 and died not long afterward in 2016.

Her name was Sylvia Bloom and even her closest friends and relatives had no idea she had amassed a fortune over the decades. She did this by shrewdly observing the investments made by the lawyers she served.

“She was a secretary in an era when they ran their boss's lives, including their personal investments,” recalled her niece Jane Lockshin. “So when the boss would buy a stock, she would make the purchase for him, and then buy the same stock for herself, but in a smaller amount because she was on a secretary's salary.”

Since Ms. Bloom never talked about this, even to those closest to her, the fact that she had carefully cultivated more than \$9 million among three brokerage houses and 11 banks, emerged only at the end of her life — “an oh my God moment,” said Ms. Lockshin, the executor of Ms. Bloom's estate...

Ms. Bloom, who never had children of her own, was born to eastern European immigrants and grew up in Brooklyn during the Great Depression. She attended public schools, including Hunter College, where she completed her degree at night while working days to make ends meet.

In 1947 she joined a fledgling Wall Street law firm as one of its first employees. Over her 67 years with the firm, Cleary Gottlieb Steen & Hamilton, it grew to its current size, with more than 1,200 lawyers, as well as hundreds of staff members, of which Ms. Bloom was the longest tenured, said Paul Hyams, a human resources executive for the firm who became good friends with Ms. Bloom over his 35 years working there.

Ms. Bloom's husband, Raymond Margolies, who died in 2002, was a city firefighter who retired and became a city schoolteacher with a pharmacist career on the side, relatives said.... Nearly all the money was in Ms. Bloom's name alone, Ms. Lockshin said, adding that it was “very possible” that even Mr. Margolies did not know the size of his wife's fortune. The couple lived modestly in a rent-controlled apartment, though “she could have lived on Park Avenue if she wanted to,” Mr. Hyams said...

Just before she retired, Mr. Hyams said he saw the 96-year-old Ms. Bloom trudging out of the subway and headed to work in the middle of a fierce snowstorm. “I said, ‘What are you doing here?’ and she said, ‘Why, where should I be?’” he recalled.

Mr. Garza [the Henry Street Settlement's executive director] called the gift “the epitome of selflessness,” and a fitting gesture by a woman to the settlement, which was founded in 1893 by the public health pioneer Lillian Wald. The Henry Street Settlement now serves more than 60,000 people and provides an array of services in addition to its education support, including health care programs and transitional housing.

## **The saga of Norman Kissler – The Importance of Telling a Number of People Where Your Original Will is Kept**

- We began managing money for Norman Kissler more than two decades ago. Mr. Kissler died on September 8<sup>th</sup>, 2001.
- Mr. Kissler was employed by the U.S. Postal Service, before retiring in the late 1990s. Although Mr. Kissler never made a great amount of money during his lifetime, he had the good fortune of inheriting a few hundred thousand dollars more than twenty years ago.
- Norman lived a very frugal life, he had no wife, yes there were a couple of relatives, but he was estranged from them. He was a real character, as eccentric as they come.
- He lived in a modest apartment in the Bronx, I am being kind. He loved to travel but would boast that he would only stay at the least expensive hotels, and always sought to obtain the most inexpensive fares possible. At his insistence, whenever we corresponded with him it had to be on a blank letterhead with no return address on the envelope. He was always fearful that a neighbor would find out that he was a man of considerable means, and that they would rob him.
- Although our records go, back to 1980, we began managing Mr. Kissler's account prior to that date. In any event, Mr. Kissler's account was worth approximately \$626,000 in 1980 and by September 30, 2001 it had grown to almost a \$6.1 million. The \$6.1 million figure is after taxes, some of Mr. Kissler's living expenses and our fees.
- When Mr. Kissler passed away, he was living at Kittay House, (a geriatric facility). It took Kittay House, and the Bronx Public Administrator's office more than a couple of weeks to find someone who knew Mr. Kissler. We were that "someone", and the only reason the public administrator was able to locate us was they happened to find a brokerage confirmation with our name on it...How sad!
- Many years ago we sent all our money management clients a copy of a book written by John Train, entitled "The Money Masters." After Mr. Kissler completed reading the book, he entered our office, unannounced, thanking us for the book, but proclaiming very proudly that after reading a book, that was given to him, he would give the book back to the party that gave it to him, who then should share it with another person. Furthermore, he professed his love for The New York Public Library, and how he enjoyed spending many hours at the main branch.
- It was precisely at that point in time, knowing that he had no close relatives or friends, I advised him that if he didn't want his money to escheat to the State, which I knew he didn't want, since he hated paying taxes, he had better have a will drafted. I also suggested that since he enjoyed The New York Public Library so much, he should seriously consider making The Library the sole beneficiary of his estate.
- He thought about it for a short period of time, asked us to recommend a lawyer to draft his will. When he heard what the lawyer's fee was going to be, he decided to use a lawyer provided for by his union.
- The will was drafted, one of the witnesses to the will was our receptionist, Alice Radzicki, and a copy of the will was left with us.
- In 1999, a second will was drafted, again by a union attorney...both wills were identical in nature, with the New York Public Library receiving all of Kisslers assets.



- Here lies the problem – nobody can find the original will. According to New York state law you need the original will, otherwise Kissler’s assets could theoretically escheat to the state. That point has become moot since two of Kisslers long lost relatives have surfaced, and have laid claim to the estate.
- The court is attempting to reach a compromise – dividing the estate 50% to the library and 50% to the heirs.
- We have taken it upon ourselves to protect Norman Kisslers wishes. We have written numerous letters to the New York State Attorney General, The Surrogate Court, The Bronx Administrator, and have appeared before surrogate Lee Holtzman, on Kissler’s behalf.
- There is no question in our mind, Norman Kissler wanted all his money to go to the New York Public Library. He communicated it to me verbally on a number of occasions, we have copies of two separate wills, each drafted on different dates, both explicitly leaving the money to the New York Public Library...It would be a huge travesty of justice if the New York Public Library doesn’t get all of Kissler’s money! Stay tuned another hearing is scheduled for January...In the meantime make sure enough people know where your original will is located...

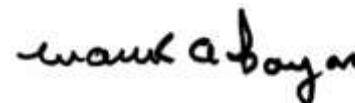
**Update since our 2003 Letter**

- The case eventually reached a resolution where the relatives that Norman detested received a significant portion of his estate.

Should you have any questions, we are always available.

Best regards,

Mark A. Boyar



Jonathan I. Boyar



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