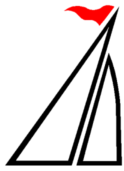
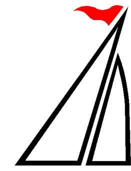

WINDWARD CAPITAL

Risk Averse Asset Management

2019 First Quarter Review

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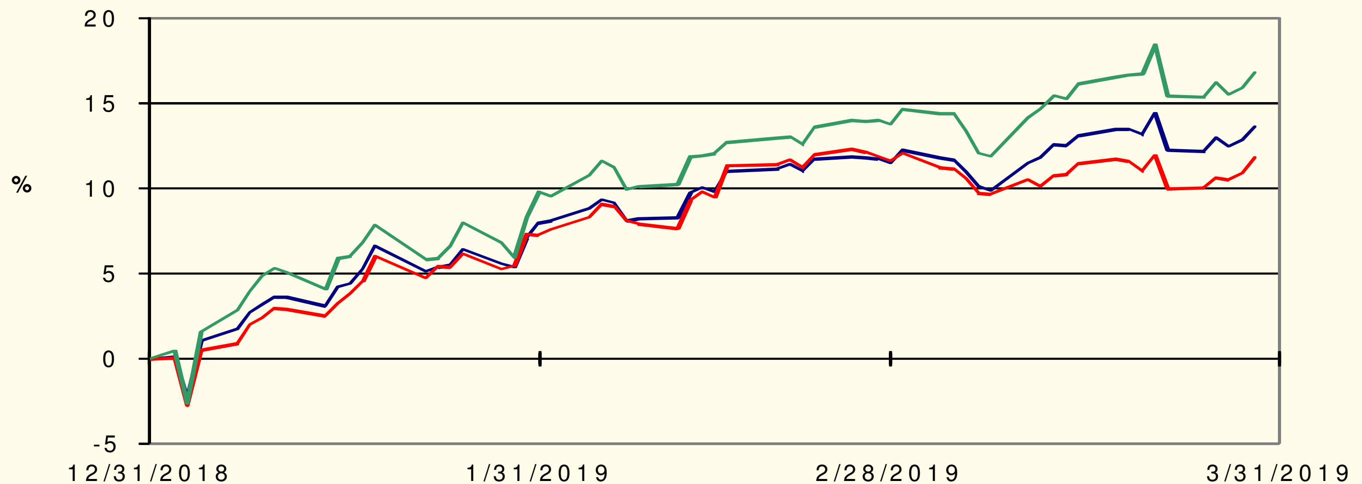

Misunderestimated

"Genius is a rising market."

—John Kenneth Galbraith (1908–2006)
Economist

The major U.S. equity market indices increased during the First Quarter of 2019, with the Standard & Poor's 500 Index (S&P 500), Dow Jones Industrial Average (DJIA), and NASDAQ Composite Index (NASDAQ) returning +13.65%, +11.81%, and +16.81%, respectively, for the period—and continued to advance into April, reversing a substantial portion of their significant Fourth Quarter 2018 declines. As a result, the major U.S. equity market indices are now flirting with the all-time highs reached in September 2018.

Although slowing, the near-term corporate revenue and earnings outlook remains positive. For the Year, 2018 year-over-year S&P 500 Revenues and Earnings growth was +8.8% and +20.0%, respectively, with 2019 year-over-year growth rate projections of +4.9% and +3.7%, respectively. Additional factors providing underlying support to the markets include: consistent but moderate economic growth, optimism regarding the positive impact from "tax reform," and liquidity effects.

As we have discussed before, based upon the (by historical standards) unprecedented degree of uncertainty associated with the Trump administration's ultimate policy agenda/directives (and their domestic and international ramifications), we believe that near-term financial market movements may continue to be unpredictable. From an economic perspective, this administration has (among other issues) advocated policies of

trade protectionism and immigration reduction, individual and corporate income tax cuts, infrastructure investment, and the deregulation of financial services, healthcare, and energy policies. In our opinion, there remains too much uncertainty and lack of details associated with the policies and directives of the Trump administration to be able to confidently make any definitive assertions regarding their long-term impact—either positive or negative—on the geopolitical and global macroeconomic outlook, much less the financial markets. Until there is further regulatory and/or legislative clarity, we can only be confident that the near-term investment environment will continue to exhibit greater uncertainty and increased volatility—a risk that may be poised to increase as the 2020 Presidential election approaches.

As investors, we remain politically agnostic in evaluating the economic and corporate impacts of public policy. That is the reason why we would prefer to analyze the actual legislative mandates and policies that are enacted and determine their corporate beneficiaries before considering major changes to the current investments in *Windward*'s portfolio strategies. As a result, in the interim, our strategies may underperform relative to the market indices over the short-term given the degree to which other market participants make ungrounded assumptions, and/or high-frequency trading and algorithmic "investment" strategies engage in daily financial market trading based upon such things as Trump's "tweets" (as an example). Regardless of the policy initiatives ultimately enacted by the Trump administration (and despite ongoing financial market volatility), we believe that we will, however, continue to be successful in making profitable long-term investments for *Windward*'s portfolio strategies.

We believe that the risk associated with financial market volatility is mitigated in *Windward* portfolios to a large degree by the fact that we are invested in "high quality," dominant, financially-strong, leading companies with best-in-class managements, high incremental returns on invested capital, and business models with sustainable competitive advantages.

As always, we continue to monitor domestic and international political and economic developments as they unfold. As a result, from our long-term perspective, ongoing equity market volatility continues to revolve around numerous global macroeconomic and geopolitical risks that we have elucidated upon in the past. As noted in our previous *Quarterly Review*s, some of these risks include:

- ✓ Central bankers' aggressive monetary policy actions since the 2008 Financial Crisis have only produced subpar global economic growth. Zero interest-rate monetary policy (ZIRP) has borrowed consumption from the future, underscoring the challenge of future economic growth and resulting in a global dearth of demand and surfeit of supply, with concomitant deflationary risks.

- ✓ No one knows the consequences of an extended period of ZIRP. (Indeed, if there were no consequences to ZIRP, interest rates could have been held at zero forever—in the past, as well as into the future.)

- ✓ Monetary policy overkill (in duration and in the level of interest rates) continues to produce adverse consequences of malinvestment and has resulted in the hoarding of cash and reduction in spending by the disadvantaged savings class.

- ✓ The "exclusive prosperity" of the "haves" (versus the "have nots") is politically unstable, leads to more uncertainty (and unexpected outcomes), and will likely have a negative and more volatile impact on social systems, the global macroeconomy, and the financial markets. As a result, global macroeconomic growth becomes uneven and less predictable.

- ✓ The world has never been more "flat" (i.e., more networked and more interconnected). As a result, country-specific actions have the potential to quickly lead to global consequences.

- ✓ The viability of the European Monetary Union (EMU) remains uncertain.

- ✓ The economies of the BRICs (Brazil, Russia, India, and China), previous drivers of global macroeconomic growth, are slowing—in some cases, quite dramatically and uncontrollably.
- ✓ An increase in U.S. interest rates will have significant negative ramifications for those developing world economies that have dramatically increased their U.S. Dollar-denominated debt over the last decade.
- ✓ High-frequency trading, algorithms, and the pervasive use of ETFs, combined with overall financial market illiquidity, is a recipe for increased volatility.
- ✓ Demographically, the aging of the populations of the developed world will have important implications for future demand growth and entitlement costs.
- ✓ Terrorism (including cyber attacks), religious radicalism, and geopolitical instability are increasing and will be more of a threat in the future than in the past.
- ✓ Global political and economic coordination is at an all-time low, and isolationism/protectionism seem likely to be a mainstay in the time ahead.
- ✓ With monetary policy no longer providing extraordinary stimulus to domestic growth, the U.S. needs intelligent, innovative, and effective tax and fiscal policies to shoulder the responsibility of catalyzing economic activity. It still remains uncertain what progress, if any, will be made on these fronts.

We closely monitor these, as well as other, risks when managing *Windward*'s portfolios of investments. Since we take a long-term view, we typically do not react to short-term financial market fluctuations driven by near-sighted market participants. However, should there be a change in the global macroeconomic indicators and/or corporate fundamentals that we monitor, we are prepared to take whatever action is necessary to protect our clients' capital.

As you know, *Windward*'s goal is to protect our clients' capital and mitigate market-related risks by investing in specific, high-quality businesses that have long-term, secular growth opportunities. Indeed, we prefer to take a proactive approach to managing risk by investing in specific companies that are taking advantage of the changes in their operating environment to create long-run opportunities for their businesses. Our long-term performance results demonstrate the success of this disciplined investment approach.

Repeal and Replace

For the last year, the Fed has been draining U.S. Dollar liquidity mercilessly, both by shrinking its balance sheet and by raising rates. As a consequence, the Broad Dollar Index has soared to an 18-year high. This squeeze has been slow torture for a world financial system that has never been more Dollarized or more sensitive to U.S. borrowing costs, especially in those emerging markets that were flooded with cheap Dollar debt during the Quantitative Easing/ZIRP years. The extra twist this time is that the Fed has had to cope with the Trump administration's late-economic cycle fiscal stimulus of tax rate cuts which, while sustaining employment and productivity levels, also comes with the associated risks of overheating.

As we mentioned in our *2018 Fourth Quarter Review*, despite an apparent recent increase in geopolitical and global macroeconomic uncertainty (including issues like Brexit), monetary policymakers still retain significant influence over the course of the financial markets. In that regard, it is notable that the U.S. Federal Reserve (Fed) has recently reversed course on tightening. In our view, this policy shift marks a critical moment in the interest rate cycle, with potentially positive implications for global asset markets and for the health of

the international economy over the next year.

At its March 20, 2019 meeting, the Fed effectively acknowledged that its final interest rate hike of 2018 was an error. In trying to fix that error, monetary policymakers have quickly shifted gears from *forestalling* inflationary pressures to *supporting* inflation and extending the economic expansion. The implication for financial market participants is to expect that the next Fed interest rate move is much more likely to be down rather than up.

As we discussed in our *2018 Fourth Quarter Review*, the December 2018 rate increase always seemed more model-driven than reality-based. At the time, the downturn in the financial markets had gone on too long and too deep to be easily ignored while the inflation numbers were not strong enough to demand the Fed's attention. Worsening market conditions coupled with a more evident slowing in economic activity forced Fed Chairman Jerome Powell and his colleagues to adopt a "patient" policy stance in January. The Fed went one step further in March by cementing that patience in its rate forecasts: eleven of the seventeen members of the Federal Open Market Committee now anticipate no rate hikes in 2019. Even more dovish were the 2020 and 2021 forecasts, which no longer anticipate that containing inflation requires restrictive monetary policy.

It is hard to understate the importance of this shift. The Fed's models have not worked this way in the past. In previous iterations of the forecasts, the expectation of unemployment remaining below its natural rate would trigger inflationary pressures. To stave off those pressures, the Fed perceived the need to raise rates *above* "neutral" to slow the economy enough to nudge unemployment upwards. Now the Fed believes it can let unemployment hold persistently *below* the natural rate without triggering inflation and without Fed policy becoming restrictive.

These forecasts reflect the Fed's growing concern that inflationary pressures remain too weak even as the U.S. economy's expansion heads into its tenth year. Powell made those concerns clear in his press conference by noting that "I don't feel that we have convincingly achieved our two percent mandate in a symmetrical way" and then later describing low inflation as a "major challenge of our time"—a risk that we had previously recognized and discussed with you many times over the last several years.

The Fed apparently has finally realized that persistent low inflation remains a problem. In the push for higher interest rates, the Fed seemed to have lost sight of the policy challenge they still face years after the end of the 2008 Financial Crisis. That challenge arises because the close proximity of rates to the zero lower bound leaves the Fed with comparatively little room to respond to a full-blown recession. Weak inflation complicates this asymmetry because it leaves real rates still high even if the Fed pushes nominal rates back to zero.

To avoid the problems of the zero lower bound for as long as possible, the Fed needs to ensure that inflation stays sufficiently high to hold expectations at its target. The policy implication is that they need to err on the *dovish* side. The December rate hike was an error on the *hawkish* side. They now realize that error and have set the stage to move in the other direction.

In practical terms, this means that a rate hike would require an actual and persistent upward spike of inflation rather than just a forecast of higher inflation as a result of inaction. In other words, the Fed now actually needs to see inflation that could become destabilizing. That is a sharply higher bar for a rate hike than we have seen so far in this rate hike cycle.

On the other hand, a Fed concerned that inflation mired below target will erode inflation expectations at a time when the zero lower bound remains a policy challenge will tend toward additional policy easing should the outlook deteriorate further. Note that, at this point, the Fed has essentially eased policy as much as possible via lowering the *expected path* of rates. The next step would be an actual rate *cut*.

We suspect that not much deterioration in the economic outlook will be needed to force the Fed's hand. The Fed currently projects U.S. Gross Domestic Product (GDP) growth this year to be +2.1%, just slightly above the longer-run estimate of +1.9%. If the growth outlook slips again, we expect the Fed may cut interest

rates as an insurance policy.

Balancing Act

As you may recall, in the aftermath of the 2008 Financial Crisis, the Fed (and other global monetary policymakers) turned to Quantitative Easing (QE), among other unconventional measures, to inject cash into the markets in order to ease financial conditions and support the economy after their primary policy tool, short-term interest rates, fell to zero (ZIRP). In general, QE is a monetary policy tool in which a central bank purchases government or other fixed income securities from the market in order to lower interest rates and increase the money supply. Global central banks, including the Fed, collectively purchased $9.1 trillion of assets between 2010 and 2017. In the Fed's case, years of bond purchases via QE caused the central bank's assets to swell from $900 billion in 2006 (6% of U.S. GDP) to $4.5 trillion by the end of 2014 (25% of U.S. GDP), providing significant financial accommodation to the economy.

In October 2017, the Fed decided that the U.S. economy was finally healthy enough to start shrinking its $4.5 trillion balance sheet by reducing its holdings of U.S. Treasury securities and mortgage-backed securities (MBS). This normalization process—so-called "Quantitative Tightening" (QT)—accelerated progressively to $50 billion per month in the Fourth Quarter of 2018 and was viewed by Chairman Powell as being on "auto-pilot." As a result, as of the end of the First Quarter of 2019, the Fed's balance sheet had been reduced to $3.9 trillion (20% of U.S. GDP). Although the Fed expected that shrinking its balance sheet assets by as much as $50 billion per month would be as boring as "watching paint dry," there is some indication that these actions, combined with their raising of short-term interest rates during that period, may have had unintended negative economic consequences and contributed to increased volatility in the financial markets.

Rather than relying on the balance sheet to impact economic activity, the Fed continues to view changes in the target range for the Federal Funds (short-term) interest rate as its primary means of adjusting the stance of monetary policy. Consistent with its recent shift toward more "patient" monetary policy, then, the Fed has somewhat clarified its plans for the balance sheet. Specifically, the Fed stated in March that it intends to gradually stop shrinking its balance sheet and that it:

- ✓ Will maintain a balance sheet big enough to satisfy banks' demand for reserves, with a buffer above that so that the Fed will not have to intervene in the money markets on a daily basis;
- ✓ Expects banks to demand more reserves than previously thought, so its balance sheet will likely be larger than before the Financial Crisis; and
- ✓ Could use its balance sheet more actively as a monetary policy tool, but only if interest-rate adjustments—its primary tool—were to prove inadequate.

We interpret this decision to eventually end balance-sheet reduction as consistent with the Fed's recent more-accommodative interest rate policy.

It is important to recognize, however, that, by definition, the Fed has never known, and currently does not know, the exact size of the balance sheet that is consistent with effective control over short-term rates because its impact is not fully realized until after-the-fact and because there are many other economic variables involved. In addition, the composition of the balance sheet is important: not only does it matter how much the Fed holds in U.S. Treasury and MBS, but also—for Treasury securities—whether they are predominately short-term Bills (maturities less than one year), medium-term Notes (maturities between one and 10 years), or long-term Bonds (maturities greater than 10 years).

On this issue, the Fed faces several upcoming decisions. First, once the balance sheet gets to the desired (as yet undetermined) size, what will the Fed do with its still-large holdings of MBS (currently representing approximately 40% of the balance sheet, compared to virtu-

ally none before the Financial Crisis)? Will it just let them run off passively, or more actively sell them off? (Under a passive approach, it would take several decades for the holdings to disappear.) Second, with regard to its holdings of U.S. Treasuries (currently 55% of the assets), what should the composition be? Before the crisis, the Fed held U.S. Treasury securities *across* the maturity spectrum, with a bias toward short-term Bills. Currently, 17.5%, 53.8%, and 28.7% of the Fed's Treasury securities are held in Bills, Notes, and Bonds, respectively. Given the Fed's recent dovish monetary policy shift, we believe that there is more reason to adjust the holdings back toward short-term U.S. Treasury Bills. Holding mostly Bills would reduce exposure to interest rate risk and increase the firepower available to fight future economic downturns. Should QE be needed again, the Fed would have greater scope to extend the maturities of its holdings, not just increase the size of its balance sheet.

Ultimately, we believe that the Fed will continue to focus on short-term interest rates as its primary monetary policy tool and, as long as the economy is strong enough to hold interest rates above the zero lower bound, attempt to de-emphasize management of the balance sheet as largely technical in nature. However, in the unlikely event of a significant economic downturn, it is important to note that the Fed still retains additional policy ammunition via its balance sheet.

Stop Making Sense

After growing at annualized rates of +2.2%, +4.2%, and +3.4% in the First, Second, and Third Quarters of 2018, respectively, U.S. Real GDP grew at a +2.2% annualized rate during the Fourth Quarter. Based upon recent economic data, we believe that this economic slowdown has continued into 2019.

Although every recession begins with a softening of the data, so, too, does every "weak patch" in an overall economic expansion. Indeed, this expansion has already experienced three Quarters of negative growth: in the First and Third Quarters of 2011, and in the First Quarter of 2014. In addition, it is also important to note that, compared to the past, the U.S. economy has shifted toward having a higher degree of short-term variability around a lower long-term trend rate. The combination of more variability around lower trend growth means that there is a higher probability of experiencing negative growth readings outside of recessions. In other words, a negative GDP report would no longer fall outside the normal range of Quarterly growth, whereas that was not the case for the roughly two-decade period prior to the 2007-2009 Great Recession.

Historically, recessions typically occur when the Fed overtightens monetary policy or fails to ease quickly when the economy faces a negative shock. As discussed earlier, it is important to recognize that the Fed has already effectively eased policy by pausing interest rate increases and through balance sheet shrinkage. In other words, they have already delivered an accommodative response. Even more importantly, they delivered this response *before* the economic data had deteriorated substantially. Compared to past cycles, this is a fairly early move on the part of the Fed. Although the Fed did not actually *cut* interest rates, it did the next best thing by shifting into "patient" mode and lowering the *expected future path* of short-term rates. As a result, the Fed's actions already appear to have disrupted the pessimism that was building in the financial markets and the overall economy.

We would also note that the Fed stands ready to cut rates if needed, although policy makers do not currently see this as the most likely path. The lack of any evident inflation concerns means that the bar to a rate cut is fairly low. Should the economic outlook deteriorate, we believe that the Fed will act. Finally, recall that this is not the first time that the Fed has suddenly shifted to a dovish stance. As we have discussed in the past, the Fed did something fairly similar in early 2016 by pulling back expectations for four rate hikes that year and, in the process, short-circuiting the slowdown at the time and rendering recession calls null and void.

Although every weak economic data point will need to be carefully analyzed for signs of a possible recession, it is also important to assess the *totality* of the data.

This is a much more difficult task. Consequently, the anticipated economic slowdown in the months ahead will make for some interesting analysis as it will be easy for pundits to see a recession in every soft indicator. Although we expect to see an increase in soft data as the economy slows, it is important to remember that, historically, "growth" remains the norm, "recession" is the rarity, and "deep recessions"—like that experienced coincident with the 2008 Financial Crisis—are generational in nature.

Deal or No-Deal

Over in Europe, evidence is mounting of a deepening economic malaise due to the slowdown in China, East Asia, and Turkey, combined with uncertainty related to both the U.K. Withdrawal Agreement (i.e., Brexit) and U.S. trade relations. As a result, over half of the Eurozone is either in recession or close to it.

The monetary union has again mismanaged cyclical policy at a crucial turning point, allowing a downturn in global trade to metastasize into something potentially worse. Whether or not EMU authorities fully understand the financial forces at work—and they did not in 2008 or 2011—some of them must be wondering whether the Eurozone can endure the shock of a potential "no-deal" Brexit in these circumstances—at least of the kind that entails a rupture in trade flows.

The Brexit showdown comes at a hazardous moment for Europe:

- ✓ Germany barely escaped a technical recession in late 2018. It is now in a soft slump—a casualty of China's slowdown and the Asian credit crunch.
- ✓ French industrial output is contracting, and business confidence has declined significantly. Fading growth and the *gilets jaunes* movement have between them derailed the Emmanuel Macron Presidency. Little remains of his reform drive—and even less of Macron's grand bargain with Germany to fortify the Eurozone both politically and economically.
- ✓ Italy is in full recession—again. Italy's lingering malaise plays havoc with the country's debt trajectory, whereby a seemingly stable ratio of 131% of Debt-to-GDP can spiral up towards very quickly to 140+% once the "denominator effect" kicks in. Rome must refinance debt worth 17% of GDP this year without the shield of QE by the European Central Bank (ECB)—that is to say, without a marginal buyer or lender-of-last resort standing behind the Italian debt market.

What is extraordinary is that the ECB persisted last year with its pre-announced plan of bond tapering even though real non-financial M1 money supply for the whole Eurozone had dropped to recession levels. (Money supply movements are important indicators because they are usually harbingers of economic growth/contraction, with the data usually leading the real economy by six-to-nine months.) It then continued to dial down stimulus as the economy buckled. Bond purchases have dropped from a peak of €80 billion per month to zero. In effect, this equates to a string of rate increases. As a result, the ECB has been tightening pro-cyclically into a slowdown, repeating the policy errors of 2008 and 2011.

Although ECB President Mario Draghi must know that this is a mistake, his hands are tied: Germany is no longer willing to tolerate QE, deeming it a backdoor transfer to the Southern European "Club Med" countries. The result is to entrench deflationary forces and undermine the debt solvency of weaker EMU states. The EU Stability and Growth Pact and the European Fiscal Compact, married to the "rules culture" of the European Commission, inhibit any form of countercyclical fiscal stimulus. (Even if it came, it would still be too little, too late, in our opinion.) Beyond punishment and surveillance, there is still no banking union—leaving the sovereign/bank doom-loop of 2012 intact. Nor is there any fiscal union or sharing of debt liabilities. As we have discussed in the past, EMU remains a fair weather construct built upon unwork-

able foundations. In the meantime, the EU is chronically unable to generate its own internal, organic demand growth, and has instead relied upon world trade for economic support.
The net result is that the Eurozone currently faces the non-negligible risk of its third recession since the 2008 Financial Crisis. It should be clear in Brussels, Paris, Berlin, and Rome that the Eurozone cannot withstand another episode along the lines of 2011-2012. Southern Europe is already a populist powder keg; Latin societies will not tolerate another round of austerity cuts. Nor is there any appetite for fresh bailouts in Germany where the anti-Euro AfD party chairs the Bundestag's Budget Committee.

This greatly raises the stakes in the event of a "no-deal" Brexit. At the moment, U.K. political dysfunction continues as Parliament is deadlocked, British Prime Minister Theresa May's party is divided, and her Cabinet is mutinous. May has recently proposed a delay of Brexit until June 30. European Council President Donald Tusk, on the other hand, has rejected this proposal and has agreed to and offered an extension until October 31—which could end early if British lawmakers sign on to the EU's current terms of departure or if EU leaders believe that London has shown bad faith. (Also thrown into this mix are the political implications of the U.K.'s participation in the May 23-26 European Parliament elections.) Whether or not additional time ultimately resolves any outstanding fundamental issues, results in a re-negotiation, and/or alleviates the risk of a "no-deal" Brexit, remains to be seen.

Will Eurozone authorities risk an economic shock precipitated by a "no-deal" Brexit that results in a potentially significant contraction of GDP through multiple channels of contagion and through cascading effects on trade, supply chains, capital flows, and confidence—at a time when much of the Eurozone remains economically vulnerable? Will the U.K. Parliament throw the entire process into disarray by calling for a general election, ousting Prime Minister May, and/or initiating a second Brexit referendum?

At this point, no one knows.

Let It Ride

Despite ongoing uncertainty (and resultant volatility), the U.S. equity markets have exhibited significant strength since 2009. To us, the greatest risk of future equity market declines continues to revolve around the numerous global macroeconomic and geopolitical risks that we have elucidated upon in our introduction and that we have discussed over the years since the onset of the 2008 Financial Crisis.

However, despite these current challenges, the U.S. economy continues to grow, and we do not foresee a recession in the near term. To us, that means that the long-term upward bias in stock prices should continue. In addition, recent dovish comments by the Fed, additional Chinese economic stimulus, as well as the potential for a U.S.-China trade resolution, could spark significant buying interest. We believe, therefore, that potential market volatility can create an exceptional opportunity to take advantage of the misunderstandings of myopic market participants and purchase high-quality businesses that meet our investment criteria.

Our investment process utilizes a combined top-down/bottom-up approach whereby, based upon our analysis of the components of global macroeconomic GDP, we identify a variety of investment themes, both secular and cyclical, that drive further fundamental analyses of individual businesses that meet our investment criteria. Currently, some of our investment themes include:

- ✓ *Rise of The Rest*
  Globalization and the development of the middle class in emerging markets is a long-term secular trend.

- ✓ *Disruptive Innovation*
  Companies that are disruptive innovators are well positioned to outperform their peers in the current economic environment.

- ✓ *Regulation*
  Financial Services regulation, Healthcare reform, and Climate Change policy are all cur-

rently areas of government focus, and the economic sectors within these areas may, therefore, be subject to challenges or opportunities based upon how successful the government is in implementing its programs.

- ✓ *Continued De-leveraging*
  De-leveraging and the shrinking of private and public balance sheets will be a multi-year process that will restrain global macroeconomic growth.

- ✓ *The Great Unwind*
  The eventual "normalization" of monetary policy may result in unforeseen and unintended consequences.

- ✓ *China Rebalancing*
  The rebalancing of China's economy from investment- to consumer-driven has significant global macroeconomic ramifications.

- ✓ *Supply and Demand*
  Global macroeconomic growth remains anemic due to a surfeit of supply and a dearth of demand.

- ✓ *Demographics*
  Demographically, the aging of the populations of the developed, and some developing, economies will have important implications for future demand growth and entitlement costs.

As you know, we do not predict, nor does your *Windward* portfolio own, "the market." Instead, we seek to mitigate market risk and generate excess returns by making long-term investments in individual businesses with the following underlying fundamental characteristics:

- ✓ *Quality*
  Dominant, financially strong, leading companies with best-in-class managements, high incremental returns on invested capital, and business models with sustainable competitive advantages

- ✓ *Growth*
  Companies with predictable and sustainable above-average growth in revenue, earnings, and free cash flow

- ✓ *Value*
  Companies that are undervalued on either an absolute or relative basis, based upon our projections of future cash flow and earnings

Windward's portfolios of individual businesses, with their own company-specific fundamental dynamics, are continuing to thrive and prosper. In the short term, this fact may be obscured by "market action"—which results in highly-correlated security price movements during periods of increased volatility—and/or the negative influences of ETFs, asset allocators, and algorithmic traders—whose focus is on baskets of securities or on stock symbols, not on underlying business model fundamentals. However, financial history has proven, time and again, that, over the long term, investors are ultimately rewarded by being owners of these types of companies.

We have been investing this way for decades, and have successfully navigated a variety of historic market environments.

We believe that the "indices" will become less relevant as time goes on and that successful wealth creation and capital preservation in the years to come will become increasingly dependent upon the identification and ownership of those businesses that, although possibly impacted by exogenous events in the short run, remain relatively immune to these global macroeconomic issues over the long run due to their own underlying growth dynamics.

We remain exceedingly optimistic on the prospects for the individual companies that we own in *Windward* portfolios and encourage you to contact us should you have any questions or concerns.

Sources:
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U.S. Bureau of Labor Statistics
U.S. Department of the Treasury
U.S. Federal Reserve

HAS YOUR FINANCIAL CONDITION CHANGED?

Portfolio decisions are based on an individual's income requirements, tax bracket, time to retirement, risk tolerance, and other characteristics. If your financial condition has changed, or is about to change, please call us. We strive to prepare a portfolio that meets each investor's objectives, and the more information we have, the better the job we can do. If you have any questions regarding your portfolio, your asset allocation, or any investment within your portfolio, please let us know.

THE FUTURE IS NOW

As you may know, we post a weekly commentary on our website every Friday afternoon. We only mail some of these comments out when markets are particularly unsettled. Please be aware that these notes will continue to be available on-line, and we want to encourage you to sign up to receive a password for access to our secure web-site.

Our website provides the capability for clients to review their portfolios, their year-to-date realized capital gains, and income and expenses. Clients also have access to our weekend market comments. These reports are updated after 8:00pm each Friday, and are available to clients who have requested access. Clients may also request that their accountants and/or attorneys have access to the same information. We hope you will visit us at www.windwardcapital.com.

If you have interest in these capabilities, or if you would like to receive a copy of our Form ADV Part II free of charge, please email Steve Pene at: spene@windwardcapital.com, or call Mr. Pene at our main number: (310) 893-3000.

NOTES

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