

Encouraging Earnings Helps August Returns

Earnings season and the accompanying second quarter reports are now largely completed. The results were a pleasant surprise as expectations for this year's second quarter were low given the timing of Covid-19 shutdowns. We were pleased, even relieved, with the updates and outlook comments as the level of uncertainty remains high. Stock prices reacted generally quite well to the results and there is some evidence that investors are rotating towards more attractively priced sectors. Since earnings and cash flows are more important in building long-term intrinsic values, we believe we will be further rewarded if the recovery continues.

Fixed-income investments have also had a nice stretch. Many securities have dramatically recovered off previous lows and recent earnings support the case for continuing receipt of interest with increasing probabilities of full payment upon maturity. This is very encouraging for our income-related accounts. Even with the improving outlook for these securities, most other bond prices, particularly longer-term issues, continue to trade at high prices. We have added a few new names to our Short/Intermediate category and expect to remain focused on shorter-term maturities, floating-rate features, higher-yield opportunities, and/or special situations. As we have mentioned before, we prefer to limit our interest-rate risk at this time - particularly avoiding larger allocations in expensive higher-quality, longer-term issues. Within the last couple of days, we saw the benefit of this stance as the Federal Reserve has shifted to allow a little more room for inflation.

Our strategy of moving away from areas most impacted by the virus and shutdowns and into sustainable areas like grocery, food, wireless, broadband/fiber, ecommerce (we'll have a lot more to say about our direct and indirect investments in ecommerce in future updates), packaging, shipping/transportation, pharmaceuticals, and diversified/international companies has reduced the pandemic risks to our portfolios. Most of these companies reported very satisfactory earnings and expressed (guarded) optimism about the future. Even if we get a vaccine sooner than expected, we feel these companies are well positioned and relatively well priced. Some current changes to daily habits will stay with us for the foreseeable future and many of our companies are well positioned to benefit.

The prospects for emerging from this environment are improving as the medical community is doing unprecedented work developing vaccines and treatments. Of course, do not get overly optimistic because there is plenty of evidence that the virus will prove difficult to overcome. However, it seems unlikely we will go through another wave of widespread shutdowns, treatments appear to be improving outcomes, and there are emerging signs that the worst is behind us-at least as it relates to the disease.

Before we finish this market update, we need to note that other investors are willing to pay exorbitant prices for some securities. We are not. We believe strongly that our value-based approach is the correct, logical, and rational approach in the long-run - even if it

lags in some market cycles (despite some misconceptions otherwise, this does mean we will buy reasonably-priced growth/technology securities - something we've owned a fair amount of in past cycles). However, we have seen this kind of market before where investors bid prices of some securities to sky-high levels. It has not ended well for those investors who lost their patience and/or discipline. If you remain inclined to bid up prices further, read "Investors Have Been Making the Same Mistake for 300 Years, If Isaac Newton could lose all reason in the pursuit of riches, so can anyone else." in this month's *The Atlantic* (by Thomas Levenson, Professor of science writing at MIT). Professor Levenson makes a strong case for not "losing your mind" and staying rational - despite pressures that are hard for even extremely intelligent people to resist. While the future will prove out, we believe our value-based thesis will be validated.

***As always, it is a pleasure and a privilege to service your portfolio needs,
and we thank you for your trust and business.***



**Private Management Group, Inc.
15635 Alton Parkway, Suite 400
Irvine, CA 92618**

**Tel: (949) 752-7500 | Fax: (949) 752-2299
PMG@pmgadvisory.com | [Web](#)**

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