Fortunato Asset Management (FAM)
Q2 2015 Newsletter

On the Horizon

The Greek crisis and coming Federal Reserve rate hike continue to be the major worries of the day in the market. The outcome of either should have little impact on growth and the market's medium and long term prospects. The U.S. Market is fully priced in my opinion and may be looking for a reason to correct, but there remains out of favor industries and shares of good companies selling for compelling values. We spend our time researching these companies and their prospects from a fundamental bottom up standpoint. From there we gain insight as to which industries are out of favor, and which companies are undervalued within the sector.

Europe remains the beneficiary of easy money policy and sells for more reasonable valuations from a Market Cap to GDP standpoint. There may soon be opportunities to buy German shares as they are a major beneficiary of a lower Euro due to their export emphasis. The Greek crisis has brought valuations down to reasonable levels, while prospects remain attractive.

We continue to like financial shares in the U.S. as the most undervalued sector. Regulation is a thorn, but banks and insurance companies are making more money and trading at low fundamental valuations. Certain technology shares in the U.S. remain very good values as well.

One sector that has recently become more interesting is the luxury goods and apparel industry. The strong dollar has hurt year over year earnings comparisons in the space, but the companies are healthy and the shares have over-corrected to the down side in many cases. I highlight one of these companies below. A third industry with good prospects at low valuations is the commercial engineering and construction sector.

Despite the airline industry's cyclical nature, I like several companies in the space. Market fears about capacity expansion keep airline shares at very depressed valuation levels compared to the overall market, while profits are healthy.

The Best Part – Equities We Like

Every quarter I highlight a company or two which we like with a few notes on the reason.

Michael Kors (symbol: KORS)
Uncertainty has gone haywire on this global luxury brand over the past year. Momentum and fast growth investors have been selling with fervor, the company missed its Q1 consensus earnings expectations, and a few analysts have downgraded and gone negative on the stock. Uncertainty can be

our friend in a low risk situation, and that's what I believe we have in Michael Kors – a stock that has become undervalued, unpopular, and less risky as it has declined in price from $100 to $41. The company recently missed the consensus earnings estimate in Q1. This was primarily due to lower tourism sales in the U.S. as a result of the stronger dollar. The Apple watch could be having some impact on the watch business as well and represents 8% of total sales.

On the positive side of the spectrum, the company is still in growth mode. Sales in Q1/15 increased by 23% in constant currency and 17% in absolute terms over Q1/14. The company's plan is building out 50 new locations in North America, 50 in Europe, and 10 in Japan for 2015. And management projects double digit revenue and earnings growth going forward. The company trades for 10X past years earnings and around 9X times this years – though I believe they will do better than expected due to the full year presence of their new North American online business, along with the build out of digital sales channels in Europe and Japan. The Board of Directors has approved a $1B buyback of the stock or 11.6% of shares outstanding at today's price. Insider employees made significant options purchases in the middle of June at $47. The purchasers include 3 SVPs, the CEO, CFO, and honorary chairman Michael Kors. The company has no debt. There is nearly $1B in cash on the balance sheet. Deducting the cash gives us 9.2X trailing earnings. The company is funding all their growth through cash flow. The management team looks strong to me. And it's got a third less calories than your regular beer and it's less filling (ah, excuse me, wrong Coors).

News About the Fund Strategies

There will be times when the companies share prices that we purchase will continue to decline after we make our initial purchases and as a result, our performance over periods of six months to two years may lag the market. During these times we burrow down, grab the roots of the quality undervalued enterprises that we are purchasing, and buy more if possible. One such recent example is Chicago Bridge and Iron. The companies stock fell from the $80 range to under $40. We started buying at around ~$65 which was $5 less than Berkshire Hathaway's most recent purchase at ~$70. CBI continued to execute well on their strategy and performance was sound, but many extraneous factors caused the stock to drop. One was short seller allegations about wrong reporting from the Shaw acquisition. Another was (and is) the market's misconception about the impact of lower oil prices on the companies prospects and current backlog. As the stock declined into the $50s we purchased more, as it dipped below $40 we bought more. After the most recent earnings call the shares rebounded to $55 before sliding back to today's $50.

Fees and Costs

The three fund strategies have a low expense structure and I consider it a competitive advantage. FAM pays all its own operational costs including audit, legal, accounting, administration, tax and filing fees. None are passed on to investors. There are two components to beating the market indices. The first is to have low frictional costs (ie low fees and costs). And the second is to generate superior returns. Low frictional costs will assist in superior long term performance.

Alignment with Investors

I have a substantial percentage of personal assets in the three Fortunato Asset Management strategies.

Fortunato 2 charges no management fee to qualified clients, only performance fees – which are 20% of returns over 4% annualized (subject to high-water marks). I am bullish on the long-term future of Fortunato and plan on managing fund strategies as long as I am able. Our interests are completely aligned.

Final Thoughts

Thank you for investing with Fortunato. It's a pleasure to serve you. If you should need a confidential financial evaluation or consultation, please remember that this service is included once per year with your Fortunato investment. While financial planning is not my expertise as an investment adviser, I can help you evaluate the performance of current investments, recommend allocation options, and consult on a variety of other investment related topics.