Fortunato Asset Management
Q4 2017 Newsletter

Thoughts About the Market

In an amazing feat of positive sentiment, 2017 was first year on record for the S&P 500 index to post a positive return in every month of the year. The index ended the year with an 18.7% gain. The recent joke on Wall St. is that if you rolled out of bed in the morning, you made money in 2017. This is a reference to the wide breadth of the market rally in nearly every sector, asset class, and geography.

Of significant note was the Federal Reserve raising the Fed funds rate 3 times to end the year at the range of 1.25% to 1.5%. 3 more hikes are expected by the Fed in 2018. Easy monetary policy has been the most important factor in this stock market bull, so normalizing policy brings us closer to the end of the cycle. Officials in China were reportedly bothered by the U.S. tax bill passing, particularly the lowering of the corporate tax rate to 21%. Apparently Chinese officials feel the U.S. is now too competitive, the playing field being leveled. As a result they are also raising rates to prevent capital flight. Rates will be important to watch going forward.

As you have probably read before in our newsletter, the overall market by most measures is at pricey levels, justified only by low interest rates. But high valuations are in and of themselves not good predictors of market downturns. During times like this our strategy is to hold appropriate levels of cash or cash-like investments. I believe it is essential to have this “dry powder” at the ready to enable us to take advantage of downturns, corrections, and more reasonable prices when they inevitably occur. And in some sense, holding cash is a passive byproduct of the inability to find enough value in the securities we research. We will be in a great position to invest at great prices down the road. This is when some of the biggest returns from stock investing occur.

Where is the Puck moving in 2018?

A tick up in inflation seems a good bet to me in 2018. The U.S. unemployment rate is down to 4.1%, which means if you want a job, you can pretty much get one. The naysayers point to increased productivity to keep salary increases tampered, but I think it's highly likely we will see wage gains this year. Oil and copper prices have been ticking up recently. Housing prices have also been strong.

As a result, we have been focused on finding attractive priced stocks in the energy and materials sectors, which typically do well in the late stage of the business cycle and under inflationary conditions. Emerging markets may also continue to do well for a while.

Bitcoin and Cryptocurrencies

To maintain fashionable status, everyone must put in a word about Bitcoin these days (me included). Bitcoin's meteoric 1,700% rise or thereabouts in 2017 seems indicative to me of dangerous market conditions. And I believe, in the end, there will be lots of irony in Bitcoins undoing as a technological marvel that is brought down by the limits of its own technology (high energy costs to mine/validate, and slow transaction times). The other dominoes should fall with it.

The Best Part – A Stock We Like

Cleveland Cliffs (NYSE:CLF)

In March of 2015 I wrote an article for Seeking Alpha about U.S. iron ore producer Cliffs that pointed out why the company would survive. Due to poor expansion and timing decisions from prior management, the company's debt burden came close to caving the company. Enter the current CEO, Laurenco Gonclaves, installed in 2014. Gonclaves, a veteran of the business for more than 35 years, has done a fantastic job of jettisoning the poisonous tentacles attached by the previous management. If you want to hear an entertaining earnings call, chime in sometime to Mr. Gonclaves. The company has an enviable position as the top U.S. iron ore pellet supplier.

We started purchasing this stock again a few months ago on the belief that there were multiple things that could go right. The Trump administration has not done much to help U.S. Steel producers. But China, with a new priority to clean up pollution, has cut dirty coal and steel operations in many areas. This benefits Cliffs because cheap Chinese steel is a major hindrance to U.S. steel producers who buy iron ore from Cliffs. Cliffs is a materials sector stock trading at cheap valuations. On the first trading day of 2018, the stock jumped 12%, but we believe there is lots of room to run.

https://seekingalpha.com/article/3023626-cliffs-natural-resources-golden-shield-and-gonclaves-will-prevail

Investor Highlight – Stanley Drukenmiller

Chances are you may never have heard of the low-key and spotlight shy Stanley Drukenmiller, but he amassed the best investment record I have run across in the history of Wall St. Over a 30 year period (1980-2010) as founder and captain of hedge fund Duquesne Capital Management, his firm returns over a 30 year period are purported to be as high as 28% to 30% per year annualized. His investment strategies relied upon a unique combination of macro as well as fundamental, technical, and currency trading skills. He managed much of Duquesne alongside other money management positions such as one with George Soros managing the Quantum Fund.

Soros had a significant impact on Drukenmiller's psychological investing state. One of the lessons Drukenmiller learned from Soros was something along the lines of, “When you're sure you're right, no trade is too big.” And, “the bigger your gains in a year, the more aggressive you can be.”

Druckenmiller was born and raised in Pittsburgh and studied English and economics at Bowdoin College in Brunswick, Maine, where he received his bachelor's degree. He sometimes earned money by playing poker and by running a hot dog stand with fellow student Larry Lindsey, who later became a Federal Reserve governor. He dropped out of a PHD program to pursue his first job as an oil analyst for Pittsburgh National Bank.

Like the Fortunato investment strategies, Druckenmiller was/is not a fan of the philosophy that a portfolio needs to be widely diversified. Here are a couple of his comments on the matter; “And if you look at all the great investors that are as different as Warren Buffett, Carl Icahn, Ken Langone, they tend to be very, very concentrated bets. They see something, they bet on it, and they bet the ranch on it.”

And further on the topic, “And that's kind of the way my philosophy evolved, which was if you see-only maybe one or two times a year do you see something that really, really excites you....The mistake I'd say 98% of money managers and individuals make is they feel like they have to be playing in a bunch of stuff.” We concur.

Today, Druckenmiller is a philanthropist but still actively trades his own family office fund as investing is still his favorite hobby and profession.

Our Strategies, Performance, Fees, Costs and Alignment

We manage separate accounts for clients with three fund strategies. Our minimum investment is $250K. We have a low expense structure, with Fortunato paying all its own operational costs including audit, legal, accounting, administration, tax and filing fees. None are passed on to investors.

In 2017 we accomplished very solid returns with the average stock holding increasing over 30% for the year while maintaining large amounts of cash in our accounts in Fortunato 1 and 2.

Below is a recap of each strategy, fee structure, and performance for Qualified Clients:
Fortunato 1 Growth and Value Strategy. Invests in a combination of reasonably priced growth stocks and value stocks. No Management Fee, Performance Fee is 25% over a 6% per annum return. On the first 6% return, no fee. Goal is a 14.5% average annual return over time. This is our primary strategy for outside clients and our main focus.

Fortunato 2 Concentrated Value Strategy. Invests in a 5 to 10 value and deep value stocks (concentrated positions). No Management Fee, Performance Fee is 20% over a 4% per annum return. On the first 4% return, no fee. Goal is a 15% average annual return over time.

Fortunato 3 Dividend and Income Strategy. Invests in a conservative assortment of bond funds, limited dividend paying stocks, and preferred stocks. The fee is .55% of assets under management. Goal is a 6% average annual return.

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 for Fortunato clients.

My family maintains a substantial portion of our savings in the three Fortunato strategies; aligning my interests perfectly with investors. I am bullish on the long-term future of Fortunato and plan on managing fund strategies as long as I am able.

Final Thoughts

Many thanks to Brittany Rowland and Brian Jones for their valuable ongoing contributions to research and technology.

Thank you for investing with Fortunato. It's a pleasure to serve you. No matter what the future holds, there will be excellent opportunities to invest in great companies.