

*Marble Harbor Investment Counsel, LLC
Excerpt from
First Quarter, 2019 Letter*

We are pleased to send an excerpt from our first quarter client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

Paul Davis, L.J. Harrington, Eric Robb and Daniel Rosenblatt

Dear Client:



With the winter's end upon us, we hear the ski bums amongst us swooning about the miles of perfectly groomed trails they enjoyed this past season. We also hear tales of far more gnarly terrain, chock full of unexpected ice and rocks, inconveniently located trees and daunting mogul fields. They're as enthusiastic about the flawless conditions as they are about the challenging ones. Why? Because several of them went straight from diapers to snowsuits. Their experience and conditioning allows them to read the mountain and react nimbly to just about anything it throws their way.

Far too many on the mountain aren't so well prepared. They think they're the next Michaela Shiffrin as they fly down the pristine, powder-packed blues. But put them on a double black diamond, and the delusions of grandeur whiz by them as they're raced down the hill in a rescue toboggan. Ice, trees, moguls, deep powder, steep inclines and any number of other variables can make a beginner or even an intermediate panic and do the wrong thing at the wrong time, leading to an accident.

Skiing is a skill that takes years of practice, conditioning and knowledge. Accomplished skiers have put in their time on the slopes, so the sport has become second nature to them. Likewise, we've put in our time when it comes to investing. Of course, we haven't been doing it since we were toddlers, but we've been around enough to have witnessed numerous cycles. The past several years have been one long, well-groomed intermediate trail; however, volatility returned with a vengeance in the fourth quarter, with the market dropping 20% from its September peak.



Three months later, the S&P was up 13% and, at this writing, is nearly back to its all-time high. After years of skiing gentle cruisers, we're now riding the bumps.

Many retail investors skied off a cliff as soon as they hit the black diamonds. According to Morningstar, in December, U.S. mutual funds and ETFs saw outflows of \$83 billion, the greatest exodus since 2008. Those who pulled out of the market locked in the disappointing performance of the fourth quarter and then missed the stellar performance that started on December 26th. Consider the damage they did to their net worth: If their portfolios were down 20% and they had to pay embedded capital gains, their after-tax return could have been -30%! It may take several additional years of both work and investing to dig out from under that avalanche.

Contrast that scenario to your experience. Although we were cognizant of the potential pitfalls in the market, volatility did not shake our confidence in the *businesses* we own for you. You received your dividends, avoided capital gains taxes, your higher-quality companies outperformed the market and you were well-positioned to enjoy this year's strong appreciation.

Anyone can ski on the greens or the blues. When the market is going up, index investing seems easy, but most index investors don't come anywhere near the performance of the index over the long term because they haven't trained for the day when the conditions get rough, and far too often, they do the wrong thing at the wrong time. A recent study from the research firm, DALBAR, reported that volatility and bad timing led the average U.S. investor's portfolio to drop twice as much as the S&P 500 in 2018, losing 9.42% over the course of the year, versus a 4.38% retreat by the S&P.

Over the last six months, regardless of the vicissitudes in the market, the intrinsic value of the businesses you own neither dropped nor increased by 20%. It has risen modestly. Training and conditioning provide skiers with the stamina to stay on the slope and the skills to negotiate whatever terrain they encounter. We keep our eyes firmly set on the simple truth that over time as your companies grow their earnings, cash flow and dividends, value will accrue to you. Whether green, blue or black, this gradual accretion is a tried and true trail to both attain and maintain wealth.

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