



# Auxier REPORT

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## Spring 2019 Market Commentary

Favorable economic trends in the US continued in the first quarter. Consumer spending comprises over two thirds of the US economy. Services are also big, contributing over 68% of US GDP and over 83% of private employment (Moody's). Lower oil prices, declining borrowing costs, regulatory relief and increasing wages have provided a positive backdrop. Credit spreads are still very tight despite the accelerating growth in covenant-lite corporate debt and leveraged loans. The Fed made a material reversal at year-end and lower interest rates have fueled gains for both stocks and bonds. Unprecedented technological innovation is driving impressive productivity gains which has helped to keep inflation in check. If California were a country it would rank in the top five globally by GDP. The recent plethora of initial public offerings coming out of California this year is a huge positive for that state which is heavily dependent on capital gains for the majority of its tax revenues. Trade uncertainty and Brexit are contributing to weakness in Europe, Japan and China which impacts US companies exposed to those end markets. \$10 trillion in negative yielding bonds continues to hamper European banks and lending. Where socialism grows so does inflation and stagnation. Inflation in Venezuela now tops one million percent annually. Bondholders there have been crushed.

Program trading and the growth of exchange traded funds have led to some wild swings in securities as mathematical algorithms tied to momentum strategies accentuate moves—both up and down. Oil declined over 35% in the fourth quarter of 2018 only to rally over 40% in 2019. This highlights the importance of knowing the facts, fundamentals, supply/demand and underlying cash flows of what you own. In 2018 we endured two brutal corrections, one in the spring and one at year-end, marking the first time in 24 years that Treasury bills outperformed stocks. After a similar market decline in 1994 a strong rebound in equities lasted for three years. To enjoy the fruits of compounding it is so important to buy right and then stick with good businesses over long periods.

## Opportunities

Healthcare is an industry that can get hit hard on political headlines like “Medicare-for-All.” The cost of this proposal is estimated at \$28-32 trillion over a decade (Urban Institute). Since 1999 we have done well buying businesses with strong fundamentals where the headlines are gloomy. We see value in healthcare today. Uncertainty and negative sentiment mask advances in the cures for many diseases through data analytics and medtech. Looking across the investment spectrum we see excesses in venture funding and private equity. Private equity firms are forced to pay high control premiums with borrowed money. There is now over \$1.8 trillion in buying power in private equity. Bond yields today after tax and inflation don't compensate for the loss of purchasing power. The heavy mathematical-based trading in exchange traded funds is creating attractive opportunities as the liquidity buffers have diminished in recent years, leading to shocking drops and temporary misappraisals in many blue chip names. There is a big advantage in dealing with small sums of money that are not subject to a timetable or “liquidity event.” Our universe of investable ideas is large. According to Bernstein, the valuation spread between the most expensive and cheapest stocks is the widest in 70 years. Value tends to outperform when dispersion in valuations across the market is at an extreme.

## **Euphoria in Technology**

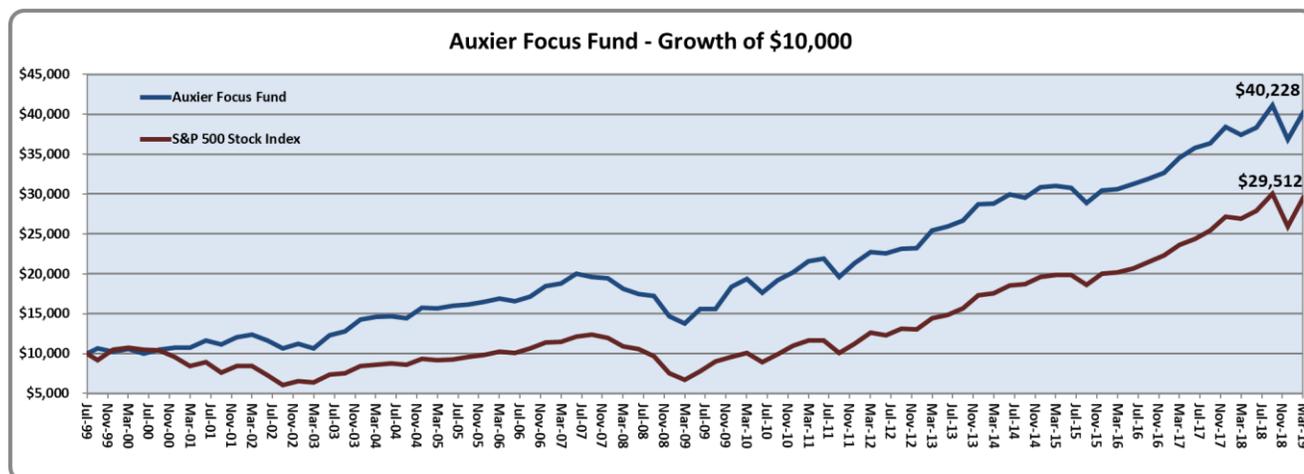
Low interest rates have contributed to a boom in US venture funding (\$137 billion in 2018) and now an avalanche in IPO supply. Just as we saw in 1999-2000, there is a growing enthusiasm surrounding money-losing business models. Many of the delivery models are dependent on freelance workers (gig economy) that tend to dry up in tight labor markets. Costs are sure to rise with unemployment levels at 50-year lows. Over \$20 billion dollars a year is being poured into streaming content with more than 500 new programs this year. Who has time to watch all these shows? Some recent IPOs are seeing valuations in excess of 50 times sales, such as the enterprise software company Zoom, a provider of video conferencing. This compares with the average S&P company that trades less than three times sales. WeWork is a shared-office real estate company that is being valued at over \$46 billion. Last year they lost \$1.9 billion on revenue of \$1.8 billion. This is starting to remind me of March 2000, as envy took hold and retirees were putting 100% of their life savings in tech stocks that were going parabolic. Many internet mutual funds were doubling over short periods only to go out of business within three years. In 2000 the Nasdaq lost 39.29% of its value dropping from 4069.31 to 2470.52. The next year it retreated 21.05%, from 2470.52 to 1950.40. In 2002, the index lost 31.53% falling from 1950.40 to 1335.51. From the March 2000 high of 5048.62 to the October 2002 low of 1139.90 the Nasdaq index lost 76.81% (Dow Jones). So much for the efficient market theory. In 2018 speculators in Bitcoin lost over 75%.

Investing is about buying productive assets that will yield increasing cash flows over time. It is about understanding the qualities of management that can create or destroy value. It is the “craft of the specific.” At this point of the tech cycle over 81% of the new companies coming to market are losing money (Dow Jones). The idea of putting your hard-earned savings on autopilot without an understanding of odds, fundamentals and a daily dedicated research effort has always baffled me. Look at the S&P passive index craze which peaked in 1999 only to see the worst ten-year period in US stock market history through 2009. The Auxier Focus Fund returned a net 78.43% vs. -9.10 % for the S&P 500 from 12/31/99 to 12/31/09.

## **Economic Trends**

Powerful investment trends include the digitization of the economy. Visa and Mastercard are enjoying the growth in the conversion from cash to plastic. Cerner is digitizing medical offices. Alphabet, Microsoft, Facebook, UnitedHealth and Amazon are examples of industry leaders that enjoy powerful networks and are utilizing artificial intelligence and data analytics to drive productivity. The advertising business is being transformed as digital ads now exceed 50%. Newspapers have been on the wrong side of the digital trend in ads as 1800 closed between 2004 and 2018 (Dow Jones). Travel fundamentals are very strong, global airfares are dropping and 80% of the world population has yet to travel on a plane. Boeing is suffering today but longer term their problems appear fixable and demand trends solid. People young and old love to travel and continue to value “experiences.” Airbnb, Booking Holdings and Marriott are some examples of companies that should continue to benefit. The legalization of hemp is a potential disrupter in healthcare, cosmetics, food, plastics and building materials to name a few. In 1619, Jamestown colony law declared that all settlers were required to grow Indian hemp. George Washington and Thomas Jefferson were big hemp farmers. We see a huge market for hemp CBD oil in pain relief and the fight against inflammation. Oregon is a leader in hemp research.

## First Quarter 2019 Performance Update



Auxier Focus Fund’s Investor Class returned 9.16% in the first quarter vs. 13.65% for the S&P 500 Index and 11.81% for the DJIA. Stocks in the Fund comprised 92% and gained 11%. The equity breakdown was 79% domestic and 13% foreign. A hypothetical \$10,000 investment in the Fund since inception in July 1999 to March 31, 2019 is now worth \$40,228 vs. \$29,512 for the S&P 500. This was achieved with an average exposure to the market of less than 79% over the entire period. After the steep 13.52% decline in the fourth quarter of 2018, The S&P 500 rebounded dramatically as the Fed reversed policy pausing interest rate hikes. The fears of a sharp earnings recession have also abated with revenues growing over 5% in the first quarter.

### Contributors to the quarter: Our outlook on a cross section of portfolio positions with a positive return for the quarter ended 3/31/2019.

#### Mastercard Inc. (MA)

While the banks in general have languished, Visa and Mastercard have continued to show strong operating results and enjoy powerful networks in the face of an increasingly competitive payment space. The Fund has now gained over ten times the original investment in Mastercard and nine-fold in Visa. This shows the value of tracking fundamentals of individual businesses and knowing which to hold for the very long term.

Mastercard has the third most blockchain patents of any company yet CEO Ajaypal Banga has remained cautious saying that “the business model is not proven”

Auxier Focus Fund – Investor Class  
 Average Annual Total Returns (03/31/2019)  
 Since Inception (07/09/1999) 7.31%  
 10-year 11.29%  
 5-year 6.90%  
 1-year 7.58%  
 3-month 9.16%

*Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. As stated in the current prospectus, the Fund's Investor Class Share's annual operating expense ratio (gross) is 1.10%. The Fund's adviser has contractually agreed to waive a portion of its fee and/or reimburse Fund expenses to limit total annual operating expenses at 0.98%, which is in effect until October 31, 2019. Other share classes may vary. The Fund charges a 2.0% redemption fee on shares redeemed within six months of purchase. For the most recent month-end performance, please call (877) 328-9437 or visit the Adviser's website at [www.auxierasset.com](http://www.auxierasset.com). The recent growth rate in the stock market has helped to produce short-term returns that are not typical and may not continue in the future.*

and that there was still “a lot to improve and change over time.” However, in a recent conference (Fintech Ideas) Mastercard indicated they are still deeply invested in eventually using blockchain to improve supply chains and deter counterfeit goods. Mastercard had a 52% return on investment (ROI) in 2018 with over \$5 billion in free cash flow.

#### Central Pacific Financial Corp (CPF)

Located in Hawaii, Central Pacific has been able to consistently improve key performance indicators including net interest income, net interest margin, return on equity and efficiency ratio. Hawaii saw a banner year with visitor expenditures of \$18 billion, up 6.8% over 2017.

#### Zimmer Biomet Holdings (ZBH)

Zimmer Biomet specializes in knee and hip replacements while also providing a variety of other joint replacements. With the obesity rate in the United States over 30% and the number of Americans over 65 nearing 50 million, the demand for joint replacements will continue to grow. Zimmer Biomet is trading at a discount with a forward price-to-earnings ratio of under 15x. They had over \$1.3 billion in free cash flow in 2018.

#### Microsoft Corp. (MSFT)

Satya Nadella has led Microsoft to another record quarter by focusing on Microsoft’s proprietary digital capabilities. This is most evident in their push in artificial intelligence, which can use Microsoft’s expansive amount of data to “learn” more than other programs could. Their subscriber and cloud-based products have been firing on all cylinders. Azure has been a rocket, growing over 70% in the first quarter alone. Microsoft has over \$135 billion in cash and short-term investments and returned \$6.1 billion to shareholders through dividends and share repurchases in the first quarter of 2019.

| Top Equity Holdings          | % Asset |
|------------------------------|---------|
| Mastercard Inc.              | 4.8     |
| UnitedHealth Group Inc.      | 4.2     |
| Bank of New York Mellon Corp | 3.7     |
| Medtronic PLC                | 3.4     |
| Pepsico Inc.                 | 3.4     |
| Johnson & Johnson            | 3.3     |
| Philip Morris International  | 3.2     |
| Microsoft Corp.              | 3.0     |
| Merck & Co.Inc. New          | 2.7     |
| BP p.l.c.                    | 2.7     |

#### BP p.l.c. (BP)

CEO Bob Dudley’s bet on market stabilization has paid off with oil prices steadily rising since the new year leading to increased margins. BP has also started to reap the rewards of their heavy investments in discovery and technology. Their recent expansion in the Atlantis platform network increased production to 200,000 barrels of oil and 180 million cubic feet of natural gas per day. Meanwhile, their technology investments have allowed them to reduce overhead and cut their operating costs. BP has a dividend yield of over 5.5%.

**Detractors to the quarter: Our outlook on a cross section of portfolio positions with a negative return for the quarter ended 3/31/2019.**

#### Biogen Inc. (BIIB)

Biogen dropped sharply on news it was canceling its once-promising Alzheimer’s drug, Aducanumab. One of the first Alzheimer’s drugs to make it to phase three trials, Aducanumab, had extraordinary potential but was canceled after disappointing trial results led Biogen to determine it was no longer a cost-effective investment. Still, they are the most focused company we can find in researching diseases

of the brain like multiple sclerosis, Parkinson's, and ALS. Biogen is now trading at under 11x earnings and has remained flexible with nearly \$5 billion in cash and equivalents.

#### The Kroger Co. (KR)

Kroger is in the first year of its 2020 Restock Kroger program that aims to improve efficiency and differentiate the company with exclusive brands. In 2018 Kroger achieved over \$1 billion in cost savings through process improvements, adjusted earnings per share on the high range of guidance, and operating profit and free cash flow goals. In addition, they raised dividends for the 12<sup>th</sup> consecutive year, announced partnerships with Home Chef, Microsoft, Nuro, Ocado and Walgreens and expanded pickup and delivery to reach 91% of Kroger households. Like most grocery stores, Kroger has a high inventory turnover ratio of over 14x allowing them more flexibility in response to changes in the economy.

#### UnitedHealth Group (UNH)

UnitedHealth Group's stock price has corrected mostly due to a push for Medicare-for-All by presidential candidate Bernie Sanders. The company has been successful with the use of data analytics and scale to serve clients at a lower cost than rivals. This has resulted in strong enrollment growth and industry leading returns on capital. They have been a leader in product innovation as well. UnitedHealthcare grew in the first quarter to now serve over 2 million people while Optum continues its strong performance with double-digit revenue and earnings growth. UnitedHealth had over \$13 billion in free cash flow in 2018.

#### Berkshire Hathaway Inc. (BRK.B)

The holding company famous for its CEO Warren Buffett, Berkshire Hathaway has made a major bet on bank stocks which has hurt them due to the headwinds of a flat yield curve and slow loan growth. In addition, goodwill write-downs on Kraft Heinz cost Berkshire over \$3 billion on its 26.7% stake. Still Berkshire is probably the best run property casualty insurance company in the world led by skillful managers like Ajit Jain.

#### The Coca Cola Co. (KO)

Coca Cola continues to be the leading brand in the beverage industry. In order to adjust to evolving market trends they just announced a new product called Coca Cola Coffee that will soon be released in 25 global markets. Their stake in Monster Energy Drinks and focus on healthier beverage options such as Coke Zero continues to pay off. Despite strong top-line organic revenue growth of 6% in the quarter the company has still trailed Pepsi in the push for healthier drinks. The company is reinvesting heavily in its brands and enjoys significant economies of scale and unit cost advantages over competitors. Over the last 8 years Coke has returned over 90% of their free cash flow to investors through share buybacks and dividends.

### **Is Inflation Dead?**

*Businessweek* recently had a cover entitled "Is Inflation Dead?" In 1979 when stocks were a compelling generational buy at nine times earnings, *Businessweek* ran a cover "The Death of Equities." We are seeing the potential for food inflation as China has lost close to a third of their hogs to disease. Ethanol mandates are rising from 10%-15%, boosting corn demand. Most agriculture crops are close to or below cost of production as farm incomes are off nearly 50% from 2013 highs. We could be close to the bottom of a long downturn in agriculture. Shipping costs are climbing as truck driver shortages intensify. Companies such as PepsiCo and Procter & Gamble have been able to raise prices. Pepsi and Procter are showing some of the best growth in over five years. We can't predict macro events, but we can intensively research

well-managed companies that have the ability to endure through the most difficult economic environments. Many of our investments have low mandatory capital investment needs, high and growing free cash flow yields and attractive returns on invested capital. This type of model is best in periods of increasing inflation.

## Conclusion

While we are encouraged by the market recovery, earnings in general have not been materially improving. In an environment that is enthusiastic about “growth at any price” we remain focused on making careful buys in outstanding businesses, with strong ethical leadership, durable models with solid balance sheets and improving free cash flow. We are looking to buy at a discount to intrinsic value with the goal of a double or triple play over five to ten years. We believe the pendulum has swung too far in the direction of money-losing speculative ideas many of which lack sustainable earnings. When asset classes go parabolic it has been our experience that an inflection point is close where markets will purge the excesses.

We appreciate your trust.

Jeff Auxier

***Before investing you should carefully consider the Fund’s investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling (877) 328-9437 or visiting the Fund’s website. Please read the prospectus carefully before you invest.***

**Fund returns (i) assume the reinvestment of all dividends and capital gain distributions and (ii) would have been lower during the period if certain fees and expenses had not been waived. Performance shown is for the Fund’s Investor Class shares; returns for other share classes will vary. Performance for Investor Class shares for periods prior to December 10, 2004 reflects performance of the applicable share class of Auxier Focus Fund, a series of Unified Series Trust (the “Predecessor Fund”). Prior to January 3, 2003, the Predecessor Fund was a series of Ameriprime Funds. The performance of the Fund’s Investor Class shares for the period prior to December 10, 2004 reflects the expenses of the Predecessor Fund.**

The Fund may invest in value and/or growth stocks. Investments in value stocks are subject to risk that their intrinsic value may never be realized and investments in growth stocks may be susceptible to rapid price swings, especially during periods of economic uncertainty. In addition, the Fund may invest in mid-sized companies which generally carry greater risk than is customarily associated with larger companies. Moreover, if the Fund's portfolio is overweighted in a sector, any negative development affecting that sector will have a greater impact on the Fund than a fund that is not overweighted in that sector. An increase in interest rates typically causes a fall in the value of a debt security (Fixed-Income Securities Risk) with corresponding changes to the Fund’s value.

Foreside Fund Services, LLC, distributor.

*The S&P 500 Index is a broad-based, unmanaged measurement of changes in stock market conditions based on 500 widely held common stocks. One cannot invest directly in an index or average.*

*The views in this shareholder letter were those of the Fund Manager as of the letter’s publication date and may not reflect his views on the date this letter is first distributed or anytime thereafter. These views are intended to assist readers in understanding the Fund’s investment methodology and do not constitute investment advice.*