FAHNESTOCK ASSET MANAGEMENT
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Dear Client,

"It seems to be a law of nature, inflexible and inexorable, that those who will not risk cannot win."
-John Paul Jones, the father of the American Navy

There is no way to avoid risk in investing. Take too much risk and an investment could go sour, take too little and inflation will erode purchasing power. A captain would only intentionally sail through a storm if the risk justified the reward and this holds true for investing. Just as sitting in the harbor forever is not an option, nor is stuffing cash under the mattress. **As long term investors, we embrace a strategic mix of risks in your portfolio to meet your unique goals in the context of your finances and emotional makeup.**

Risk is subjective, some people enjoy jumping out of planes, others are paralyzed by the thought of leaving their homes. Investors face many different types of risk: credit risk, concentration risk, liquidity risk, leverage risk, interest rate risk, currency risk, and purchasing power risk. Mismanaged risk can result in loss of capital, loss of income, unmet expectations, and missed opportunities.

Wall Street has a metric to quantify risk, volatility. Volatility, a statistical concept, measures the magnitude of past changes in security values. The bigger the historical deviations, the riskier an investment by Wall Street standards. But is an investment risky just because it was volatile in the past?

While volatility as a proxy for risk fits neatly into a formulaic approach to investing, it only captures the reaction to past events, rather than the qualitative, unmeasurable aspects of risk that could exist going forward. <u>We instead frame risk as the possibility of a permanent loss of capital that cannot be recuperated through time and patience.</u> Understanding and engaging risk in a portfolio is as much an art as it is a science.

So how do we manage risk? It is important to match one's investment strategy with their time horizon so as to never be forced to sell in a downturn. This can be avoided by owning high grade bonds that come due in appropriate timeframes and/or by owning securities that pay a steady income. Investors with longer time horizons can typically take more risk because they have the luxury of <u>time and patience</u> through downturns.

Another way we manage risk is through diversification. **It's telling that the financial media constantly parades experts, all highly regarded members of their field, and yet rarely do they agree.** No one can predict the future so the odds of meeting long term goals can be improved by identifying long term secular trends and strategically selecting securities from a variety of industries, geographies and sizes. We are diligent to neither over or under diversify; 30-35 stocks is appropriate to represent the equity portion of your portfolio.

We rely on fundamental analysis to assess the financial health of an investment and own companies with bright futures, strong competitive positions, free cash flow generation that can consistently be returned to owners and, most importantly, with valuations that are not divorced from reality. We stick to our process and do not get caught up chasing the "flavor of the month".

Crucially, we resist the urge to time the market or react to the headlines. Investments react differently to market cycles and changing economic conditions, patience is a must to allow themes to develop.

Volatility is a part of investing, but volatility in itself is not risky, overreacting to the short term natural ebbs and flows of the market is the trap. There is an everpresent list of worries – elections, war, inflation, recession – but that always has been, and always will be, the case. Think of what we have been through in the last 10, 20, 100 years and consider that <u>no matter what has come our way, markets have eventually recovered to new all time highs 100% of the time</u>. We remain long term optimists and are excited for what the future holds.

Wishing you a cool and breezy summer,

Sincerely,

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