# Third Quarter Letter September 30, 2019

*"Basically, price fluctuations have only one significant meaning for the true investor. They provide them with an opportunity to buy wisely when prices fall sharply, and to sell wisely when they advance a great deal. At other times, he will do better if he forgets about the stock market and pays attention to his dividend returns and to the operating results of his companies."*
*- Benjamin Graham, Columbia University professor*

Before we get into the investment thoughts and highlights from the third quarter, Live Oak Private Wealth is excited to report that we have launched corporate trustee services led by our skilled fiduciary professional, Daniel Hughes. This local, personalized service dovetails perfectly into our existing trust and estate services, which help protect personal wealth today and for generations to come. Make sure to visit our website to read Daniel's recent blog post about our trust offering as well as other important content from the team regarding goal-based financial planning, retirement cash flow planning, investment tax considerations and charitable giving.

We all know time flies, especially as we age, but it is hard to believe that Live Oak Private Wealth is a year old! What a first year we have had. We are all excited with what we have built thus far and where we are going with our team's collective vision of wealth management. If any of you are reading this and haven't yet met our entire team and seen our beautiful campus, please do so. We have a compelling story to share with you.

The U.S. market, as measured by the S&P 500, managed to squeeze out a slight increase in the third quarter. By doing this, the U.S. market held on to its largest year-to-date gains in recent memory. This has continued to prolong one of the longest bull markets in history. Bonds rose as well and declining interest rates have helped drive stock market returns upward, while at the same time reflecting the uncertainty investors feel about the global economy, trade wars with China and the Fed's decisions around easing or tightening. The U.S. economy, as measured by the consumer, remains on strong footing, yet there are concerns that the longer the trade war with China rolls on, the higher the probability that the U.S. consumer will start to feel the negative effects and become more cautious.

While the quarter ended quietly, it was loud and volatile underneath the surface. Stocks ramped up to new highs in July but then dropped hard in August only to claw its way back up to a slight gain in September. Every quarter that goes by, it seems that there is more and more uncertainty, volatility and unease. Most of this directly relates to geopolitics and especially Washington. When I think about it, never in my 33-year investment career have I seen so much seemingly revolving around what will happen from a political perspective. There is massive polarity when contemplating the agendas of the two parties. When studying past market and presidential election cycles, typically if the U.S. economy is doing well and unemployment is low, inflation is in check, the incumbent president is usually re-elected. This next election will be more than interesting.

U.S. politics, elections and other global geopolitics tend to move markets more now than ever in history. This is most likely due to the significant change in the public stock market structure now that passive assets outweigh active assets and algorithmic computerized trading of exchange traded funds is leading to increased volatility. You, as a reader of these letters, may be as tired of reading about the risks we see related to the computerized trading as we are about writing about them. But the influence of “rules based” computerized trading strategies, that key off interest rates, geopolitics, trade and tweets, continues to grow more extreme by the quarter. According to J.P. Morgan, passive strategies now control 60% of U.S. equity trading volume while quantitative funds control another 20%, a staggering 80% combined. And based on a recent report by Thomson Reuters, algorithmic trading systems are now responsible for 75% of global trading volumes. None of these strategies have been tested in a recession. Exchange traded funds, especially the dominant capitalization weighted ones, have not been tested to see if the “daily liquidity” that the “machines” thrive on, pairs well with the far less than daily liquidity of the assets underlying the ETFs. It’s unclear and unnerving to us whether modern market makers will provide the liquidity necessary to stabilize markets in the event of a crisis.

One of the core tenants of Live Oak Private Wealth’s investment philosophy is understanding and recognizing that in investing, you win more by losing less. Many investors today pay more attention to returns than risks, while our approach argues for the opposite: Pay more attention to risks than returns. Risk is omnipresent, and managing it is about assessing the variations of risk such as computerized trading or excessive valuation of recent “unicorns” that have come public. Some form of risk is inherent in all aspects of long-term investing and the key to mitigating it is being aware and conscious of it daily.

Now that we are ten years into this bull market cycle since the financial crisis, thankfully most all investors are enjoying a high-water mark of wealth. Most investment accounts are fairly flush, and the balances are large. We focus on that because you always lose money downward from a bigger number and gain money upward from a lower number. Remember this example: if your investment portfolio is worth $1,000,000 and you expose it to a 50% loss, it becomes $500,000. Then you need for your $500,000 portfolio to double (go up by 100%) simply to break even. It is very tough to find stocks or markets with 100% upside. It can take years to get back to break even. On the other hand, if you can keep your portfolio exposed to say a 20% decline or $800,000, your opportunity to recover is easier and shouldn’t take as long. If you are in retirement or getting close to retirement, this mathematical principal is very important to your financial longevity. We get it.

Having now recovered, enlightened and informed by my travels to Italy and Croatia this summer, I was surprised by the level of global tourism I witnessed. It had been a while since I was last in Europe, and it was eye opening to see the number of global travelers, especially in that region of the world. It was so exciting to see firsthand what we hear about in regard to a growing middle class in the world. All I could think about was one of our research theses around global transportation. It was hard for me to appreciate the statistic below, yet I experienced it for myself by the sheer numbers of global travelers I saw from all over the world.

| | |
|---|---|
| United States as a percent of the world’s population | **5%** |
| United States as a percent of the world’s GDP | **25%** |

It is hard to comprehend the effects of a growing global middle class, especially travel and tourism. Based on statistics by the United Nations and the OECD, the global middle-class population was 1.8 billion in 2009 and is estimated to be 3.2 billion next year and 4.9 billion in 2030. Middle class spending is increasing and shifting from the U.S. to the rest of the world. Again, using estimates from the OECD, consider these statistics:

| | | | |
|---|---|---|---|
| 2009 Middle class spending | $21 trillion | 26% U.S. | 74% rest of the world |
| 2020 Middle class spending (est.) | $35 trillion | 17% U.S. | 83% rest of the world |
| 2030 Middle class spending (est.) | $55 trillion | 10% U.S. | 90% rest of the world |

Considering our investment thesis around global transportation, the world's transportation infrastructure has not kept pace with the rising demand for travel by this massive growing percentage of middle-class individuals globally, therefore we have investments in French airplane manufacturer Airbus Industries and airplane engine maker Safran. Given that some statistics show miles flown growing at 6% a year, we can see hopefully a long-term trend benefitting us.

One of the many core competencies of the Live Oak Private Wealth team is knowing as much as possible about our businesses we are invested in. Our research effort casts a wide net. This quarter, we traveled to New York in September to attend two investment conferences, both of which also eluded to the many global investment opportunities. We split our time over the two days trying to gather as much research and understanding as possible. I attended a conference put on by MOI Global called Latticework, which has been lauded as a uniquely impactive interactive forum of the best minds from the MOI Global community. There were many takeaways, but a presentation by Rupal Bhansali from Ariel Investments was particularly insightful and led me to read her recent book, "Non-Consensus Investing." Connor was in different meetings with other contacts and trying to connect with a prominent money manager who was attending Mastercard's (another core portfolio holding) analyst day at the New York Stock Exchange. The next day we both tag-teamed a day of research with the global investment team at Davis Advisors. We came home that night with strong convictions around several businesses we are invested in, such as New Oriental Education, United Technologies, Alibaba and financials such as Bank of America. We are fortunate to have such a well-rounded and diversified team at Live Oak Private Wealth and to be able to travel to these types of conferences to learn from those smarter than us and benefit from variant perceptions that you gain by getting away from your daily, biased, home-research routine.

So, as we look out to the fourth quarter, 2020 and beyond, we remain confident in the long-term fundamental strength of the American economy, yet in the next 14-15 months we will undoubtedly experience politically based volatility unlike anything seen in more than a generation. This volatility will occasionally feel quite uncomfortable and we will be working overtime to try and separate real risk from perceived risk during these uncertain times. We will be trying to 1) figure out what we know, 2) figure out what we don't know and 3) figure out what we can't know. We will remain diligent towards risk management at the possible expense of returns. We are keenly aware of the fact that much of your savings you are entrusting us with is irreplaceable. We understand that survival is the key to investment success and to finish first, you must finish. Above all else, we will maintain our steady course of intelligent, long-term investing…always looking for quality businesses that are undervalued or misunderstood to opportunistically capitalize on with our shared capital.

Our team reads many quarterly letters such as this one from many other smart, successful investment teams. We were reading one from Don Yacktman where he referenced "Hakuna Matata," which translates as "no worries," and is a popular song from "The Lion King," the Disney blockbuster movie and Broadway show. The philosophy of "no worries" has prevailed for quite a while during the last ten years and the market returns pan that out. We believe when people are not worried, you should worry. "Hakuna Matata" didn't work out well in "The Lion King" and is not an intelligent investment approach by our standards. We believe it is important for you to have a team of advisors and investment professionals like us who will worry for you. We have experienced volatile environments and risks before, and we will navigate through them in the future by focusing on our disciplined investment strategy. We will remain vigilant toward the risks that are inherent today.

We remain humbled and appreciative by your willingness to compensate us for doing something that we love to do and is so meaningful and rewarding to us all. Our entire Live Oak Private Wealth team looks forward to our continued shared success in this partnership.

With warmest regards,

J. William (Bill) Coleman III

and the Live Oak Private Wealth Team

## Portfolio(s) Discussion and Commentary

Our investment team manages four equity portfolios in addition to our fixed income solutions. Each of these four equity portfolios are unique with different approaches.

- Focused Opportunity
- Select
- Equity Income
- International

## Focused Opportunity Commentary and Thoughts

Our Focused Opportunity Portfolio is our signature investment portfolio which carries our highest conviction opportunities. This portfolio has unlimited flexibility to shift among styles and can appear uncomfortably idiosyncratic at times. Bargain investments can usually be found around controversial events on a company, general pessimism or those that have been performing poorly of late. Focused Opportunity invests across the capitalization spectrum and is conviction weighted to our most attractive companies.

**In the third quarter, the Focused Opportunity Portfolio returned 2.08% (gross) and is up 19.31% YTD (gross).**

**Ten Largest Investments**

September 30, 2019

| | Year Acquired | | Year Acquired |
|---|---|---|---|
| Berkshire Hathaway | 1998 | United Healthcare | 2012 |
| Apple | 2011 | CarMax | 2018 |
| Microsoft | 2006 | Charter Communications | 2007 |
| Bank of America | 2013 | CVS Health Corp | 2018 |
| Google | 2008 | Abbot Labs | 2016 |

Portfolio Activity: During the third quarter, we sold Bank of New York and made small additions to Charles Schwab and Fed Ex.

**Performance Attribution**

| Contributors | | Detractors | |
|---|---|---|---|
| CVS Health | +14.82% | Schlumberger | -13.10% |
| Apple | +11.12% | Fed Ex | -10.68% |
| Google | +11.03% | HCA Healthcare | -10.50% |
| Brookfield Asset Mgmt. | +10.10% | United Healthcare | -10.44% |
| Verizon Communications | + 6.53% | Walt Disney | - 8.00% |

## Focused Opportunity Featured Company:

### Berkshire Hathaway

Berkshire is currently trading at one of the widest discounts to intrinsic value in many years. Being a conglomerate, Berkshire is one of the least followed and misunderstood large cap companies in the market. Berkshire's value is derived by almost half insurance and half in diversified operating companies such as MidAmerican Energy, Burlington Northern Railroad, Clayton Homes, Shaw Carpet, Benjamin Moore and others. Many, including us, value Berkshire at a multiple of 14 times earnings, which we feel are understated in the current low interest rate environment. Given Berkshire's cash hoard of over $100 billion, we expect a sizable accretive acquisition during the next downturn. Berkshire has also adjusted its buyback policy which should continue to enhance our returns.

## Select Portfolio Commentary and Thoughts

Our **Select Portfolio** might be best understood using a sports analogy. Select consists of our "bench players" or our "on deck circle" of companies. These are companies we admire and ones who compliment positions in Focused Opportunity. Select would be considered an all-cap core portfolio that is style agnostic. It invests across the capitalization spectrum yet leans towards growth. Select is also conviction weighted to companies we view have the best price to value relationship.

**In the third quarter, the Select Portfolio returned 1.24% (gross) and is up 20.28% YTD (gross).**

**Ten Largest Investments**

September 30, 2019

| | Year Acquired | | Year Acquired |
|---|---|---|---|
| Google A | 2009 | Comcast | 2004 |
| Fox Corp A | 2019 | Anthem | 2002 |
| Citigroup | 1998 | Facebook | 2019 |
| Lowes Companies | 2018 | Mohawk Industries | 2018 |
| Markel | 1998 | Liberty Sirius XM | 2007 |

Portfolio Activity: During the third quarter, we made no portfolio changes.

**Performance Attribution**

| Contributors | | Detractors | |
|---|---|---|---|
| Lennar Corp. | +16.16% | Mohawk | -17.68% |
| Medtronic PLC | +10.72% | Anthem | -15.08% |
| Liberty Sirius XM | + 8.96% | Apache | -12.33% |
| Lowes | + 7.59% | Fox Corp A | -12.21% |
| Markel | + 7.01% | Cheniere Energy | -10.07% |

## Select Portfolio Featured Company:

### Comcast (CMCSA)

Comcast is the largest U.S. cable system operator with more than 30 million customer relationships. Comcast also owns NBC Universal, theme parks and SKY, a Pan-European Satellite TV broadcaster. It's been about a year since the bidding war between Comcast and Disney for the Fox and SKY assets and Comcast's business results continue to improve, notwithstanding the slow melting ice cube of the cable TV bundle. The broadband internet business continues to promote healthy subscription growth as it fills the cord-cutting streamers' appetite. Comcast currently trades at a multiple of 8-9 times operating income and is well positioned to continue to grow and prosper as a true diversified media content and distribution juggernaut.

## Equity Income Portfolio Commentary and Thoughts

Our **Equity Income Portfolio**, like our other three, is a concentrated portfolio. Equity Income consists of high-quality companies with sustainable competitive advantages with average to above average dividend yields, along with the potential for dividend growth. The portfolio's objective is to offer the opportunity for attractive total returns with the possibility of slightly higher income.

Equity Income, like Select, Focused Opportunity and International, is a go anywhere portfolio that is style and capitalization agnostic.

**In the third quarter, the Equity Income Portfolio returned 5.02% (gross) and is up 17.59% YTD (gross).**

**Top Largest Investments**

September 30, 2019

| | Year Acquired | | Year Acquired |
|---|---|---|---|
| JP Morgan | 2007 | Home Depot | 2004 |
| Walmart | 1998 | Bristol Myers Squibb | 2018 |
| Exxon | 1998 | Intel | 2019 |
| Chevron | 2017 | Target | 2018 |
| Cisco Systems | 1998 | Pepsi | 2009 |

Portfolio Activity: During the third quarter, we made no portfolio changes.

**Performance Attribution**

| Contributors | | Detractors | |
|---|---|---|---|
| Newell Brands | +23.00% | Invesco Ltd. | -17.53% |
| Target | +22.97% | Cisco Systems | - 9.74% |
| UPS | +16.36% | Exxon | - 7.77% |
| Home Depot | +10.34% | Cummins Inc. | - 5.89% |
| Bristol Myers Squibb | + 9.81% | Chevron | - 5.00% |

## Equity Income Portfolio Featured Company:

### Newell Brands

Newell is an American worldwide marketer of consumer and commercial products such as Rubbermaid, Coleman, Paper Mate, Elmer's, Graco, Calphalon, Mr. Coffee and Yankee Candle just to name a few. Newell's debt-fueled acquisition of many of these brands over the years has not panned out as successfully as management hoped. The sentiment around the company seems to be changing as more aggressive cost cutting and non-core asset sales seem to be starting to move the needle in optimizing the portfolio of companies. By focusing on the brands with the most attractive margins and growth potential, Newell can drive operational efficiency while improving financial flexibility and free cash-flow productivity. Newell is tremendously underearning its potential and could offer quite a bit of upside with the shares around $16.00.

## International Portfolio Commentary and Thoughts

International Portfolio: Our International portfolio is also highly concentrated in what we feel are superior, growing businesses. The portfolio's objection is to expose us as long-term investors to other opportunities worldwide. The mandate allows for unlimited geographical reach and can own any size capitalization business. Most of the world's growth is outside the U.S. and therefore, we hope to capitalize on that by owning great businesses at fair prices.

**Ten Largest Investments**

September 30, 2019

| | Year Acquired | | Year Acquired |
|---|---|---|---|
| Nestle | 2002 | Safran | 2018 |
| Alibaba | 2018 | JD.Com | 2018 |
| New Oriental Education | 2018 | Ten Cent Holdings | 2018 |
| Fiat Chrysler | 2018 | Development Bank of Singapore | 2018 |
| Ferguson | 2019 | Airbus Group | 2018 |

Portfolio Activity: During the third quarter, we made no portfolio changes.

**Performance Attribution**

| Contributors | | Detractors | |
|---|---|---|---|
| New Oriental Education | +12.54% | Teva Pharmaceutical | -26.18% |
| Safran | + 7.57% | Baidu.com | -12.92% |
| Sanofi | + 6.33% | Siemens AG | -10.68% |
| Nestle | + 6.13% | Encana | -10.51% |
| Ferguson | + 2.26% | Ten Cent Holdings | -10.43% |

## International Portfolio Featured Company:

### New Oriental Education

Formed in 1993, New Oriental is the largest and most recognized provider of private educational services in China. The company has over a 38.1 million student enrollment. The company has a network of 1,100 learning centers, schools and bookstores. The mission of New Oriental is primarily to provide after-school tutoring and entrance exam prep as well as private schooling. China has tremendous barriers to college entry with roughly only 1 in 50 students qualifying. The college entrance exam process is extremely difficult without the testing prep classes New Oriental provides. Occupancy is growing by 20% per year, driving 30%+ increases in revenue and profit for New Oriental. The stock is not cheap, but the runway for growth appears very attractive.

## Appendix 1
## Live Oak Private Wealth Investment Philosophy
**Three Pillars**

We consider potential losses before gains. We think about multiple scenarios that could affect us. We ask how much we might lose before we ask how much we might make.

We focus on absolute returns, not relative returns. Our goal is to lose less than the market. We don't manage to a benchmark.

We do not focus on the macroeconomic environment. We focus on truly great businesses we can invest in at a fair price.

**Our Beliefs**

We believe your lifetime investment results will be mostly governed by two variables: behavior and asset allocation. We consider the three quotes below by two very famous investors daily in our thoughts, research and work.

*"To buy when others are despondently selling and to sell when others are avidly buying, requires the greatest fortitude and pays the greatest reward."*
*John Templeton*

*"Be fearful when others are greedy and greedy when others are fearful."*
*Warren Buffett*

*"Price is what you pay, value is what you get."*
*Warren Buffett*

**Guiding Principles**

- A share of stock represents a share in the ownership of a business.
- A stock exchange is nothing more than an auction place that provides a convenient means for exchanging your ownership in a business for cash and vice-versa.
- Our investment approach would be akin to applying a private equity mindset to investing in public markets.
- We limit our search for qualifying investments to good businesses. They have identifiable, sustainable competitive advantages.
- Risks to us is permanently losing capital over a five-year time horizon. Market volatility is not risk to us.
- Our primary return goal is to compound capital at real rates of return (4-5%) in excess of inflation over our five-year time horizon.
- Compounding capital at 7% doubles your assets in 10 years.

## Disclosures

1) Past performance is no guarantee of future results and future performance may be higher or lower than the performance shown.

2) This performance composite represents results from all actively managed, fully invested accounts at the firm. The composite results include all accounts managed for capital appreciation and income.

3) There can be no assurance that our portfolio management or any account managed by our investment managers will achieve a targeted rate of return or volatility or any other specified parameters. There is no guarantee against loss resulting from an investment.

4) Performance is presented net of fees. Calculated using Orion standards. Periods greater than one year are annualized. This information has been obtained from sources that were deemed reliable, but cannot be guaranteed nor verified.

5) The method for calculating the composite returns includes a monthly weighted (weighting of monthly beginning values, adjusting for time-weighted average returns to derive quarterly and annual returns).

6) Investment objectives, returns, and volatility are used for measurements and/or comparison purposes only and are only a guideline for prospective investors to evaluate our investment strategy and the accompanying risk/reward ratios.

7) Comparison to any index is for illustrative purposes only. Certain information, including index and benchmark information, has been provided by third-party sources, and although believed to be reliable, has not been independently verified and its accuracy cannot be guaranteed.

8) The information contained here is not complete, may change, and is subject to, and is qualified in its entirety by, the more complete disclosures, risk factors, and other important information contained in Part 2A or 2B of Form ADV. This presentation is for informational purposes only and does not constitute an offer to sell or as a solicitation.

9) Live Oak Private Wealth is a subsidiary of Live Oak Bank. Investment advisory services are offered through LOPW, LLC, an Independent Registered Investment Advisor.

10) Opinion and thoughts expressed are those of Bill Coleman and not Live Oak Bank.