October 2019

Dear Clients and Advisors:

We are pleased to announce that all Corbyn-managed accounts enjoyed another quarter of positive returns, adding to the strong performances achieved during the first half of the year. The fixed income markets remained strong as investors continued to search for yield, while a subdued but still growing business environment helped to nudge equity prices slightly higher.

Fixed Income

The fixed income market's positive performance during the quarter was driven by the decline in short- and longer-term interest rates, particularly in August, which pushed bond prices higher. The move in interest rates took its cue from the news headlines. Deteriorating global economic data and trade issues led the Federal Reserve ("Fed") to lower short-term rates by 25 basis points in both July and September. Currently, the Fed Funds futures market indicates that investors anticipate further rate cuts before year end. The increased flow of funds into the fixed income market seemed to be an indication that investors were looking for safe havens as global frictions continued to percolate.

The recent move by the Fed to cut short-term interest rates and the negative interest rate environment that exists throughout the majority of the European Union has only intensified the search for yield by fixed income investors looking for an adequate return on their capital. Negative interest rates, or positive rates that are below the rate of inflation, are quite unusual and provide an investor with no real return. For those who studied economics in school, it is doubtful that this topic was covered in your textbook. This unprecedented situation has forced many traditional fixed income investors with income needs to seek higher yields from alternative investments. Unfortunately, many of these alternative investments could expose investors to a greater degree of risk and the potential for significant losses.

Corbyn's fixed income strategy seeks to generate consistent risk-adjusted performance by controlling the two key risks that can affect bond investors' performance - interest rates and credit quality.

Given the current negative and ultra-low interest rate environment, the inherent unpredictability of interest rate movements, and the more active role that central banks are taking in the market, we remain uncomfortable extending duration significantly, an act that would inject greater interest rate risk into the portfolios. Just a year ago, the 10-year U.S. Treasury yield was slightly over 3% with the consensus assumption being that rates would continue to move higher, reflecting strong global economic growth and accelerating inflation. However, by the middle of this past quarter, the yield had fallen to 1.5% as global central banks cut rates amidst concerns of decelerating growth and lackluster inflation. This move propelled the recent rally in longer-term bonds. Should this pattern reverse itself, investors in longer duration bonds could suffer corresponding, but negative, returns. Investors have been reminded, once again, just how difficult it is to predict the movement of interest rates.

By remaining focused on bonds with near-term maturities or likely redemptions, we significantly reduce interest rate risk and can focus the majority of our research efforts on fundamental credit analysis, in particular, how a specific debt issue is going to be paid off. The goal remains the same – to provide consistent, competitive positive returns while avoiding much of the volatility caused by movements in interest rates. For the portfolios that include both equities and fixed income securities, the fixed income securities are expected to not only produce consistent positive returns, but also provide a measure of stability, with the fixed income "ballast" reducing the volatility of the portfolios to equity market swings.

Equities

The equity market experienced some intra-quarter volatility, especially with August's decline, but moved higher in September to finish the quarter with low single-digit returns. The general trends that we discussed in this year's previous letters continued to influence investor sentiment and, consequently, equity valuations. Trade tensions remained front-page news as President Trump proposed additional tariffs and China retaliated, although investors continued to hold out hope that a resolution or at least a de-escalation would be forthcoming. The ongoing trade dispute appeared to negatively influence global growth as economic reports pointed to a slowdown, particularly in Europe, China, and the global industrial sector, as many corporate executives, awaiting more clarity concerning trade policies, put spending plans on hold. Despite this uncertainty, the U.S consumer, buoyed by a strong job market, relatively painless inflation levels and low interest rates, continued to spend at a very healthy rate, supporting the domestic economy.

In this environment, we remain focused on executing our strategy of investing in well-capitalized companies with a history of strong and compounding free cash flow, ideally with attractive secular or company-specific catalysts. A strong balance sheet and free cash flow provides a company with the flexibility to create value for shareholders in both good times and bad. Additionally, company-specific catalysts can often provide opportunities for value creation within management's control that are less dependent on macroeconomic conditions.

With short-term market movements seemingly driven by the geopolitical headlines (or tweets) of the day, we believe that these companies have the opportunity to provide solid long-term, risk-adjusted performance.

We wish you a wonderful fall and Holiday season and look forward to writing to you again early next year. Please feel free to contact us at any time with any thoughts or questions.

Respectfully,

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