Dear Clients and Friends of Accretive,

The first quarter of 2019 is in the books and the market was strong, in every sense of the word. Which market? Pretty much any market. The rally was broad based and across major asset classes, which we'll dive into greater detail later in this letter.

In our introductory letter, we wrote at length about our investment process, which is guided by empirical research on what has been shown to be effective over time. If you did not receive a copy of that letter and would like it, please call or email us and we will be happy to send it to you. In this letter, we hope to communicate more about our investment process and what we believe to be one of the more important elements of that process. Consequently, if you know someone who may have an interest in this letter, please feel free to forward it along.

This Quarter's Investment Topic

This quarter we're going to discuss a key element in our investment process and a critical component of process improvement: writing.

It may seem odd at first to think of writing as a key component to an investment process. Most advisors wouldn't consider it to be a part of their process at all, but we think they should. Writing has many benefits that over time can improve an investor's thinking, and hopefully the end result for clients.

At Accretive, after we have done the necessary research on an investment to commit capital, we formally document changes to our portfolios with a brief summary of the investment thesis and what we expect to happen. When doing this, we try to put it in language an intelligent high school student could understand. This is what we call a "pre-mortem" and everyone at the firm gets the memo.

Having committed our thoughts to paper helps us during the ongoing oversight and allows us to monitor developments more effectively. Not everything works out right away - often there's a period of frustration before something works out. Knowing the reasons for a decision helps us see through the frustrating periods. It also helps us identify when things are changing for better or worse and help inform our decision making on the back-end.

If we sell or reduce something, we document the reasons why. If it worked out, we can take a *short* victory lap (the emphasis is on *short* because we don't want success to lead to overconfidence). If the investment did not work out as hoped, we have to be honest about the reasons why and what we got wrong. We spend more time on the mistakes with the goal of learning something from the outcome, so we only make the same mistake once. If there was good or bad luck, we try to acknowledge that also. This is what we call a "post-mortem", and everyone at the firm gets the memo.

Writing helps us organize our thinking in a concise manner, memorialize the original reasons for investing, and keep track of whether the things we expected to happen occurred. It also helps us key in on areas where our analysis is weak or our thinking needs to be improved, identify types of investments that we get wrong, and keep track of how our decisions worked out over time.

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In the end, writing things down creates accountability, promotes intellectual honesty, and helps foster a growth mindset. We consider it to be one of the more important things we do as it relates to the investment process.

Since this is a practice we have engaged in for years, we thought it might be helpful to share some key learnings:

- The longer the pre-mortem, the less likely the idea tends to have worked the way we anticipated
- Similarly, the more complicated the idea, the less likely it has worked out
- It has generally not paid to buy lower quality, even if it appears cheap
- Buying at the bottom or selling at the top is mostly luck

You would think this recordkeeping and seeking insights to continually improve is standard in the industry. For institutional investors and professional money managers it usually is, but as far as we know this is not a common practice among financial advisors. We think it should be.

This Past Quarter
The first quarter of 2019 was a good one for investors, as stock and bond markets rallied globally.

The S&P 500 was up 13.65%, and small cap stocks participated nicely with the Russell 2000 up 14.58%. Even foreign stocks got in on the action, with the MSCI EAFE increasing 10.13% and the MSCI Emerging Markets Index up 9.95%.

Normally against a robust equity market, you'd expect to see rates rising and bond investors experiencing some losses. That wasn't the case this time around, as rates fell across the curve and credit spreads tightened. The Bloomberg Barclays US Aggregate Bond Index was up 2.94% and the High Yield Index was up 7.26%.

We finished 2018 with a bad fourth quarter and came into the year with most commentators bearish. Fears of a central bank induced slowdown were widespread, and markets fell as participants felt Fed Chair Jerome Powell didn't seem to get it. The Federal Reserve got into something of a staring contest with markets, then the Fed blinked, and markets were off to the races.

We said in our last letter that the Fed knows one of the most reliable leading economic indicators is the S&P 500. This raised the question of who was influencing whom. Was the market influenced by the Fed or was the Fed influenced by the market? Once the market felt the Fed could be swayed, the yield curve and futures went to predicting no rate hikes in 2019 and potentially a cut in 2020. This conjures up memories of the "Greenspan put" that fueled the first tech bubble of the late 1990's; whether a "Powell put" has the same effect remains to be seen. We note that the Fed tends to create messes it then must clean up, fulfilling its dual mandate as both arsonist and firefighter.

The Outlook
We came into the year thinking 2019 may not be as difficult as 2018 turned out to be, or at least we hoped not. So far, that point of view has been correct. As we look into the rest of 2019, we are looking at a market with fuller valuations and some emerging risks to growth. The valuations are fuller, but in the context of a low rate environment, seem fair enough, and as long as growth can be delivered it's not that big of an issue. Growth tends to allow issues like fuller valuations to work themselves out over time. The fuller valuations to us mean that the easy money has probably been made this year, but there could be harder money to be made, and/or some opportunities along the way, and we're not opposed to that.

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Right now the yield curve is flat and at times inverted (depending on where and when you look). Historically that's been a harbinger of more difficult times. The debate is whether a flat or inverted curve is merely a signal that a slowdown is coming or a contributing factor to slowdowns. Put us in the contributing factor camp, as we think it tends to distort money markets and tighten financial conditions. We think short term rates are currently above the natural rate, if the Fed chose not to set them, but not too much higher. That all said, the curve can still normalize or the Fed could adjust its stance. Time will tell.

Our Portfolios

In this quarter our portfolios performed more or less in line with our expectations. Generally speaking, our portfolios tend to be positioned to handle a more difficult market than outperform a robust one.

In our equity portfolios, we had some cash drag which hurt a little in a market that went up more than 13%. We wish we'd acted faster going into the start of the year, but we think there will be other opportunities and the cash represents an option to put money to work in more difficult markets. What we need to do is determine our course of action before those markets arrive and be brave enough to do something when the time comes.

In our more diversified portfolios, the mutual funds and ETFs we held met our expectations. In general, conservative portfolios were up nicely but less so than portfolios with more aggressive objectives. The outcome should make sense, given what happened in the quarter.

Closing Remarks

Our first full quarter is in the books and the support from folks that are interested in what we are building at Accretive has been very encouraging. We have a great core group of clients and you are collectively a pleasure to serve. A strong core allows us to focus on activities that create value for clients, which in our experience is actually the most effective business development initiative. A number of you have suggested to friends and family that they should check us out, and for that we are very appreciative and thankful.

If you happen to have questions, please feel free to call or email us, we'd welcome the opportunity to speak with you. For those readers that are clients of ours, we thank you for the trust and confidence you have placed in our company; we don't take it lightly. For those readers who may be thinking of becoming clients, we appreciate your interest and look forward to serving you one day.

Thank you,

Gary C. Ribe, CFA, CFP®
Chief Investment Officer, Managing Member

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