MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

4th Quarter, December 31, 2017			
	12/31/17	**% Change 4th Quarter**	**% Change Year to date**
Dow Jones Industrials	24,719.22	10.96 % *	28.11 % *
S & P 500	2,673.61	6.64 % *	21.83 % *
Russell 2000	1,535.51	3.34 % *	14.65 % *
BC Aggregate BD Index		0.39 %	3.54 %
2 YR Treasury Yield	1.890 %		
10 YR Treasury Yield	2.409 %		
30 YR Treasury Yield	2.740 %		

* *Includes reinvested dividends*

Observable Trends in Interest Rates

In early May of 2017, Berkshire Hathaway's faithful gathered for the company's annual meeting. Known as the "Woodstock for Capitalists," Warren Buffett (Chairman) and Charlie Munger (Vice Chairman) spent the better part of the day reviewing the year and answering shareholder questions in a lively Q&A session. Late in the morning, a shareholder asked Warren Buffet to estimate the rate that Berkshire's intrinsic value could be compounded over the next ten years. Buffet first answered that intrinsic value can "only be calculated … in retrospect." He then went on to discuss the importance of future interest rates in determining intrinsic value. Buffet noted:

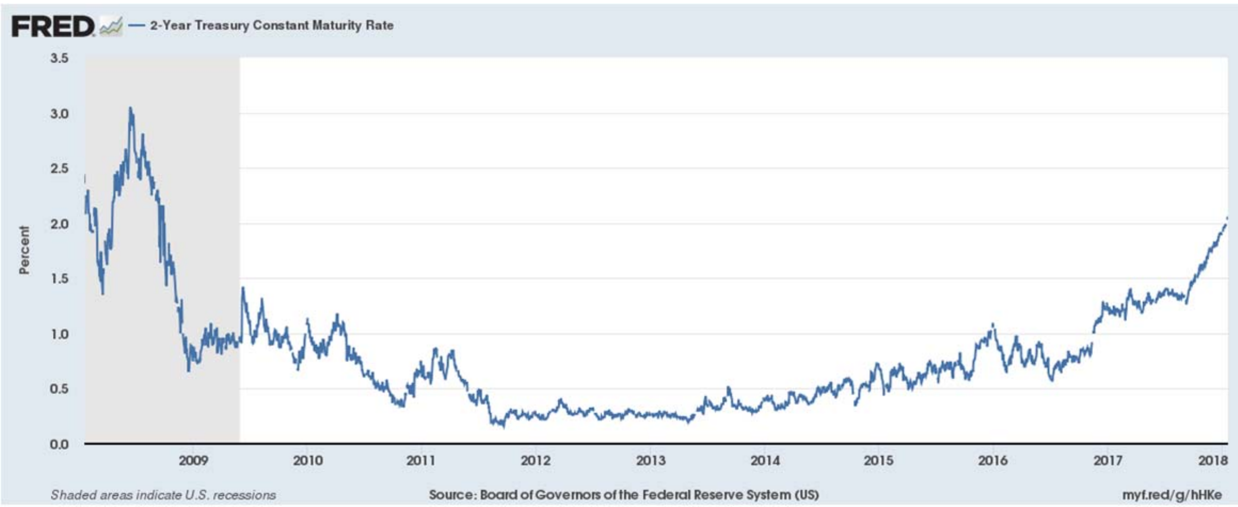
> If you ask me to give the answer to the question – if I could only pick one statistic to ask you about the future before I gave the answer – I would not ask you about GDP growth. I would not ask you about who was going to be president. I would ask you what the interest rate is going to be over the next 20 years on average…

While forecasting future interest rate movements has shortened the careers of many economists, ignoring observable trends in interest rates will relegate an economist to oblivion. The long secular decline in interest rates began in 1981 with the ten year Treasury yielding over 15%. Thirty five years later, in July of 2016, the ten year hit a historic low of 1.45%. The ten year is currently yielding 2.64%. Rising interest rates may pose significant risk to portfolios.

Our Canary

We understand the significance and importance of the ten and thirty year Treasury yields, but at this juncture we are paying closer attention to the breakout in the two year Treasury. We view the two year Treasury yield as our canary in a coal mine. The chart below, from the St. Louis Fed, depicts yield movement over a ten year period.

2 YEAR TREASURY CONSTANT MATURITY RATE



As you will note, the yield (now 2.06%) is higher than it has been in almost ten years. Also notable is the pace of the advance over the last six months. In July of 2017, the two year was yielding 0.58% and with a yield surge in January of 2018, it is now yielding 2.06% which is a 255% gain in approximately six months.

The current leg of this equity bull market, which began in March of 2009, has gorged itself on a low interest rate diet. Even though the economy was muddling through with low GDP expansion, the fuel of extraordinarily low rates helped to lift the Dow from 6,547 on March 9th, 2009 to 26,000 on January 19th, 2018. The economy is heating up (GDP should exceed 3% this year) and unemployment is low but the equity markets are facing higher interest rate risk going forward. While some sectors, like the financial industry, may benefit from a higher interest rate environment, conventional wisdom suggests an inverse relationship between interest rates and stock market valuations. From a bottom- up perspective, companies with high debt levels, particularly shorter term debt, are more vulnerable. Our focus on bottom- up research combined with our value style lets us adjust your portfolio one position at a time. When long term secular changes are occurring, both risk and opportunities increase. We look forward to adjusting your portfolio in line with observable trends.