MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

1st Quarter, March 31, 2018

	3/31/18	**% Change 1st Quarter**	**% Change Year to date**
Dow Jones Industrials	24,103.11	(1.96) % *	(1.96) % *
S & P 500	2,640.87	(0.76) % *	(0.76) % *
Russell 2000	1,529.43	(0.08) % *	(0.08) % *
BC Aggregate BD Index		(1.46) %	(1.46) %
10 YR Treasury Yield	2.74 %		
30 YR Treasury Yield	2.97 %		

* *Includes reinvested dividends*

Marty Whitman

Marty Whitman, the founder of Third Avenue Management, died earlier this week at the age of ninety three. Marty was a renowned deep value investor, passionate about the merit of exhaustive research in individual companies. His Third Avenue Value Fund beat the stock market by a wide margin over a 20 year period ending when Marty retired in 2012. Marty was a blunt man who took issue with Eugene Fama's Efficient Market Hypothesis (EMH.) In an oversimplification, EMH suggests that markets operate efficiently and stock prices instantly reflect all available information. The EMH theory is partially responsible for the tremendous growth in all forms of passive investing. While our language is not as salty as Mr. Whitman's, we are equally passionate about the risk associated with index investing and ETF's.

Robert Shiller, a Yale University Economics professor and Nobel Prize winning economist warned of the potential risk of passive investing. He noted late in 2017 that:

> The problem is that if you are talking about passive indexing, that is something that is really free-riding on other people's work ... The strength of this country was built on people who watched individual companies. They had opinions about them. All of this talk of indexes, it's a little bit diluting of our intellect. It becomes more of a game … It's a chaotic system.

Shiller went on to compare passive investing "to seeing a green light at an intersection and crossing the street without looking both ways." We saw some of that chaos enter the market in February of 2018. On February 5th, the markets were struggling with fears of inflation and potentially higher interest rates. At 3 PM, the Dow was down approximately 800 points, within minutes plunging to a loss of 1597 points. At the day's end, the market recovered a bit, closing down 1175 points. Three days later, on February 8th, the Dow fell another 1000 points and entered correction territory.

We believe the significant outflow of ETF funds and indexing combined with liquidity issues has exaggerated the market's movements in early February. There is no individual security price discovery in passive investing; money flows blindly into an index or ETF. Good and bad companies alike benefit from capital inflows to an index and conversely suffer when money flows out. The movement can be dramatic in the short term as we witnessed on February 5th and February 8th.

While passive investing has benefits (low cost index tracking and theoretical diversification,) one needs to be mindful of associated risk. Since 2009, fund inflows have been positive and have contributed to the highly correlated rise in various indexes. When markets flatten or decline, individual security analysis will become critical as the market eventually differentiates individual issues and markets become less correlated.

Marty Whitman would have understood today's volatility and taken advantage of it. He noted "The kind of investing I do doesn't really depend on how the public stock market does. If I'm right, these very undervalued companies will be taken over, liquidated or refinanced, and that's where you make your money."

As passive strategies become more popular, their risk is rising. We believe in building a portfolio of individual stocks, stocks we have researched and can be held for the long term.