MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

3rd Quarter, September 30, 2019	9/30/19	% Change 3rd Quarter	% Change Year to date
Dow Jones Industrials	26,916.83	1.83 % *	17.51 % *
S & P 500	2,976.74	1.70 % *	20.55 % *
Russell 2000	1,523.37	-2.40 % *	14.18 % *
BC Aggregate BD Index		2.27 %	8.52 %
10 YR Treasury Yield	1.68 %		
30 YR Treasury Yield	2.12 %		

* *Includes reinvested dividends*

Time Value of Money

> Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it.
>
> *attributed to Albert Einstein*

There are certain fundamental tenets in investing that form the basis for financial analysis and forecasting. At the core is a simple concept that fascinated Einstein: the time value of money. Simply put, money received now is more valuable than the same amount received in the future because of the potential to invest that money and earn a compounded return.

Historically, borrowers paid interest to the banks or individuals from whom they borrowed. For example, if you wanted to buy a home, a bank would lend you money which you would repay over time with interest. On the deposit side, if you deposited money with a bank, they would return your deposit with interest.

Central banks across the world utilize various tools to nudge interest rates up or down in an effort to maintain a healthy economy. In 2014, the European Central Bank posted its credit facility rate at a negative 0.10%. In a negative rate world instead of earning interest, depositors receive less money in the future for a deposit made today. Negative interest rates undermine one of the founding priciples of modern finance, the time value of money.

The policy of lowering yields has continued since 2014, and today over 25% of sovereign and corporate bonds (the majority are in Europe and Japan) are priced to deliver a negative return. As of September 30th, 2019, these were the 10 year government yields in selected European countries and Japan:

International Interest Rates
10 Year Notes

	Denmark	France	Germany	Switzerland	Netherlands	Japan
Sept 2019	-0.549 %	-0.270 %	-0.570 %	-0.753 %	- 0.424 %	-0.153 %

In the United States, yields are very low, but still positive. US Treasury Bills, considered the safest investment in the world, are currently yielding aproximately 1.6% with a nine month maturity.

In theory, a brief period of negative or very low interest rates should stimulate spending by discouraging saving. Yet no one knows the eventual consequences of sustained negative yields. What we do know is that negative yields cause a distortion in the balance of risk / return investing. Jim Grant, editor of *Grant's Interest Rate Observer*, aptly decribed the inherent problem triggered by low or negative interest rates:

> Ironically enough, ultra-low interest rates themselves seed the risks from which the buyers of negative-yielding debt are apparently seeking shelter. Investing risks abound even in times of normal rates. Aberrantly low rates set up the competition for yield that generates the distortions that sooner or later (as they say in Silicon Valley) break things.

This low yield has pushed investors out on the risk curve and we are beginning to see some spectacular failures, particularly in venture capital/private equity markets. The poster child for the downside of moving out on the risk curve in search of higher returns is a company named WeWork.

WeWork's business model provides shared office space to individuals or groups who like the benefits and ambiance of a robust work place with amentities. In an oversimplification, they purchase large tracts of space, transform it into smaller spaces that they then lease (hopefully at a profit) to tenants. This is actually an old real estate business model, modestly profitable. The colorful personality and charisma of the founder of WeWork, Adam Neumann, drove the private valuation to $47 billion in mid-summer. As they prepared to go public, the financials were scrutinized and the losses and debt that WeWork was accumulating were so great that the public offering was cancelled. The valuation is now most likely valued somewhere below $10 billion, a loss of $37 billion in less than three months. WeWork is a prime example where ultra low rates provided the jet fuel for the absurd valuation.

Our discipline of Value Investing forces us to adhere to metrics that limit risk, avoiding the likes of WeWork, Uber, Theranos and Peloton. Identifying predictable and durable streams of cash flow is our antidote for ultra low or negative rates. Value stocks like Coca Cola, General Mills, Kimberly Clark, Texas Instruments and Seagate Technologies deliver dividends and earnings growth to our portfolios each quarter, and unlike negative yielding investments, continually replenish our portfolios with cash. In addition, they tend to increase those streams with relatively predictable growth. If Einstein were alive today, he would likely find shelter for his compounding wonder in value stocks like the ones mentioned above.