November 2018

On Friday, November 23rd the S&P 500 closed in correction territory for the first time since September 20th's closing high, as stocks successfully (so far) retested October 29th's low. With sentiment once again at a bearish extreme, the trigger to launch stocks higher came Wednesday. From the front page of Thursday's WSJ:

Fed Chairman's Remarks Spark Market Rally

Dow climbs over 600 points after Jerome Powell's remarks on monetary policy

By Amrith Ramkumar and Nick Timiraos

The Dow Jones Industrial Average surged more than 600 points Wednesday, erasing its November tumble, after Federal Reserve Chairman Jerome Powell eased investor worries about an aggressive increase in interest rates.

In remarks Wednesday before the Economic Club of New York, Mr. Powell said interest rates are "just below" broad estimates of a neutral level—a setting designed to neither speed nor slow economic growth.

Investors read his comments to suggest that the Fed's rate increases might stop sooner or happen more slowly, though he didn't say so directly. The Fed chairman didn't provide any more guidance on the likely path for rates, and noted they remain low by historical standards.

Stocks climbed immediately after Mr. Powell's midday remarks, led by shares of internet and health-care companies. The advance morphed into a broad-based rally with all but one of the S&P 500's 11 sectors climbing.

The Dow industrials added 617.70 points, or 2.5%, to 25366.43, extending this week's rebound. The S&P 500 climbed 61.62 points, or 2.3%, to 2743.79, joining the blue chips in the green for the month as both indexes logged their best day since March 26. Meantime, the tech-heavy Nasdaq Composite rose 208.89 points, or 2.9%, to 7291.59.

All three indexes are up more than 4.2% for the week. It was the first time since Nov. 1 that the benchmarks climbed in three consecutive sessions.

Mr. Powell appeared to retreat from a comment he made in early October that described the Fed's benchmark interest rate as a "long way" from neutral. That remark helped send stocks sliding, raising concern about tighter financial conditions that could slow economic and profit growth.

Still, most analysts expect the central bank to raise rates next month and continue to boost them next year.

About 32% of investors expect at least three more increases by December 2019, down from 37.3% a day earlier, CME Group Data show. ...

On Wednesday, Mr. Powell, who became Fed chairman in February, pointed to the range of neutral-rate projections submitted by 15 Fed officials at their policy meeting in September, varying from 2.5% to 3.5%. The Fed's benchmark federal-funds rate since then has been between 2% and 2.25%—or just below the lowest estimate.

If the Fed, as expected, raises the fed-funds rate next month to a band between 2.25% and 2.5%, that would leave it touching the bottom of the range of neutral estimates but four more quarter-percentage-point increases from the top.

The Fed's pattern of raising rates gradually—roughly once a quarter over the past two years—aims to balance two risks.

"We know that moving too fast would risk shortening the expansion," Mr. Powell said. "We also know that moving too slowly—keeping interest rates too low for too long—could risk other distortions in the form of higher inflation or destabilizing financial imbalances." ...

U.S. stocks in recent weeks joined major indexes around the world and assets sensitive to global growth in a synchronized retreat. President Trump has criticized Mr. Powell and the Fed for raising rates, asserting that the central bank was threatening U.S. growth as stocks tumbled.

Despite this week's rise, the Dow industrials remain 5.4% below their Oct. 3 highs, while the S&P 500 and Nasdaq are off 6.4% and 10%, respectively, from their records earlier this year.

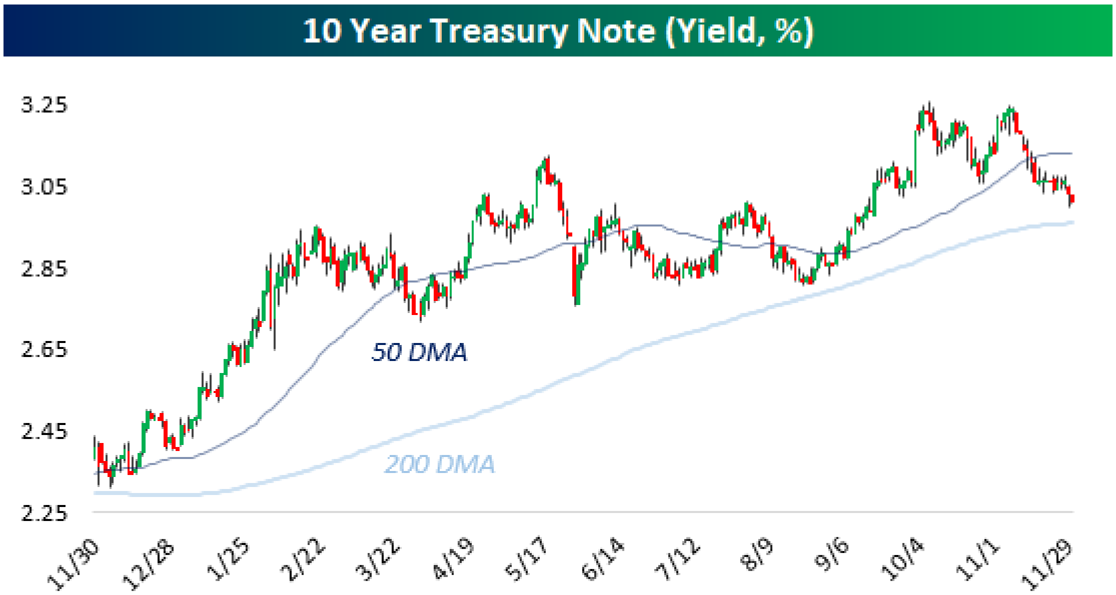
The retreat has been led by fast-growing technology companies that some investors fear won't be able to continue boosting sales at the same pace in a rising-rate environment. Many of those stocks led Wednesday's rally, with Apple, Amazon.com, Google parent Alphabet and Netflix all up more than 3.7%. ...

Ahead of an end-of-week Group of 20 summit in Buenos Aires and an expected update on trade, investors have been weighing whether recent declines in the technology sector are a temporary blip or a broader change in market leadership. ...

The yield on the benchmark 10-year U.S. Treasury yield fell to 3.044% Wednesday from 3.057%. Yields fall as bond prices rise. The WSJ Dollar Index, which measures the U.S. currency against a basket of 16 others, slumped 0.5%, and has edged lower since hitting its highest level since March 2017 earlier this month.

The moves came as investors also parsed figures showing a second reading of U.S. third-quarter economic growth stayed at 3.5% and new home sales slumped last month. Weakness in the rate-sensitive housing and auto sectors continues to worry some analysts anxious about tighter financial conditions.

The rally continued through Friday, with the S&P 500's gain of 4.9% being its best weekly return since 2011. Interest rates continued to retreat, as shown in Bespoke's chart from Friday. Also from Friday, BCA Research's weekly Global Investment Strategy: "The model's near-term outlook on bonds has improved greatly in recent weeks after having spent the better part of the last 18 months in bearish territory. To be clear, this is a tactical signal: The model's cyclical fair-value estimate for the U.S. 10-year Treasury yield stands at 3.71% – 67 basis points above current levels – which implies that the 12-to-18 month path for yields remains to the upside. Nevertheless, with global growth slowing and lower energy prices dragging down inflation, there is a good chance that the 10-year yield will temporarily fall below 3% before resuming its structural uptrend."



"Pundits forecast not because they know, but because they are asked." -- John Kenneth Galbraith

So if you had asked a gaggle of "pundits" what is wrong with the stock market during the current correction the resulting lists would have invariably included rising interest rates (see above) and our trade war with China. Our view of Trump is that he will easily contend for the worst president in history, and that he will do whatever he believes is in his best interest at the moment. However, that doesn't mean that his dealings won't sometimes also be in the best interest of our country. He continually sows chaos, and then takes credit for riding to the rescue. We are loath to make predictions, but this is why we previously shared our view that Trump's administration would conclude the renegotiations on NAFTA before the midterm elections. His tendency to measure his own performance by the stock market should always be kept in mind when listening to the Chicken Littles. From the WSJ this morning:

U.S., China Reach a Truce on Trade

The U.S. will delay a planned increase in tariffs on Chinese goods, as the two sides prepare for further negotiations

By *Lingling Wei*, *Bob Davis* and *Alex Leary*

Dec. 2, 2018

BUENOS AIRES—China and the U.S. agreed to a cease-fire in a trade battle that has shaken global markets, with the U.S. postponing plans to increase tariffs on $200 billion in Chinese goods and the two sides entering negotiations on other contentious issues.

The truce was designed to ease tensions after months of escalating trade conflict, and held out the prospect that the world's two largest economies could find an accommodation that would set their trading relationship on a different path. ...

According to the White House, the two nations will discuss thorny issues of Chinese economic policy, including forced technology transfer, intellectual-property protection, non-tariff barriers, cyberintrusions and cybertheft, services and agriculture. The two sides would "endeavor" to wrap up the talks in 90 days.

Should the talks fail, the White House said, the tariffs on the $200 billion of goods would increase to 25% from the current 10%. The tariffs were set to increase to that level on Jan. 1.

Chinese Foreign Minister Wang Yi and Commerce Vice Minister Wang Shouwen, in a press briefing, said only that the talks would focus on removing all U.S. tariffs and Chinese retaliatory tariffs and made no mention of a deadline. ...

The deal .. emerged after a dinner between President Trump and President Xi Jinping following a summit of the Group of 20 nations in Argentina ....

Already, officials in China have begun to plan for negotiations in Washington in mid-December, people briefed on the plans said. ...

The 90-day time frame given by the U.S. means the talks would wrap up around March 1, just before China's annual national legislative session, a time when Chinese leaders are wary of making concessions to foreigners, heightening the stakes.

"An escalation of the tariff war then would be embarrassing for Xi Jinping," said Scott Kennedy, a China expert at the Center for Strategic and International Studies, a Washington think tank.

The cease-fire follows the model of partial agreements the U.S. has cut in recent months with the European Union and Japan, U.S. officials said.

According to the White House, Beijing agreed to purchase a "very substantial" amount of agricultural, energy, industrial, and other products from the U.S. ...

Other pledges went well beyond trade issues. Both sides agreed that China would designate the heavily addictive opioid Fentanyl a controlled substance, subjecting those selling the drug to criminal penalties. They also said China would help the U.S. in its efforts to get North Korea to give up nuclear weapons.

Mr. Wang, China's foreign minister, said the U.S. had agreed to continue to adhere to the one-China policy, where Beijing asserts that Taiwan is a part of China. The White House statement didn't mention that issue. ...

Two from Morningstar's resident guru that cast further doubt on anyone's ability to foresee the future:

Yes, Stocks Can Become Overvalued

John Rekenthaler 13 Nov 2018

The Socratic Method
Friday's column (which we shared and is now posted in our website's Worth Sharing section in **Trump's "very close to complete victory" - 11/12/18**) advocated self-awareness. The stock market's movements seem to be meaningful, but their signals are spurious. Therefore, investment wisdom consists of learning to avoid the temptation to trade. The investor who acknowledges his ignorance is better off than the investor who does not.

That argument, of course, was not invented here. From Plato's "The Apology": *I am wiser than this human being. For probably neither of us knows anything noble and good, but he supposes he knows something when he does not know, while I, just as I do not know, do not even suppose that I do. I am likely to be a little bit wiser than he in this very thing: That whatever I do not know, I do not even suppose I know*. ...

A reader, Marvin Menzin, noticed. "Your advice implies that investors should buy and blithely hold. It ignores the possibility they might want to reduce your exposure because of excess stock-market valuations. I think it would be an excellent column if you were to address when investors should rebalance to lower-risk portfolios, especially when it's a retirement account and taxes are not germane. Investors are told to stay the course. The *Titanic* stayed the course!"

Well, Mr. Menzin, this is that column. Although I must confess, the "when" is exceedingly rare. Since World War II, I can think of only one clear and obvious occasion when U.S. stock investors should have reduced their exposure. ...

Judgment Time

Unfortunately, I do not see how mechanical processes can guide investment strategies that are based on stock-market valuations. Those who have tried--most famously by using the Shiller CAPE P/E Ratio, which examines stocks' cyclically adjusted price/earnings ratios--have failed. Such measures work well in hindsight, but they have not been useful predictors. Their explanatory power has been academic rather than actual.

The discrepancy occurs because, well, things change. Implicit in every market indicator is the concept that the past repeats itself. The stock market's fluctuations--and the breathless stories that accompany those gyrations--create a false impression. They suggest that this time is different, when in fact it is not. The average, unbeknownst to the forecaster, has moved.

When devising their indicators, researchers face no such problem. They obtain a date set, determine its mean, study the deviations, and discover signals that explain the patterns. Within their constructs, the signals cannot help but to inform. They were, quite literally, built to succeed for the evidence that they examined.

There is no such stability in the real world. It may be that future conditions remain similar to those of the past, in which case the newly released indicator will likely prove valuable. But often, that is not so. For example, owing to many reasons (including a low inflation rate, the lengthening of the economic cycle, and, in recent years, record corporate profit margins), the price ratios for U.S. stocks have been higher during the past 25 years than they were before. That has played havoc with stock-market price indicators, the Shiller CAPE Ratio included.

Historical Assessments

Which leaves those wishing to avoid an overpriced equities market depending on judgment. For 20 years following the conclusion of World War II, there was no judgment to be applied. Remaining in equities was the correct decision.

Then came 15 terrible years, through the mid-1980s, when stocks were devastated by inflation. For that stretch, investors would indeed have done well to avoid equities. However, making that choice involved understanding the economy, not judging the level of equity valuations. It wasn't that stock prices were particularly steep. It was instead that inflation spiked far higher than it had been, and also far higher than it would become.

Since the early 1980s, stocks have crashed three times.

Two of those occasions, I believe, were almost impossible to anticipate. Black Monday in 1987 came out of nowhere; even in hindsight, it is difficult to understand why. The 2008 financial crisis, on the other hand, happened for well-documented reasons. But once again, the determinants were economic. Across the globe, banks collapsed and housing markets sunk. No stock-market indicator could have anticipated that.

The one occasion in which judgment served was during the "New Era," when technology stocks posted valuations that still exceed all subsequent levels. Sentiment was equally overheated. That truly was a time to slash one's stock-market exposure. Even then, though, the timing needed to be right. Those who sold equities in 1996 fared worse than those who stayed the course and held through the worst of the downturn. (In a televised speech on December 5, 1996 then-Federal Reserve Board chairman Alan Greenspan famously warned: "Clearly, sustained low inflation implies less uncertainty about the future, and lower risk premiums imply higher prices of stocks and other earning assets. We can see that in the inverse relationship exhibited by price/earnings ratios and the rate of inflation in the past. But how do we know when **irrational exuberance** has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?" However, it took another 3 years for the dot-com bubble to burst.)

In short, Friday's column overstated its case. Sometimes stocks *do* cost too much. But recognizing when that situation arises, and profiting from the knowledge, is a severe task. ...

The Prediction of a New Normal, Reviewed

John Rekenthaler 27 Nov 2018

Bad Moon Rising
The most-cited economic forecast of this millennium has been 2009's "New Normal" prophecy, which posited that this time, for once, was indeed different. The economic future would differ sharply from that of the past. As many people seized upon the label, there was no single definition of the New Normal. However, a March 2009 missive from McKinsey lays out the main elements:

1) **Sluggish growth** in the United States and Europe.

As both companies and consumers deleveraged their balance sheets, by using their free cash to repay debt rather than to expand, gross domestic product growth would be sluggish. Both supply and demand would be affected. Corporations would have less money to invest, and consumers less for purchases.

2) More **government intervention**.

Just as the Great Depression spawned the Securities Act of 1933, and several other major financial bills, the 2008 financial crisis will lead to greater government involvement. At the least, governments will stiffen their regulations and enhance oversight; at the most, they will enact trade barriers.

3) The possibility of **social unrest**.

Torpid GDP growth, accompanied by stagnant wages, didn't figure to please the masses. The McKinsey brief states, "The big unknown is whether the temptation to blame Western-style capitalism for current troubles will lead to backlash and self-destructive policies."

Good on Economics
Kudos to the seers! Growth was, as predicted, disappointing. In the United States, the highest real calendar-year GDP growth rate was but 2.7% (in 2014), as opposed to above 5% during the previous expansion and almost 5% during the 1990s. The forecast for government activities was solid, too. Governments did get more involved, albeit more by strengthening their fiscal policies through quantitative easing than by creating new restrictions, and the feared trade conflicts have arrived. As, of course, has social unrest.

(I wonder: Did 2009's political scientists anticipate the U.S./European revival of populist nationalism? Or was this an intuition that occurred only to economists? If you know the answer, I would be delighted to hear it.)

Bad on Stocks
None of this, unfortunately, directly helped stock investors. The prognosticators correctly foresaw the political and macroeconomic trends, but they failed to understand how those events would affect equities. Unsurprisingly, they expected tepid growth, great government involvement, and social turbulence to depress stock markets. But such was not the case. Equities soared, most notably in the U.S., but for the most part throughout the developed markets.

Stocks appreciated because corporate profits surged and inflation stayed quiet. At essence, equity prices depend upon the answers to two questions: 1) how much money a company earns, and 2) the rate at which those earnings are to be discounted, due to the time value of money. If those responses are sufficiently positive, other concerns pale. That is in fact what happened. The forecasters' concerns came true, but they ultimately were set aside.

The New Normal's map was broadly accurate, as far as it went. It accurately portrayed the general economic themes. Those versed in the New Normal understood why unemployment remained higher than in previous discoveries, and that government scrutiny was to be expected. They also were prepared for the political backdrop.

In short, those who crafted the New Normal template considered the actions of chief financial officers (in repaying debt), government officials, legislators, and even voters. But they missed a key constituency: institutional investors. Corporate executives don't listen much to me, and probably not to you as well, but they do tend to pay attention to their largest shareholders. And the message they received from those parties has changed, dramatically. Corporate managements have been told to be conservative. They are under pressure to maximize current profits, rather than spend on projects for later. ...

Improving the Forecasts
Such scolding had a meaningful effect on corporate profits. By training corporate managements to retain more of their profits, rather than plow them into ventures for the future, institutional shareholders helped to boost current earnings--which, in turn, has made for higher stock prices. How much companies' higher profitability owes to restraining from capital expenditures and how much to other factors, is unclear. But there's no doubt that institutional-investor behavior has affected equity prices, in a manner that the market forecasters failed to perceive.

Whether this stock-market boost is permanent, or ... the product of a temporary "sugar high," is an open question. It may be that institutional owners have corrected corporate management's previous wasteful ways, or it may be that stock prices will lag down the line, because corporations have underinvested. Which is the case, I cannot say. I do know, however, that when formulating their projections, stock-market prognosticators need to start considering the motivations of institutional investors. They matter.

John Rekenthaler has been researching the fund industry since 1988. He is now a columnist for Morningstar.com and a member of Morningstar's investment research department. John is quick to point out that while Morningstar typically agrees with the views of the Rekenthaler Report, his views are his own.

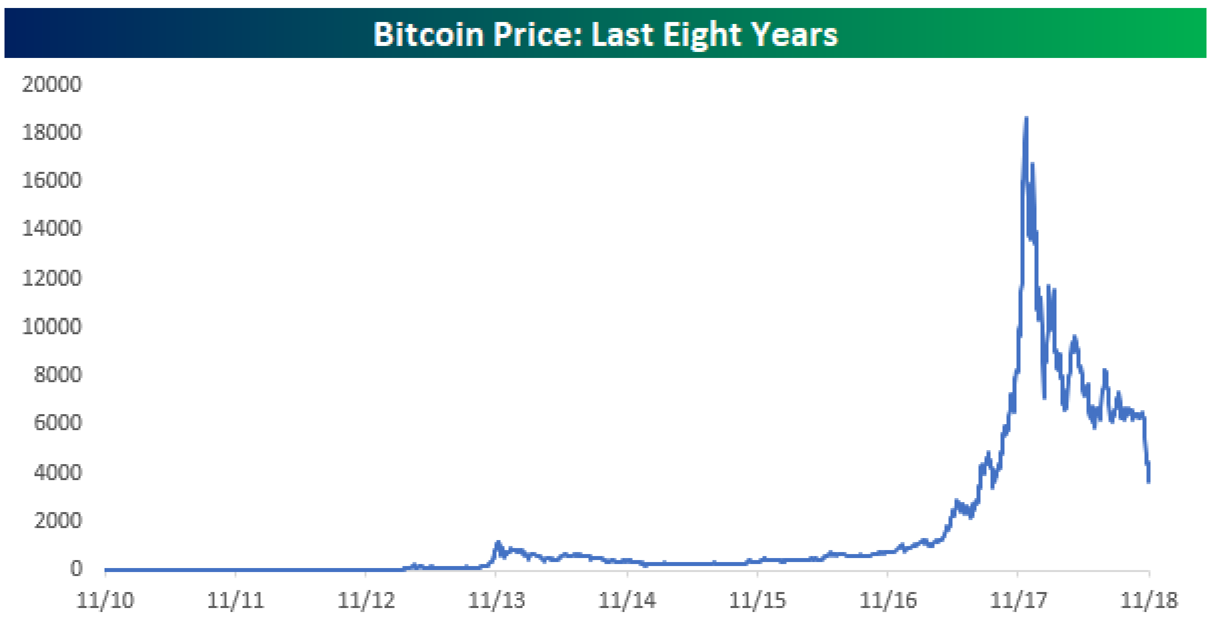
Follow-ups

On Nov. 27, 2017 I received the following email from a client: "Is there any way to invest in Bitcoin, other than creating a wallet and buying coins?" My response: "Our view of Bitcoin (and other crypto-currencies) is that it is in a classic bubble. The only question is when it will pop, not if, and trying to time that pop is very dangerous. I'm not familiar with any traded securities that would make it easy to invest in Bitcoin regardless." Bitcoin hit a new lifetime high of $9,973 that day, and would trade at an all-time high of $19,783 exactly one month later. In January I used Bitcoin as my last example of an asset bubble in an Advanced Topics in Investments' lecture at the University of Oklahoma. From Bespoke one year later:

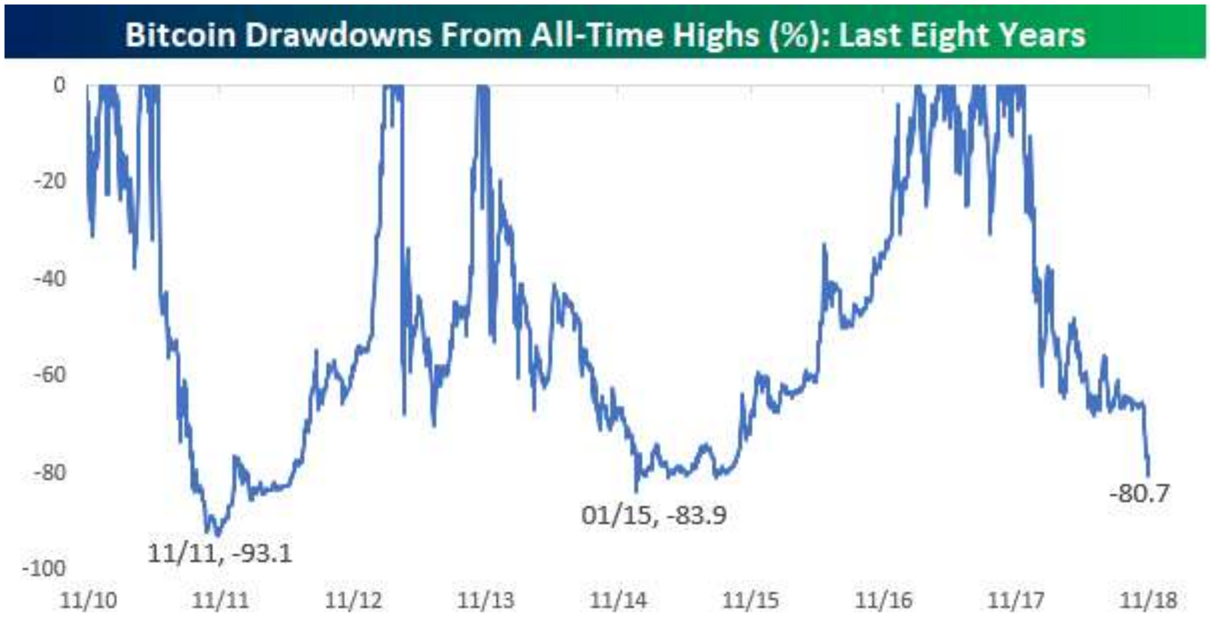
Bitcoin Keeps Crashing

Nov 26, 2018

What a difference a year makes! Last year at this time, bitcoin was in the middle of a run where it seemed to break through 1,000-point thresholds every couple of days (and in some cases even faster). Now, the leading crypto-currency is seemingly crashing through 1,000 point thresholds to the downside on what seems like a daily basis. In less than two weeks, the price has dropped below 6,000, 5,000, and now 4,000 today.



The chart above is certainly ugly, and while the decline from the peak earlier this year is by far the largest in point terms, in percentage terms as well, bitcoin's decline from the highs is nearing historical proportions. In its eight-plus year history, the current decline is only the third time that bitcoin has fallen more than 80% from an all-time high. The largest decline ended in November 2011 when the price fell 93.1% from its high. Then, in January 2015, bitcoin experienced a drawdown of 83.9% from its high. In order for the current decline to move into second place in terms of magnitude, bitcoin would have to fall below 3,006 (-17%) and to surpass the record decline from November 2011, the price would have to fall another 64% to 1,288 or lower.



If you're still a bitcoin bull, at least you know that it has actually been here before and eventually bounced back! ...

As we keep repeating, it's a Caveat Emptor world out there. From November 19th's WSJ:

Brokers Purge Their Records

By Jean Eaglesham and Coulter Jones

Thousands of brokers have scrubbed their records clean of complaints by customers and employers, allowing them to hide information from potential investors, according to a new study.

These brokers were more likely than other ones to receive additional complaints or other allegations of misconduct after their records were cleaned, according to the academic paper, which analyzed public regulatory records from 2007 to 2016.

The scrubbing process, known as expungement, is overseen by the Financial Industry Regulatory Authority, the industry-funded brokerage regulator. Under Finra rules, arbitrators are expected to allow a record to be deleted from the public "BrokerCheck" website only if an allegation against a broker is factually impossible, "clearly erroneous" or the broker wasn't involved in an alleged misconduct.

Expungement is meant to be a rare event, regulators say. But the study, which analyzed BrokerCheck records and other regulatory information, found that arbitrators granted requests nearly 70% of the time.

Scrubbing so many records — 4,572 of the 6,700 requests were agreed to— makes it hard to track bad actors and harms "the ability for regulators and consumers to monitor brokers," according to [the study] by Colleen

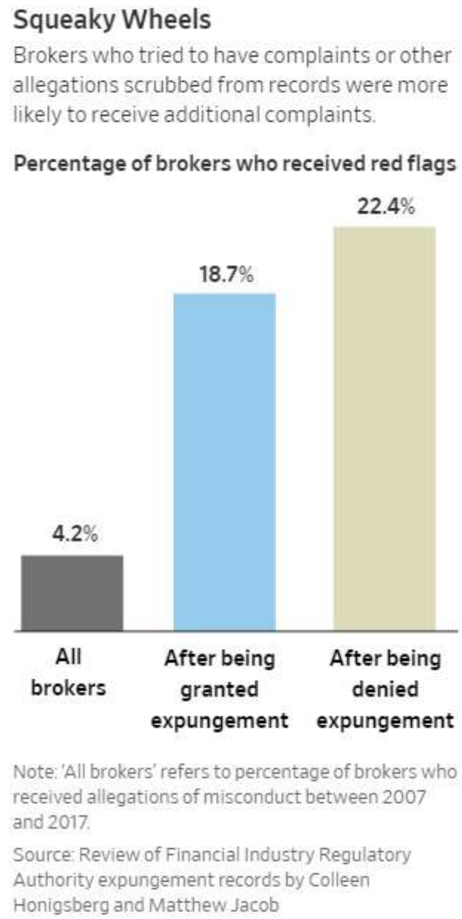
Honigsberg, an assistant law professor at Stanford University, and Matthew Jacob, an economics pre-doctoral research fellow at Harvard University. ...

There are about 630,000 active brokers registered with Finra. Most don't have any complaints or expungement requests. ...

Finra urges investors to check brokers' disciplinary records, using its BrokerCheck system. But these records don't show attempts to scrub complaints, even though such requests are a red flag, according to the study. ...

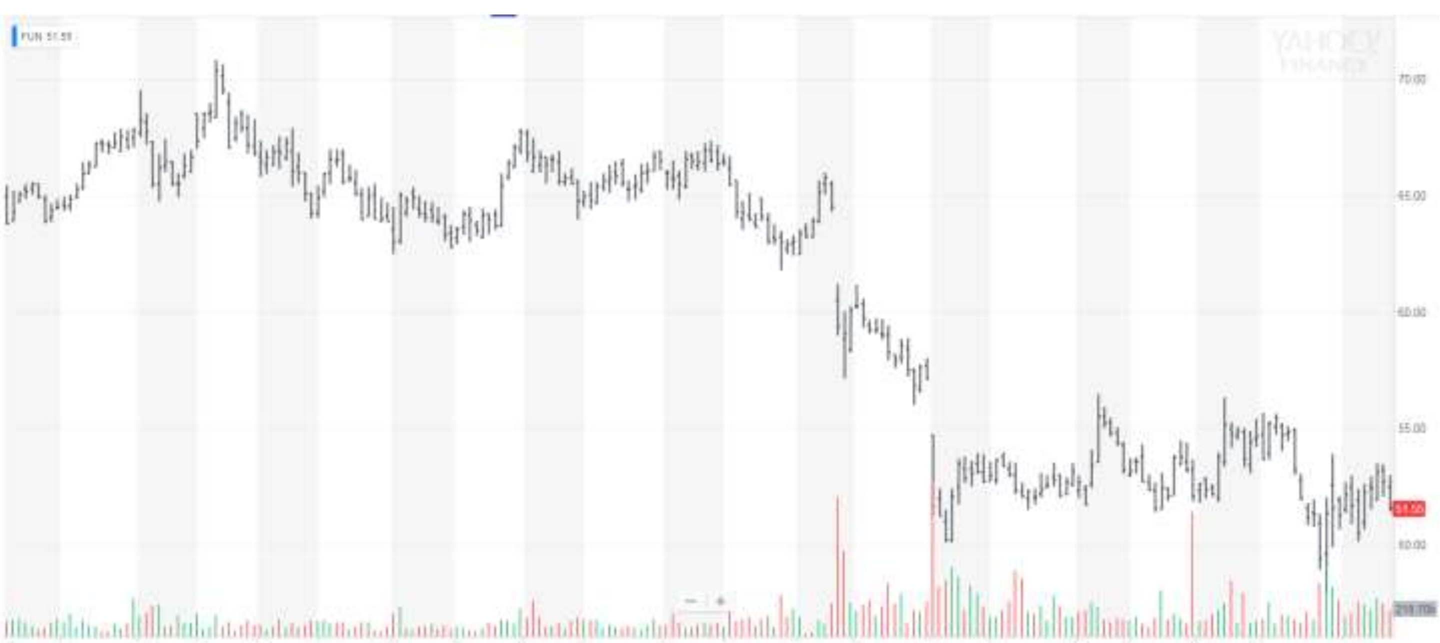
A recent surge in brokered sales of private stakes in companies, known as private placements, could fuel new requests to scrub records. Brokers who sold these deals were four times more likely to seek expungement than the industry average, according to an analysis of arbitrators' records by Ms. Honigsberg and Mr. Jacob. Their success rate – 62% -- is slightly worse than the industry average, the analysis found.

More than one in five brokers who were denied requests to scrub red flags went on to rack up additional allegations of misconduct, the study found. That compares with only 4% of all brokers who received any allegation of misconduct from 2007 to 2017, according to the study. ...



Positions

Fun - On 11/12 we added 2% positions for 2 clients in this Amusement Park MLP @ 52.2. Due to potential tax complications stemming from K-1s, HCM usually refrains from buying MLPs in IRA or 401(k) accounts.



Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
11/05/2018	1	KLEIN THOMAS		20,000
11/02/2018	2	HANRAHAN DANIEL J, AFFELD		17,000

From High Dividend Opportunities on Dec. 21, 2017, which bought on 8/26/15 @ 53.07:

Value In Resilience – Safe & Growing 5.3% Yield From An Entertainment Company

We are pleased to provide our members with an update on **Cedar Fair** (FUN), a stock that we hold in our Core Portfolio. Below is our new research report:

Summary:

- *At "High Dividend Opportunities" we value simplicity, predictability and resilience in business economics. This is especially true in times of uncertainty when many sectors are looking expensive.*
- *Taking a long-term view, we believe that "wide moat" businesses such as amusement parks have the potential to greatly outperform the markets.*
- *Cedar Fair (FUN) owns a diversified portfolio of amusement parks with high barrier to entry and a superior track record of return generation.*
- *The shares are not a great bargain today, but the expected return profile remains attractive in relation to the business risk.*
- *5.3% yield + 4% long term annual growth from wide moat assets that are recession resilient sounds appealing to us.*

Why seek to invest in highly complex ventures with unpredictable fundamentals when there are plenty of relatively simple and reliable businesses in which one can invest? This is a question that we ask ourselves on a regular basis, as we favor simplicity over complexity.

Many high-tech sector firms that trade on the Nasdaq are 'sexy', but their business model can be complex as many have their profitability rely on technology that can quickly become obsolete. They have to keep changing their product mix and keep innovating to survive. Is this "sexiness" really worth the unpredictability of these sectors? We do not think so and we prefer business models that we can easily understand. Investment Guru Warren Buffett once said:

"Never invest in a business you cannot understand."

In this sense, unless one is a tech engineer and really understands the functioning of the technologies themselves, we argue that one should limit investing in sectors he/she does not understand. ... we always seek to pick sectors that we have deep experience in, and where we have an analytical edge. This has served us well over the years and helped us avoid making costly mistakes.

Simple and Powerful Business Model

A great example to illustrate our point is **Cedar Fair L.P**, an attractive business that anyone can understand.

FUN is the owner of a portfolio of 11 amusement parks including its flagship park, Cedar Point, located in Ohio, California, North Carolina, South Carolina, Virginia, Pennsylvania, Minnesota, Missouri, Michigan and Toronto, Ontario.

These amusement parks are the typical roller coaster-filled parks that you would expect:

In addition, Cedar owns 3 water parks which are similar businesses targeting a slightly different clientele; as well as 5 hotels with over 1600 rooms that are associated to the amusement parks.

Most importantly, this is a very simple business model. Cedar buys land, develops it into recreational assets and then sells related tickets, food, beverage, etc… to earn a return on its investments. This is a business that we particularly like because ***not only is it simple, it is also surprisingly powerful.***

1. It has high barriers to entry.
2. It is recession resilient.
3. It has a history of significant return generation.
4. It has good long-term growth prospects.

High Barriers to Entry

Earnings power is not very valuable unless there is a clear “moat” to protect a company from its competitors. As such, it is always important to assess the sustainability of the earning power by looking at the competitive landscape of specific markets.

In the case of amusement parks, we note that there is not only a moat, but a “wide-moat” protecting these earnings. The amusement park market is one that is very difficult or perhaps in some cases even impossible to enter for new players. This is because first of all it requires significant land with favorable demographics which is very difficult to find at a reasonable price. Secondly, once a potential site is found, the developer must seek permits which at best are very costly and time-consuming to obtain, and at worse are simply impossible to negotiate. Lastly, even if a developer managed to find an adequate site and obtain permits, it would still require a very significant capital investment – resulting in financing issues. Furthermore, developers understand that there can be only a limited amount of amusement parks in a given market and therefore limit cannibalizing returns, so it is unlikely that a new player decides to come build a new park right next to an existing one and target the exact same clientele.

The result is a high barrier to entry business for Cedar with high and sustainable earnings power. The wide-moat is simply the result of the high hurdle to build new parks – making the position of existing park owners particularly strong.

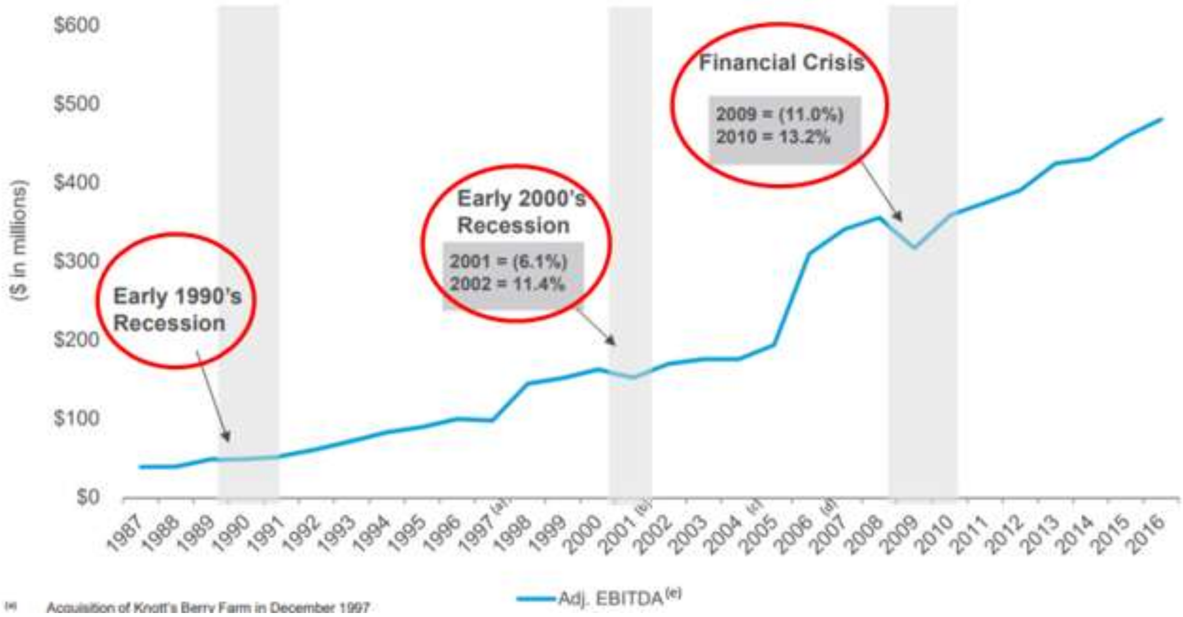
Finally, we do not expect this strong position to change anytime soon. We see no significant “disruptor” that could harm this positioning and we also note that this is an “e-commerce-proof” business.

Recession Resilient

Now that we identified that the “supply side” of entertainment parks is favorable for existing owners, it is time to turn to the “demand side”. More precisely, how does the demand behave in varying market environments?

In the case of Cedar, we note a strong resilience at the demand level, regardless of the broad economy. Cedar is a time-tested, or better we say “crisis-tested” company, that has undergone many time periods of economic crises, and yet it has shown great resilience.

Looking back at the Adj. EBITDA performance since 1987, we focus on three distinct periods namely, the early 1990’s recession, the early 2000’s recession and the latest financial crisis of 2008-2009:



While most businesses suffered very significant set-backs during these times of economic trouble, Cedar Fair managed to maintain high profitability with only relatively limited declines in EBITDA, which were quickly recovered in the following year. In 2001 for instance, EBIDTA declined 6% only to recover 11% in 2002. In 2009, EBITDA declined 11%, but shortly after in 2010 recovered by 13%.

What this tells us is that the demand for amusement park entertainment tends to remain high regardless of the general economy. People still want entertainment even when undergoing some financial difficulty, and many may even see amusement parks as budget friendly alternatives to other more costly forms of entertainment during times of recession. For instance, we could well imagine a middle-class family cancelling a long vacation which includes flights, hotels and rental car to instead visit a close-by amusement park for a few days.

Entertainment is never perfectly resilient to recessions, but amusement parks, and especially Cedar Fair appears to have assets that enjoy great demand across all cycles of the economy.

Superior Track Record of Value Creation

The fact that Cedar has a favorable "supply side" (high barrier to entry) in addition to a resilient "demand side" (resilience to recessions), has resulted in a track record with outstanding returns over its history. Since going public about 30 years ago, Cedar investors have earned a **compounded annual total return of 17%**. Put differently, a $10,000 investment would have grown to well over $1 million within the 30 years (without factoring in the impact of taxes).

Numbers don't lie, and such market outperformance is really proof of above average business economics. Wide-moat assets, with high demand, and resilience to recessions can produce wonders and this track record is an example of it. With its history of success through economic cycles, Cedar managed to increase its revenue in 19 out of the last 20 years.

Moreover, the performance of the last seven years has been very steady with record results being posted every single year. Since 2012, EBIDTA has grown at an average of 4% per year, and **the management remains committed to growing its annual distribution by 4% per year** while continuing to invest in its business, as is confirmed in their latest earnings call.

Solid Long-Term Prospects

A track record of outperformance certainly does not guarantee future outperformance; and it must be clear that we do not expect Cedar Fair investors to keep earning a compounded 17% return per year into the future. The market has changed, and the future growth could slow down.

That said, we continue to foresee solid prospects for the long run. There are many opportunities for Cedar to keep generating EBITDA growth and the long term mega-trend towards an "experience-based" business model that will keep supporting the high demand.

Cedar Fair has a solid balance sheet structure which gives the company the financial flexibility to capitalize on future prospects. The company's leverage ratio is only at 3.5 times with no significant maturities until the year 2020.

Cedar's five-year capital strategy includes spending 10% of revenue on new rides and park infrastructure to improve guest experience and drive growth. There are currently four major new roller coaster expenditures planned for 2018, two of which are "Steel Vengeance" and "RailBlazer":

Moreover, Cedar plans on investing incremental capital to develop land adjacent to its parks utilizing cash on its balance sheet. The company owns approximately 1,400 acres of undeveloped land adjacent to their parks which can be used to build hotels to expand accommodation services, increase amateur sports facilities to drive incremental attendance, and/or add new complementary commercial development opportunities in retail, dining and entertainment:


Amateur Sports Facilities


Resort Expansion


California's Great America Rezoning

Lastly on a more general note, we expect the mega-trend towards an "experience-based" business model to be a long-term catalyst for Cedar. Younger generations put more and more value towards experience based activities rather than passive ones, and we do not expect this to change any time soon.

We don't expect **Netflix** or **Amazon** to steal amusement park's business and believe that people will continue to desire to get out and **EXPERIENCE** outside world entertainment rather than just sit on their couch and watch TV shows for their entertainment needs.

In this sense, the long-term prospects appear favorable to us. We do not foresee very rapid growth from capital intensive businesses such as amusement parks, but we believe that a mid-single digit growth rate is achievable over time. And this is plenty for us… given the already +5% yield (currently 6.9%), we really do not need phenomenal growth to earn a satisfying return over the long run.

The Distributions

Cedar Fair is a limited partnership, and thus the dividends are paid in form of tax-advantaged distributions. True that some investors do not like to deal with K-1 tax forms, but such distributions can have many advantages as most are not taxable as they are received by the investor, but rather they reduce the cost basis of the investment. Untaxed distributions result in **reducing the cost basis** for the investors. The main advantage here is that these untaxed distribution can turn out to be **tax free if held by investors until death,** and thus can escape taxation altogether.

On November 30, 2017 Cedar Fair declared a $0.89/share quarterly dividend, **which represents a 4.1%** increase from prior dividend of $0.855. Below is a table of the dividend history for the past 4 years.

Dividend Type	Amount	Record Date	Payment Date
Cash	$ 0.890	--	--
Cash	$ 0.855	9/6/2017	9/15/2017
Cash	$ 0.855	6/5/2017	6/15/2017
Cash	$ 0.855	3/3/2017	3/15/2017
Cash	$ 0.855	12/5/2016	12/15/2016
Cash	$ 0.825	9/6/2016	9/15/2016
Cash	$ 0.825	6/3/2016	6/15/2016
Cash	$ 0.825	3/14/2016	3/28/2016
Cash	$ 0.825	12/3/2015	12/15/2015
Cash	$ 0.750	9/3/2015	9/15/2015
Cash	$ 0.750	6/3/2015	6/15/2015
Cash	$ 0.750	3/13/2015	3/25/2015
Cash	$ 0.750	12/3/2014	12/15/2014
Cash	$ 0.700	9/4/2014	9/15/2014
Cash	$ 0.700	6/4/2014	6/16/2014
Cash	$ 0.700	3/14/2014	3/25/2014
Cash	$ 0.700	12/4/2013	12/16/2013
Cash	$ 0.625	9/5/2013	9/16/2013

As we can note from the table, the company was able to increase its dividend payout by 14.2% since the year 2013 (or over a period of 4 years).

Not a Bargain, But a High Quality Company Selling at a Reasonable Valuation

High quality businesses with high barriers such as Coca-Cola, PepsiCo, Procter & Gamble, or Johnson & Johnson tend to be expensive. Cedar is no exception here trading at close to 22 times last year's net income.

It could however be argued that net income is not the most adequate figure to assess Cedar's valuation given its asset-heavy balance sheet and high depreciation expenses. Adding back the depreciation and amortization expense to the net income, we get a multiple that is significantly lower at 13.

While the depreciation expense may overestimate the true cost of maintaining assets, we believe that it is unreasonable to add it back completely to net income when assessing valuation. Cedar owns some assets such as roller coasters which do depreciate, but on the other hand, it also owns assets such as hotels that may even appreciate rather than depreciate. It makes it very difficult to determine what is the true depreciation expense that reflects the real loss in economic value.

Assuming a 50% reduction in depreciation expense, and adding it back to net income, we get an adj. P/E multiple of 15-16. This is far from providing a perfectly correct valuation, but it gives us an idea of what the valuation would be with more aggressive non-cash expense assumptions.

Net income	$ 177,688	$ 112,222
Interest expense	83,863	86,849
Interest income	(177)	(64)
Provision for taxes	71,418	22,192
Depreciation and amortization	131,876	125,631
EBITDA	464,668	346,830
Net effect of swaps	(1,197)	(6,884)
Unrealized foreign currency (gain) loss	(14,345)	80,946
Equity-based compensation	18,496	15,470
Loss on impairment/retirement of fixed assets, net	12,587	20,873
Class action settlement costs	-	259
Other [(a)]	1,039	1,744
Adjusted EBITDA[(b)]	481,248	459,238

This is not cheap, neither overly expensive. A solid business deserves to trade at a solid multiple, and we believe that even at this valuation, Cedar shareholders may earn a very satisfying return over the long run.

At the current price, the dividend ... is well covered by cash flow and expected to keep on growing. ...

Risks

A comprehensive list of risks have been highlighted in the company's latest 10-Q report. The most notable risk is the impact of rising interest rates which can negatively impact profitability. The company manages interest rate risk through the use of a combination of fixed-rate long-term debt, and interest rate swaps that fix a portion of their variable-rate long-term debt. ... A growing economy is likely to increase cash available to consumers, which in turn will have more money to spend on leisure and entertainment.

Bottom Line

Simplicity combined with solid business economics is music to our ears. Add to that high barriers to entry, recession resilience and solid long-term prospects – and you can be sure that we will remain interested.

Cedar Fair is not a "home-run" type of investment, but it is a solid pick for any dividend growth investor targeting above-average yields and growth over the long run.

RBS - On 11/16 we added 2% positions for 3 clients in this IVA System pick @ 5.7167.

Insider Buying:

Trade Date↑	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
10/31/2018	2	CORMACK IAN, CORMACK IAN		30,000
10/30/2018	1	MCEWAN ROSS MAXWELL		99,458
10/29/2018	2	DAVIES HOWARD JOHN, MARK		39,066

From Morningstar:

RBS Continues to Build Capital, Takes Provision Related to Uncertainty Around Brexit

Analyst Note | by Niklas Kammer Updated Oct 26, 2018

No-moat Royal Bank of Scotland continued to build its capital buffers in the third quarter as profits before tax grew to GBP 961 million from GBP 871 a year ago, although higher tax charges meant that aftertax profits fell behind last year's performance. Net interest income of GBP 2,154 million disappointed relative to last year as well as on a sequential basis owing to competitive pressures, higher average liquidity balances, and some one-off items. The net interest margin stood at 1.93%, down 8 basis points from last quarter and 19 basis points from last year. Other net interest income increased 71% to GBP 1,468 million mostly due to insurance indemnity recoveries. Higher payment protection insurance provisions due to higher-than-anticipated application volume and a GBP 100 million charge to prepare for more uncertainty around Brexit negotiations were clear negatives this quarter. We maintain our GBP 290 fair value estimate but adjust our ADR fair value estimate to $7.40 from $8.10 to account for movements in the pound/dollar exchange rate.

The settlement with the U.S. Department of Justice related to missold residential mortgage-backed securities has been finalized and paid in September, bringing this chapter to an end for RBS. The amount due of $4.9

billion (GBP 3.7 billion) was fully covered by provisions taken in previous quarters. As a result, the anticipated commencement of a GBX 2 per share interim dividend has been announced as RBS has built up a comfortable cushion above its capital requirements. Currently, the common equity Tier 1 ratio is 16.7% versus a self-imposed target of 13% and is expected to increase another 40 basis points next year with the finalization of the Alawwal merger agreement. While management said it intends to distribute excess capital eventually, share buybacks and special dividends are unlikely in our view before the stress test at the end of this year and a clearer picture of where Brexit negotiations are heading.

Business Strategy and Outlook | by Derya Guzel

While there are signs of green shoots in Royal Bank of Scotland's revenue generation, challenges regarding litigation and restructuring costs, as well as revenue generation, remain to be dealt with in the short term. RBS posted 2017 full-year annual net income of GBP 752 million versus a GBP 7 billion net loss in 2016. While operationally somewhat better than the previous year, significantly lower litigation and conduct cost and lower restructuring costs helped RBS return to profit. Although it is rather slower than peers, it seems RBS' management has found a good path to resolve outstanding issues and to operationally catch up with other banks on digitalisation.

RBS' management reiterated its target of a 50% cost/income ratio by 2020. However, it has also increased its restructuring cost target by GBP 1.5 billion to GBP 2.5 billion, which we have reflected in our estimates. While we find a 50% cost/income ratio by 2020 rather ambitious, under our current estimate, we have RBS reaching 60% by 2022.

Economic Moat | by Derya Guzel

We assign no moat rating to RBS. We believe the bank lost its economic moat when it made the wrong management decision to acquire ABN Amro in 2007-08, and it has not returned to profitability since. Since 2008, the bank's cost/income ratio has deteriorated to 95% from 54% in 2007, and averaged around 90% between 2008 and 2016. RBS is almost the only bank in the U.K. still predominantly owned by the government, following the bailout in 2008. While we think the government shareholding is temporary, we believe it will take several years for the government’s share to decline, given the difficult market conditions, along with RBS’ outstanding legacy issues and litigation. Changes in the shareholder structure, successful execution of the restructuring, and a strengthened position within core business segments would trigger us to revisit our moat rating.

In our view, only the personal and business banking segment looks moaty compared with the overall group structure; however, its cost advantage is not as visible as that of peers. Banks’ cost advantages are typically reinforced by high implicit customer switching costs. According to the current account switching service in the U.K., Santander, Nationwide, and Halifax (Lloyds Banking Group) stand as the main gainers when it comes to account switching, while Barclays, NatWest (Royal Bank of Scotland), and Co-Op Bank were among the banks that saw account switching to other banks, indicating RBS is losing current account customers to competitors.

RBS has an attractive retail banking business based in the U.K., and the segment generates around 45% of group revenue. It generates return on equity of 16% on a reported basis; we think this has the potential to exceed 25% once the restructuring is completed and litigation costs are settled. The cost/income ratio of personal and business banking on a reported basis stands at 72%, and when adjusted for restructuring and litigation cost, this decreases to 50%. As per RBS’ description, PBB services individuals and affluent customers with small businesses of up to GBP 2 million in turnover. We believe some of the bank’s strongest brands fall under PBB, including NatWest in England and Wales, Royal Bank of Scotland in Scotland, and Ulster Bank in Ireland.

From a moat perspective, we rate the U.K. banking system as fair, a view we maintain following the Brexit vote. Below, we evaluate the sector from an operating, economic, political, and regulatory standpoint and assess challenges faced post-Brexit. We think that the high cost of operating in the U.K. system, such as the bank tax and levy, will make it more difficult for U.K. banks to outearn their costs of equity over time.

We rate the competitive environment for banks in the U.K. as good, and we don't expect the long-term picture to change, despite regulators' effort to increase competition within the sector. With the efforts of the U.K. Competition and Markets Authority, as well as technological changes, there has been a noteworthy increase in new players in the U.K. banking sector (for example, Metro Bank, Secure Trust, Aldermore, Shawbrook, Tesco, Virgin, and Handelsbanken, as well as digital challenger banks such as Atom, Monzo, Tandem, and Starling).

In 2013, CMA introduced the current account switching service, which aimed to enable customers to switch accounts within seven days. However, considering that the U.K. has more than 40 million current account holders, and that since the launch of CASS in 2013, only 3 million accounts have been switched by customers (less than 10%), we believe these efforts remain insignificant in terms of fuelling the competition. The largest five banks still control 80% of the personal current account market, in what we call a cosy oligopoly. We believe the level of switching in the U.K. will never be very high, as products and services offered by banks and fees charged generally don't differ greatly between banks, and customers tend not to switch accounts because of customer loyalty and the feeling that switching would be too much hassle. We also support the view that customer service, rewards, and convenience remain the main drivers for customers to switch.

Barriers to entry in the U.K. banking sector are relatively high. In comparison with European peers, we think the U.K. banking system remains less competitive and highly concentrated. The recent CMA investigation into U.K. retail banking has revealed that, as was the case back in the late 1990s, HSBC, Barclays, Royal Bank of Scotland, and Lloyds remain the dominant players and between them hold 80% of personal accounts and 85% of business accounts.

Our base case doesn't factor in harsh economic conditions; however, volatility in the political environment should be on the rise following Brexit. The United Kingdom's current and future economic and political environment will be shaped by the U.K.'s vote to leave the European Union. This also creates some degree of risk related to adverse economic developments, which affects the outlook for the U.K. banking industry. The U.K. economy will certainly not get through Brexit damage-free. However, we think the country's economic growth will be much better than many feared. The Bank of England and the National Institute expect that, over the next three years, the country's GDP will be stronger than was widely expected ahead of the referendum.

The BoE expects there to be no slowdown in U.K. growth this year, with the economy growing by 2.0%, followed by 1.6% in 2018 and 1.8% in 2019. It expects consumers to boost spending this year by saving less and borrowing more. The U.K.'s most respected independent economic forecaster, the National Institute of Economic and Social Research, or NIESR, forecasts that U.K. activity will slow only marginally, from 2.0% in 2016 to 1.7% in 2017, with growth then picking up to 1.9% in 2018 and 2.1% in 2019.

Our base case reflects the GDP growth estimated by NIESR. We pencil in only a modest slowdown in balance sheet growth, along with a slowdown in lending, some deflation in house prices, a lower-for-longer base rate, higher inflation, volatility in the British pound, and modest unemployment. We thus forecast the tough revenue environment for banks to continue. We believe the negative impact of Brexit is already largely reflected in banking asset prices, and so we don’t see any further drastic negative impact in the short to medium term. In the long run, however, the implications will be determined once the U.K.’s invocation of Article 50 is done.

Only under our downside-case scenario do we expect the U.K. to enter a recession due to Brexit. In the worst-case scenario, any transition period longer than two years will surely result in slower-than-expected economic growth, a rapid decline in consumer spending and business activity, and poor lending growth and a rise in unemployment, which would result in a rapid deterioration in asset quality. While we think a longer transition period is good for business and companies, increased currency depreciation during the transition period will cause higher inflation, and higher uncertainty will cause GDP to decline rapidly. In our upside case, we project that the U.K. economy will not be affected by Brexit, leading to continued economic growth between 2.5% and 3% for 2017-21 and business as usual for the banks.

As we mentioned above, along with declining growth, some pickup in unemployment would be unavoidable as businesses delay investment decisions; thus, deterioration in asset quality metrics is possible. However, we believe the fall in asset quality will be limited, as banks have improved their underwriting since the crisis and have set a strong base for credit quality. We also believe that, following the 2008 financial crisis, U.K. banks strengthened their capital position and improved their liquidity and funding profiles a great deal, which in our view improves their ability to manage an extended period of economic uncertainty and cope with market volatility.

The political outlook in the U.K. also revolves around concerns surrounding Brexit. In mid-January 2017, Prime Minister Theresa May shared her vision for a “truly Global Britain”. While the U.K. will leave the single market, it will seek a smooth and orderly exit, and will look for free-trade agreements with the 27 countries remaining in the EU, or the EU27, as well as trade agreements with additional countries. However, on the political front, downside risks such as a second independence referendum in Scotland (as all 32 local authorities in Scotland voted to remain in the EU) could create further political volatility in the months to come.

We don’t expect any drastic change in the regulatory framework for banks following Brexit. We see the regulatory environment as fair, and note that it has improved significantly since the financial crisis. In the U.K, the Bank of England performs regulatory functions to maintain the financial and monetary stability of the markets via various organizations, including the Monetary Policy Committee, the Financial Policy Committee, the Prudential Regulation Authority, and the Financial Conduct Authority.

Within the EU, the European Commission is responsible for setting rules and regulations; however, members are free to apply stricter rules than necessary, as we believe is the case for the U.K. For example, to protect depositors, regulators in the U.K. apply stricter rules than the EC requires, such as ring-fencing, where banks are required to separate their retail business from their riskier activities. The FPC announced the ring-fencing framework in May 2016, and it is set to go into effect in 2019. Ring-fenced institutions with deposits over GBP 25 billion are expected to hold a capital buffer equal to 13.5% of risk-weighted assets.

Following the vote for Brexit, the European Central Bank's role in influencing BoE actions through the European System of Central Banks, or ESCB, will also change; however, legal changes and challenges are likely to continue for years to come. Overall, we believe that regulation in the U.K. financial sector is strong, and under our base case, we don’t expect any roll-back from policymakers’ current stricter approach. Regardless of all the changes, U.K. banks will remain subject to the Basel III and Financial Stability Board rules on global systemically important banks, or GSIBs.

As the U.K. is not maintaining its single-market access to the European Economic Area, or EEA, under MiFID, automatic access to EU passports for banking services will be lost. Hence, U.K. banks will require new licenses or agreements with EU jurisdictions. Under the Capital Requirements Directive, or CRD, U.K. banks may be granted equivalence; however, unlike MiFID, CRD contains no clear pathway for how this agreement might be reached. Under MiFID II, financial institutions outside the EEA have the right to use a modified version of the MiFID passport to offer their services in the EEA, if their home authority is deemed MiFID-equivalent. Therefore, depending on the final terms of Brexit, financial institutions in the U.K. may ultimately be able to use the MiFID passport.

Under our base case, as the U.K.'s regulatory framework has always been stricter than that of the EU, and as it is compatible with the EU banking system, it is possible that U.K. banks will be granted equivalence rights. In our view, as much as the U.K. financial sector needs Europe, Europe will need the U.K, as it is very much interconnected--as CityUK (a representative body of the financial industry) states, the U.K. holds 17% market share in cross-border bank lending, compared with 9% in France and Germany.

Some U.K. banks under our coverage are clearly much more dependent on local economic developments, GBP revenue, and passporting arrangements than others. However, we believe any potential cost from the loss of passporting rights should be meagre and manageable in terms of banks' P&Ls. In that sense, RBS and Lloyds will be less affected than Barclays when it comes to the increase in cost from the loss of passporting rights, as around 95% of their assets and banking activity are located within the U.K. With respect to passporting, Barclays management stated that several options are available, including the development of one of their EU-based subsidiaries or the licensing of branches abroad. HSBC also signalled that, if needed, it could transfer some activities to its French subsidiary.

Fair Value and Profit Drivers | by Derya Guzel

We adjust our fair value estimate to $7.40 per ADR from $8.10 to account for recent movements in the British pound/U.S. dollar exchange rate. Our investment case for RBS is intact. Each ADR is worth two common shares, and we use an exchange rate of GBP 1.28 per $1 as of October.

We expect operating costs to consume about 70% of revenue in the medium term versus 81% in 2017. We expect the cost/income ratio to ease toward 60% by 2022. Significant litigation- and conduct-related costs and the heavy burden of restructuring costs have led RBS to post huge losses over the past several years. We expect volatility in RBS' earnings to continue for the next two to three years. Hence, we forecast average 5% return on equity for 2018-22, well below its cost of equity of 9%. Having said that, we have a more constructive view on RBS' business model beyond 2021-22. We expect ROE to increase to 7% by 2022 compared with 2.8% in 2017.

We expect restructuring charges to cost the bank GBP 4 billion and legal and regulatory matters to cost a further GBP 1.5 billion over 2018-22. As RBS works through these issues, we think the strength of its core business will increasingly drive results. We expect net interest margin to rise to 1.4% in the medium term from 1.35% in 2017 as the U.K. economy strengthens and bad assets roll off.

Risk and Uncertainty | by Derya Guzel

We believe RBS has a better risk profile compared with five years ago thanks to progress on its strategic plan. First, the bank shifted its business geographically to the U.K. (nearly 90% of operating income now comes from the U.K., versus 75% 10 years ago) by exiting Asia, Australia, and its U.S. business. Second, the firm has successfully focused on its retail franchise, as well as reducing riskier activity in corporate and institutional banking, or CIB (12% of operating income, versus 45% in 2012) by exiting its equities, mergers and acquisitions, and RMBS trading business.

Litigation-related costs remain a risk to business reputation, capital, and profitability. As of the third quarter, RBS has reserved a total of GBP 5.3 billion for the PPI investigation; GBP 4.5 billion has been used to this point. The policy statement also introduced a two-year PPI deadline, which expires in August 2019, before which new PPI complaints must be made. While it’s a hard call to make, we believe current reserves should be enough to cover new claims.

Stewardship | by Derya Guzel

We continue to assign a Poor stewardship rating to RBS’ management of shareholder capital. Our rating is mainly due to four factors. First, it stems from past management decisions to expand aggressively and acquire ABN, despite the deal obviously not being in shareholders’ best interests. The second factor is the needed government rescue in 2008. Third, after many years, RBS is the only U.K. bank still majority-owned by the government. And finally, while important progress has been made in restructuring and refocusing on the core business, we believe litigation and misconduct issues, ongoing restructuring costs and improving profitability are only a few of the challenges that management needs to overcome in the near term. We will revisit our stewardship rating once the government share in the bank decreases to reasonable levels (ideally below 50%) and litigation issues are resolved.

On the topic of government ownership, we view it as temporary. We do not believe that reprivatizing of the bank will occur via a large sale; rather, we expect it to be gradual and in tranches. The government ownership in Lloyds, which was around 40%, was reduced to below 5% in seven years via three gradual sales (between 2013 and 2016). However, considering the higher level of ownership in RBS, and given its lower free float and lower trading volume, we think offloading RBS shares would be a lengthier process. However, we believe the first initial sale from the government will not come until RBS is in better shape.

Fred Goodwin, who was the brains behind RBS’ messy deal with ABN Amro (which is considered one of the worst deals in financial history), served as RBS CEO from 2001 to 2008. During his tenure, the bank become a global player. Following the government intervention, it was announced that Goodwin would be replaced by Stephen Hester; in our view, Hester took over the most difficult job one can have in banking. To his credit, he did an excellent job and was well regarded by the City and analysts, mainly for his achievements in cleaning up RBS’ bad assets. However, following heavy political interventions over his bonus payment, Hester asked to step down and was replaced in 2013 by current CEO Ross McEwan.

Before becoming CEO, McEwan headed the U.K. retail banking unit for RBS between August 2012 and September 2013; he came from Commonwealth Bank of Australia, where he was group executive for retail banking services for five years. He has more than 25 years’ experience in the finance, insurance, and investment industries. While we think that, under McEwan’s management, RBS has made significant progress on restructuring, we believe finding the right solutions for Williams & Glyn and tackling litigation and misconduct issues remain the most important and complicated tasks to deal with in the short term.

Previous RBS management will always be associated with some memorable errors--for example, signing what is considered to be among the worst deals in financial history by acquiring Dutch ABN Amro in 2007, on the brink of the U.S. financial crisis. Following this fatal management decision, the bank posted the biggest loss in banking history and had to be rescued by the U.K. government. Hence, following the global financial crisis in

2008, the U.K. government became the main shareholder of RBS, and it remains the main shareholder today. The government's investment in RBS was made in three tranches (December 2008, April 2009, and December 2009) and totalled GBP 45.5 billion (GBX 502 per share). In August 2015, the government began the process of selling shares back to the private sector, reducing its ownership to 72.9% from 78.3%, and in October 2015, the B shares were converted into ordinary shares, further reducing the government's ownership to 71.5%. Currently, the U.K. government owns 62.4% of RBS' outstanding shares. The government's share in RBS and Lloyds Banking Group (in which it owns a share of below 6%) is managed by U.K. Financial Investment, or UKFI.

UKFI was created in November 2008 as part of the U.K.'s response to the financial crisis. While the intensity, interaction, and intervention of the government's involvement as a shareholder in Lloyds Banking Group declined in line with its ownership, this was not the case for RBS, considering that the government remains the main shareholder. Thus, we deeply believe that decisions or issues relating to RBS management can be easily politicised and influenced by populist ideas (for example, CEO salaries or bonuses). Considering that the U.K. government is the main shareholder, the sale process would also be bureaucratic, which would not surprise us. UKFI would advise the chancellor, and this view would need to be supported by an independent review and the governor of the Bank of England.

VSM - On 11/19 we added 2% positions for 3 clients in this IVA System pick @ 32.77:

Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
11/12/2018	3	GHASEMI SEIFOLLAH, RIORDA		27,100
11/09/2018	2	CROISETIERE JACQUES M, SC		5,500