*Marble Harbor Investment Counsel, LLC*
*Third Quarter, 2020 Letter*

*We are pleased to send our third quarter client letter that discusses our current thinking. We welcome your thoughts.*

*Sincerely,*

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***Myopia****: "A condition in which close objects appear clearly, but far ones don't. Eye strain can cause headaches."*

Recently, looking at the stock market feels a lot like we've misplaced our glasses. Each day brings new stories about coronavirus cases, vaccines, the election, the Fed and with them the associated market volatility. All of this short-term news seems pellucid in its daunting immediacy – so large and so epochal. Yet focusing on the day-to-day tends to trigger our primitive "fight or flight" instinct and lead to a counter-productive view of investing. It distracts us and makes it far more difficult to recognize the enduring long-term attributes that grow businesses, companies and portfolios. It also can cause headaches.

One particularly virulent form of myopia for investors is fixating on the S&P 500. Many are asking, why is the S&P 500 up when the economy is doing so poorly? It is true that over long periods of time, the S&P 500 has been a good barometer of what's happening in both the economy and the stock market. However, there have been shorter episodes when the S&P has been more like a fun house mirror than an actual reflection of what's going on. For instance, in the 1970s, we saw the preeminence of oil and gas stocks, in the late 1990s the inflation of the tech bubble, and in 2007 banks and insurers dominated the index. With hindsight (the only 20/20 view in investing) this is perfectly clear.

Today may be one of those times when the S&P does not necessarily reflect the fortunes of either the entire market or the economy. Since March, there have been great changes to the economy and remarkable stresses and strains on society. Through this, while many have faced great adversity, certain companies have actually benefitted from these shifts. Perhaps the highest profile beneficiaries have been the technology companies who are enabling a digital transformation of how we do business and entertain ourselves. Consequently, five tech companies (Apple, Microsoft, Amazon, Facebook and Google) now make up an astonishing 23% of the value of the S&P 500. This is even more concentrated than during the dot-com bubble of 2000. As digital oligopolies unconstrained by the corporeal constraints of the coronavirus, these five have been able to grow through the pandemic. With this as a backdrop, the S&P has essentially become a concentrated, turbo-charged tech fund.

What has been the consequence of this? The S&P 500 is up 6% year to date, but if you exclude just the five largest companies, the other 495 are down 1%. A broad index of mid-sized companies is down 2%, and smaller companies have dropped 8%. The economy is likely to shrink about 5% for the year, one of the worst readings on record. We can look at the returns to stocks in many similar ways, and all show the same thing: There have been a favored few that have done particularly well, and the vast majority have had indifferent-to-poor performances. Our conclusion is that the "stock

market" isn't performing dramatically better than the economy, but a few companies within it are. It's critical to keep this wider picture in mind instead of concentrating solely on the headline returns of the S&P 500.

During most time periods, the S&P 500 reflects the business risk in the economy. However, at certain times, where one or another business sector captures the public's imagination, there can be significant distortions. At such critical junctures, sector risk as well as company-specific risk can be out of whack with long-term prospects. Today there is a keen focus on a small group of excellent companies that are benefitting from the challenges of Covid-19. There is a risk that investors may be both over-estimating the relative dominance of these companies and underestimating the resilience of businesses that are, for the moment, more challenged in the physical world.

As an investor, there is no law that says that you *must* adopt the risk profile of the index. Owning a portfolio full of Sun Microsystems and JDS Uniphase in 1999 or MBNA and Washington Mutual in 2007 would have resulted in a short burst of dizzying performance followed by painful losses and a doleful story to tell.

Our vision isn't perfect, but our enduring goal is to own steadily growing streams of profits for you at reasonable prices, even if sometimes this more diversified, less volatile approach is unfashionable. Today, you own a balanced portfolio of reasonably priced companies that we believe will generate good long-term investment returns. Our plan is to keep our glasses on and continue to look beyond the immediate maelstrom to the rising sun.

Please don't hesitate to contact us if you have any questions. We wish you continued good health.

Sincerely,

Paul, Eric, LJ, Dan and Darcy

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