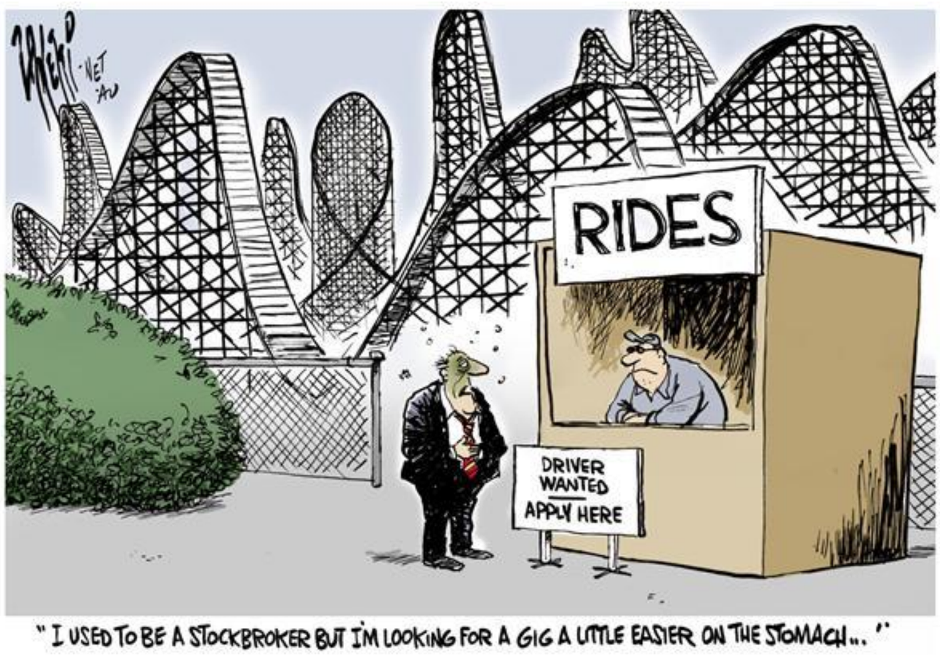
First Quarter 2016 Commentary

The stock market went on quite a wild roller coaster ride during the first quarter.

Most major stock market indexes suffered their worst-ever falls over the opening weeks of any calendar year, only to stage a brisk recovery at the end of January. The first half of February brought more turmoil, pushing the S&P 500 index more than 10% below its 2015 close at one point. From there through the end of March, though, it was almost a straight line up back to the year-to-date break-even mark by quarter-end.

Not unlike a roller coaster train that pulls back into the station after going on its harrowing journey of ups and downs, the S&P 500 index was essentially flat for the quarter, increasing by just 0.8%, or 1.3% if you include dividends.



Source: Paul Zanetti (www.zanetti.net.au)

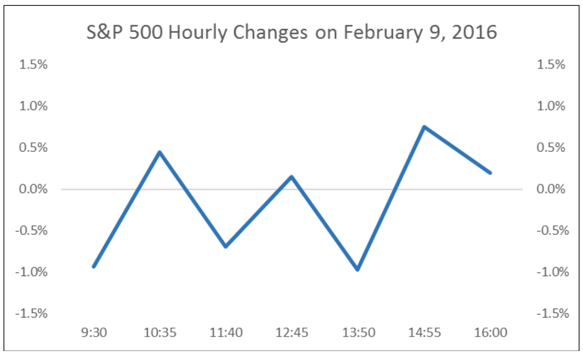
The Dow Jones Industrial Average fared slightly better, logging a total return of 2.2% during the first three months of the year.

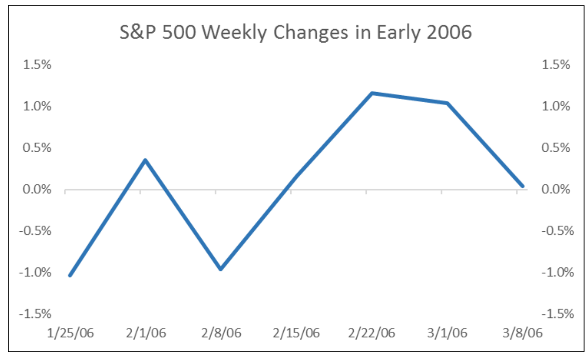
A Microcosm of Volatility

As wild as the quarter overall was for the stock market, there was one day in particular during the quarter that caught our attention. On most market days, there is a prevailing sentiment that one can sense by watching the prices fluctuate over the course of the day. Usually a day will "feel" bullish when the market averages increase a bit, or they will "feel" bearish when prices mostly decline.

February 9 of this year felt neither bullish nor bearish. The only word that comes to our mind to describe that day is "schizophrenic." Up one minute, down the next, then back up again, then down again. That one day (shown on the left in the two graphs below) saw as many wiggles and waggles as we're accustomed to seeing over much longer time periods.

In fact, we decided to compare the hourly price changes of the S&P 500 index on February 9 to the *weekly* price changes that same index experienced during a period in the not-too-distant past. That graph is shown on the right below, and at first glance it is nearly identical to the February 9 graph. If you look closely, though, you'll see that the labels on the horizontal axes of the two graphs differ materially: the February 9 graph on the left tracks the S&P hour by hour, whereas the 2006 graph on the right tracks it week by week.

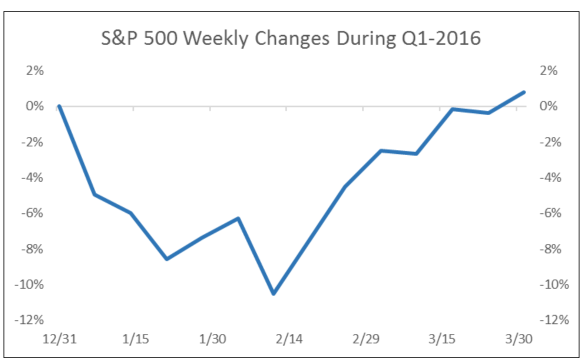


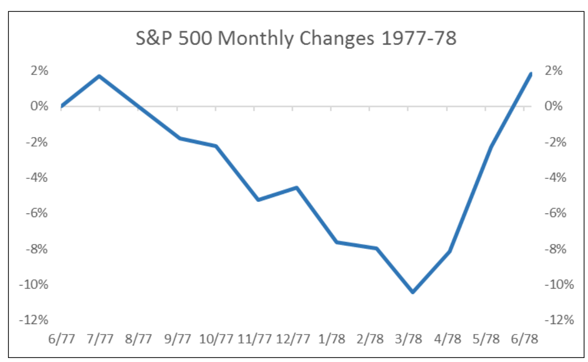


Source: Yahoo! Finance, Inkwell analysis

In a similar way, the price changes of the stock market over the course of the first quarter reminded us of the types of changes we're used to seeing over significantly longer time frames. Below we present two more graphs that look similar at first blush. However, the graph on the left is what we actually experienced during the first 13 weeks of 2016, whereas the graph on the right shows what investors lived through during a 13-*month* period in the late 1970s.

Both charts bottomed out at around 10% below where they started, then staged exhilarating recoveries back to the break-even point. Keep in mind that the bust-and-boom shown on the left played out over one calendar quarter, whereas the one on the right unfolded over the course of thirteen months.





Source: Yahoo! Finance, Inkwell analysis

Conclusion

It's as if the stock market is one of those mind-bending fractal designs you may have seen during a college math class way back when. No matter how far you zoom in or out of the picture of the fractal, it always looks the same. With market volatility exhibiting the same dizzying pattern, it's enough to drive an investor a little loopy.

That's why, for the companies we follow, we concentrate all our efforts on trying to identify and then project the underlying business' intrinsic value, and *not* the stock market value. If we're right about where the business value is headed, the stock market value will eventually converge there. It may take a series of stomach-churning dips and dives between now and then, but we should eventually be rewarded for our efforts.

We thank you for your confidence, your support, and your generous referrals. We look forward to reporting to you again in three months.

Sincerely,

FELIPE

Aaron

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