January 2020

You don't need me to tell you this, but 2019 was an unusually good year for the public financial markets. Virtually every market rebounded nicely from the sharp sell-offs that occurred in late 2018. How broad was the advance? Confluence Investment Management's Asset Allocation team tracks 12 major asset classes globally, consisting generally of domestic and foreign stocks, domestic bonds, real estate, commodities, and cash. In 2018 only two of these asset classes had positive total returns: U.S. Treasury bonds and cash.[1] 2019 was a different story entirely: *all 12* asset classes had positive returns in the calendar year. In fact, only three of the 12 asset classes failed to provide a total return of at least 10% (U.S. Treasury bonds, commodities, and cash). Yes, 2019 was truly an unusual year.

Such a year raises expectations for the following year, inasmuch as most investors seem to peg their expectations to the market. So, what's ahead for 2020? If you read my October 2019 letter, you know I can't answer that question. *We cannot predict the future*. As I noted in that last quarterly letter, it seems odd to have to say that, but so many people seem to believe that investing is all about making accurate forecasts of future events. We believe that to invest according to a prediction of the future is pure *speculation*. Rather, we hold that investing in an uncertain world does *not* depend upon a *prediction*, but upon a *process*. It is our view that a successful investment *process* is one that enhances the *probability* of favorable outcomes.

Confluence has recently begun producing podcasts, which are available on our website. I would particularly encourage you to listen to podcast episodes #5 and #6, which discuss the importance of utilizing a repeatable investment process in order to enhance the probability of success in an uncertain investment world. At Confluence, we have worked hard over the years to create processes that we believe improve the probabilities of good investment returns. We work equally hard to consistently apply those processes day after day, year after year.

In episode #6, I liken a good investment process to that of a good batter in baseball. Good batting form and approach improve the odds of success, but don't guarantee it. (Indeed, an excellent batsman still fails in about 70% of his at-bats!) Likewise, in investing, a good process improves the odds of success, but doesn't guarantee it.

The reason there are no guarantees in investing is that randomness is always with us. (Statisticians say *randomness* for what most of us call *luck*.) A good batter may put a good swing on a pitch and hit the "daylights" out of the ball yet hit it right at a fielder. But, often, a good batting approach will result in a hit. We seek to do the same in investing. A good investment process may still result in a less-than-good outcome due to the vagaries inherent in the world of investing, but we believe the probabilities of good outcomes are enhanced by a consistently applied process.

[1] This and all other references to asset class performance in this letter are based on total returns of generally accepted market indices for each asset class.

Thus, even though we don't know what will happen in 2020, we feel confident that consistent adherence to good processes will improve the probabilities of good outcomes. We don't know whether the economy will fall into a recession this year or who will be elected president in November, but we must manage client assets regardless of how these events unfold. Success, or the lack thereof, will not depend on whether we "guessed right," but on whether we stuck to our processes. That's how we look at the coming year. It may not be as exciting as a newsworthy forecast, but, unlike predicting the future, it is something we can do.

We appreciate your confidence in us.

Gratefully,

Mark A. Keller, CFA
CEO and Chief Investment Officer

This letter was prepared by Mark Keller of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change. This information does not constitute a solicitation or an offer to buy or sell any security.