MILLER VALUE FUNDS

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Bill Miller, CFA
Chief Investment Officer
& Portfolio Manager

Dear Shareholder,

The most important thing that happened to the stock market this quarter is what happened to the bond market. The benign bond bear market that began in the summer of 2016 became less benign as yields on 10-year treasuries began a steep ascent in September from just under 2.9% to a current level of 3.2%. "Safe" treasury bonds don't look quite so safe now, and a Federal Reserve still early in a tightening cycle — Fed Chairman Powell said we are "a long way" from a neutral federal funds rate — an economy growing at 4%, wage inflation beginning to pick up, and the unemployment rate at 50-year lows all contributed to raising the level of angst in bonds as yields reached their highest in 7 years. This did not initially spook stocks, which had a strong 7.7% gain in the quarter[1], but in the first week of October, U.S. equities came under pressure and small-cap stocks fell three weeks in a row for the first time since November of 2017. Most other markets globally have significantly trailed the U.S. this year, with emerging market indices particularly hard hit.

The bond market sell-off has quickly changed the narrative of the stock market bears from one saying Fed tightening and yield curve flattening might soon lead to the curve inverting, thereby signaling a sharp slowdown in growth and perhaps a recession (very bad for stocks), to one saying Fed tightening and curve steepening and rising oil prices mean growth is too strong and inflation will soon accelerate along with rising rates (very bad for stocks). I don't have a view here either way, preferring to avoid forecasting what might happen and just trying to observe what is happening.

I think if you told people that the U.S. economic expansion would be one of the longest in history, with the most consecutive months of job growth ever, and that last quarter GDP rose at a 4% rate, with corporate profits at all-time highs while unemployment was at 50-year lows, they would say that inflation would have to be at or near the top of the list of things to worry about, yet so far this year the core rate is 1.9%. We just don't know how long the expansion will last, how low unemployment can go, how long the bull market in stocks will continue, or just about anything else of economic significance as it pertains to what will happen in the next months or years.

So, to reiterate some things I have been noting in these letters for the past 10 years: It's a bull market in stocks and it will continue until it ends, and no one knows when that will be. It will end when either the economy turns down and earnings decline, or when interest rates rise to a level where bond yields provide significant competition for stocks. I have seen some folks saying that will be at 3.5% or more on the 10-year, which I find implausible as bonds will still be trading at close to 30 times a return stream that does not grow while stocks are at just under 17x next year's earnings, and those earnings will likely advance about 5% or a bit more over the long term. During the bull market of the 1990s, bond yields averaged 6%. Today's rates are still among the lowest in history, and only 2 years ago they WERE the lowest in history. Valuations of stocks do not appear demanding compared to returns available in other asset classes.

I do think people will begin to notice that bond returns in the past 5 years have been the lowest ever recorded and that is likely to only get worse if inflation continues its upward trajectory. During the "taper tantrum" of 2013, rates got to around this level and people then started to take money out of bond funds and shifted it to equity funds. We have not seen that yet — money is still coming out of equity funds — but the

probability of it happening is rising. It is worth noting stocks were up over 30% that year due in part to that phenomenon.

Stocks are not cheap, but then they rarely are unless bad things are happening, and it is hard to find much bad news in the current state of the economy. We are not having any particular difficulty in finding names we like and that we think represent excellent value. We have sold some companies to make room for others but remain fully invested.

Bill Miller, CFA

October 7, 2018
S&P 500 2,885.57

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[1]Based on the S&P 500

The **S&P 500 Index** is a market capitalization-weighted index of 500 widely held common stocks. It is not possible to invest directly in an index.

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