

Top-Down Concerns; Bottom-Up Opportunity

ACR is a “bottom-up” investment firm – our focus is on building a diversified portfolio of the cheapest quality securities we can find. Our investment decisions are not made on a “top-down” basis. For example, we do not invest in the overall stock market because we believe GDP will rise faster than expected. Avoidance of top-down decision-making does not mean we ignore macroeconomic conditions. Rather, we incorporate the analysis of economic cycles, interest rates, and global growth rates into our company level valuations.

In the past year a propitious divergence developed between macroeconomic conditions and investment opportunity at the company level. Consequently, our bottom-up selection process led us to purchase a few cheap stocks despite broader macroeconomic concerns. We believe that the prices we have secured will produce sound long run returns, regardless of whether the divergence widens or the general economy enters a recession. Below is a brief overview of current market conditions, our strategic response, and recent portfolio changes.

The macro economy is still a major concern:

- Trillions a year in investment spending out of China remain unsustainable.
- The US expansion is aging and recession at some point is inevitable.
- Overall markets are dangerously priced – stock prices are high and interest rates low.

A few bottom-up opportunities have developed:

- The recent decline in commodity prices has created economic ripple effects.
- A recession in industrial stocks has depressed earnings and stock prices of certain companies.
- Recent volatility has shaken loose a few good investment ideas in these and other sectors.

Leading us to new purchases with continued caution:

- Six new companies were added to the EQR portfolio in the past year.
- EQR’s average cash balance is down from 39% to 26%.
- ACR is avoiding overexposure to commodities and China and valuing cyclical companies cautiously.

The overall market in the first quarter ended up slightly from the end of the year, with a nice 10% dip in between. The mid-quarter decline allowed us to add three of the six companies which are new to the EQR portfolio in the past year. Yet we remain defensive. 26% cash is still high. Additionally, several companies jumped higher toward quarter end and are now too pricey for new portfolios. Therefore we are once again investing new account cash slowly. A summary of EQR investment returns can be found at www.acr-invest.com.

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In our September 2015 commentary entitled “Staying Right Sized”, we described the importance of managing the size of our investment strategies. Endless expansion is guaranteed to become a drag on investment performance – it limits our opportunity set and the ability to concentrate on our best ideas. Ever larger pools of capital require investment in ever larger companies and/or more portfolio holdings. Many a great fund manager has been laid low because their assets outran their talent. The ACR investment team is committed to avoiding this fate.

With this in mind, ACR will officially “soft” close our EQR stock strategy on June 30 of this year. We expect assets under management in the EQR strategy to be approximately \$2.75 billion at that time. During the soft close phase, new accounts will be limited in size to \$10 million or greater; additions to existing accounts will be accepted until EQR’s official “hard” close. ACR plans the hard close at approximately \$3.75 billion in assets under management (based on comparative market value metrics to today), at which time we will no longer accept new accounts or additions to existing EQR accounts. The timing of the hard close is difficult to estimate. Our best guess is in the next few years. After the hard close, ACR plans to compound the capital in our EQR strategy for many years to come based solely on long term investment return generation.

ACR is humbled by EQR’s growth. Instead of reaching for greater heights, we believe that limiting EQR’s size is the next right thing to do. Constructing a focused portfolio of our best ideas from a very large universe of small, medium, and large capitalization securities is a structural advantage we plan to maintain.

The entire ACR team wishes to thank each and every partner and client for your continued trust and confidence. We look forward to protecting your capital and maximizing your investment return in the years ahead.

Nick Tompras
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