4th Qtr. 2019 Investment Counsel Report

Market Summary

As we write this final report for the decade, there is much to reflect upon. In quick summary, stock markets ended the year 2019 in continuance of a historic uptrend. Whatever causes one wants to attribute the favorable climate, the result is clearly a good year at the end of a sustained run upwards.

Large stocks of the S&P 500 Index enjoyed not only a strongly positive 30% for the year 2019, but this group showed a meaningful advantage over the "average" stock and also a continued advantage over smaller stocks. The Russell 2000 Index of smaller companies clocked in at 25% for the year-rewarding, but at a distance behind larger US peers. To further illustrate the differences that were exhibited in 2019, the international stocks of the EAFE Index returned 22.7%, continuing a positive, but meaningfully lagging comparison.

These gaps between different market segments are very common during shorter measurement periods, such as over 12 month windows. Over the longer term, say 5 or 10 year cycles, the gaps tend to "mean revert" and stocks of various sizes and sectors blend into more consistent and correlated returns.

Given the narrowness of the S&P 500 in terms of weightings (the top 50 stocks account for 55% of the Index), and the further narrowness in which stocks appreciated last year, we anticipate the "rest" of the market to catch up with the larger peers in coming years. As we have stated in prior communications, the narrow interests of passive shareholders, combined with the narrow exposure of the S&P 500 Index allows for active investment decisions to add real value over time. By drifting away from the robotic and repeated emphasis of such benchmarks, Aurora's judgement and investment discipline can protect from the herd mentality and crowding that has led to bubbles and painful reversals in the past.

Aurora Outlook

As we not only enter the new decade, but also reflect on Aurora's 25 years of delivering our Growth At a Reasonable Price (GARP) discipline, it seems fitting to consider if history is likely to inform the next stages.

Historically, we are clearly due for an economic recession of some kind. Normal business cycles have most certainly not been repealed, and moderating growth is a natural occurrence. With the most recent downdraft having been the mother of all recessions (2007-2009), people will likely have to fight overly emotional responses to this eventuality. While there are some bubbly areas of the equity market, there are plenty of healthy and rationally priced places to invest.

Another draconian period that comes to mind is the tech bubble, roughly through the years 1999 through 2002. During this time, Internet related stocks were absolutely a bubble fueled area of the market, but the rest of the market was largely ignored. Traditional businesses and traditional

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valuations for some "chosen" stocks were disavowed, yet there were many places to avoid the correction in the over hyped areas when the bubble broke. Aurora actually enjoyed positive returns in the years 2000 and 2001, when most market averages lost money.

Today's Environment

There has been an observable connection between the froth in credit markets (lower covenants, yield chasing investor supply, and liquidity traps) and over-borrowing by some companies. Many companies have avoided a debt fueled strategy and have been content to generate respectable cash flow, while prudently re-investing in their businesses. Aurora is making a deliberate attempt to avoid leverage dependent companies, and to favor those that exhibit self-generating cash flows.

Another trend that serves to support future growth is that technology is cumulatively shifting costs curves down. One minor tool or technological step forward might not permanently move the needle, but when advances are made in technology that affect the spectrum of a business (communications, marketing, operations, etc.), the cumulative effect is that margins can remain high. While there are still cycles of profitability, and some of the easy efficiencies may not last, the overall impact on costs has allowed for stable profits in many areas.

Lastly, the inverse of the recent narrow market focus is that there are many stocks that have not appreciated as a result of flying below passive investors' radar. There are several industries (Healthcare, Energy, Consumer Staples) and wide categories (Small Cap, Value, etc.) of stocks that remain overlooked. There are many opportunities where some stocks have been ignored and rest on fair to cheap valuations.

While there are some frothy areas of valuation, some risk in over-borrowing (both government and corporate), and the high proportion of passive holders in a few large stocks- corrections in these areas are likely temporal. In broad context, things seem reasonably balanced and favorable for the positive investment climate to continue. By applying our GARP screens and discipline, and also our qualitative lenses we can seek sustainable, growing businesses while avoiding risky valuations and over-leveraged financial positions.

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