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2015 2nd Quarter Investment Progress Report

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By Michael J. Porro, CFP, EA

Our domestic GDP advanced at an estimated moderate rate of 1.9% through June 30th and our equity indexes mirrored this moderate advance; The DJIA, for example, fell by a -1.1% and our S&P 500 Index increased by .2%. Record snowfall in the Northeast and port strikes in California contributed to a slowdown in economic activity. Ongoing turmoil in the Middle East including ISIS's strengthening disruptions, slowdown in China and the mess with Greece also helped keep global economic activity from overheating. Nevertheless, we continue to advance out of the financial crisis of 2008. We passed the 6th year anniversary of the one of the longest bull markets in our history on March 9th. Our major indexes have all surpassed their all-time closing highs during the past six months with the NASDAQ finally catching up to the DJIA and the S&P 500 on April 23rd when it closed at 5,056.06 surpassing its previous high of 5048.63 reached in the year 2000.

We enjoyed several takeovers and spin-offs during the past six months, as the US markets experienced the "greatest first half (merger) activity since Reuters began tracking this data in 1980," according to Horizon Publishing. These helped to offset the losses suffered in our oil and mining investments. Beginning with the buy-out of DRA CRT Properties on January 2nd, Medtronic's takeover of Covidien in January, Windstream's' spin-off of Communications Sales & Leasing Inc. in April, Riverbed's buy-out on April 27th, BHP Billiton's spin-off of South 32 in May, Harris Corps' takeover of Exelis in June, following Fidelity National Financials' spin-off of Remy International on December 31st, we have been busy. Heinz's merger with Kraft Foods on July 1st and DuPont's spin-off of Chemours on July 6th keep the merger/spin-off trend continuing into the 3rd quarter. So, while the market averages may have been flat, investment activity was not.

The Covidien and the Exelis transactions proved to be big winners for us. We came to own both through previous spin-offs: Covidien from Tyco in 2007 and Exelis from ITT in October 2011. We made over 91% (excluding dividends earned since 2007) in Covidien and a little over 92% on average in Exelis. Riverbed gave us a 12% return over the nine months that we owned it. We bought this last July anticipating a takeover. DRA CRT Properties was bought for the $25 we paid in 2005. However, we earned the 8.5% annual dividend for the past ten years and could have sold this at the depths of its downturn in 2011 for $2.00 or tendered it in 2012 for $18.00. Instead, believing that we had value here, we held on and received our reward. The real gutsy play would have been to have loaded up on this when it traded at $2.00. Those purchasers have something to brag about.

We wait for the spin-offs, such as Communications Sales & Leasing and South 32, to come to fruition. I note that we continue to hold handsome gains in the stocks of our acquirers and spinners. Fidelity National Financial which spun out Fidelity National New in 2014 which subsequently spun out Remy Int'l in 2015, posts unrealized gains of 171% today. Our positions in the two spin-offs post unrealized gains of 185% giving us combined overall gains from our 2007 original purchase price of 356%. Harris, which we own as result of the Exelis takeover, sports a 72% unrealized gain.

During this period, in addition to the cash we earned from takeovers, we also sold 100% of our position in the Canadian Zero's that we originally purchased in 2003 in January, for a 233% gain. We thought it time to exit the Loony, as our US dollar was strengthening.

So, while the markets were virtually flat, we were still able to harvest some fruit from our labor.

I wish to underscore that most of these holdings, with the exception of Riverbed, were long term positions. Most were bought before the 2008-09 debacle and all could have been dumped for substantially lower prices during the downturn. Holding through those times of fear and panic proved the right course of action. I must remind myself and you of this because we are going through a similar period of significant weakness in our oil and metals investments. The prices of our holdings in these sectors are close to all-time lows. I must admit that I frequently want to unload them and window-dress our portfolios just so that I don't have to look at these unrealized losses. However, my experience in this business tells me that now is the time to hold and accumulate these. No one wants them. Robo-traders don't, window dressers don't. They are cheaper than cheap. These include our Canadian Oil Trusts, oil related stocks, metals and our Brazilian holdings. We are doing our best to revisit our reasons for initially buying each as we access whether to hold or buy more at the current levels.

Going forward, we anticipate a sloppy and volatile summer for stock prices and an event that will trigger a market correction between now and October. We have been reluctant to add to our positions since January and have been accumulating the dividends and interest earned in our accounts. We think that our US economy will continue to progress slowly-but-surely and the global economy will follow. We like this environment for investing and think that it provides for a longer, sustainable bull market. We find that most economic indicators, such as GDP growth, CPI, Leading Economic Indicators, Coincident Economic Indicators, Housing Market Indexes, job gains, unemployment claims and yield curve, among others, still point to continued economic expansion. In short, while we believe that this bull market is long-in-the-tooth, and should take us through a correction sooner or later, it should continue to march forward. We do not see a recession on the horizon at this time. Thus, we remain close to full invested with our cash level in the 10% range.

Please give us a call should you have any reason to discuss our thinking and your investments with us. We look forward to hearing from you. As usual, your progress reports are enclosed. I thank you, as always, for your continued confidence and business.