

### **3<sup>rd</sup> Quarter Commentary**

By

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**“In the 17<sup>th</sup> chapter of St. Luke it is written: ‘the Kingdom of God is within man’- not one man nor a group of men, but in all men! In you! You, the people have the power-the power to create machines. The power to create happiness! You, the people, have the power to make this life free and beautiful, to make this life a wonderful adventure.”**

--Charles Chaplin in The Great Dictator , 1940

**“The major fact is that manufacturing is not leaving the U.S. economy. Yes, jobs in manufacturing are down 30% since 1987, (leaving 12 million last year), but America’s remaining makers make more stuff, of higher value, then ever before. Manufacturing output, adjusted for inflation, rose 85% in the same period. Also, the current unemployment rate for manufacturing is 2.7%, much lower than the rate for the general population, and there were 337,000 unfilled job openings in manufacturing in August. Anyone who intends to bring jobs home from China or Mexico has to bring Chinese or Mexicans here, as well.”**

**“The largest problem with imposing political changes on the manufacturing economy is that we all need trade to prosper. The U.S. cannot close its doors to imports of things it needs, whether cheap or expensive, low-tech or high tech. If the government tried to do so on a large scale, it will raise costs and lower quality in its other industries.”**

**“Immigration could be our most important human resource, but we prosecute employers of undocumented workers, and we impose quotas and other barriers to legal entry. We have built a paper wall against people who want to be our most ambitious and hardest-working people, even while some Americans refuse to move across country to find work.”**

-Thomas G. Dolan in Barron’s

**“If investing is entertaining, if you’re having fun, you’re probably not making money. Good. Investing is boring.”**

--George Soros

We just completed the boring, tedious task of reviewing each of our accounts and reconciling their balances and transactions of our internal records with those held with our custodians (in most instances Charles Schwab). This work is essential to make sure that you received the dividends, interest and sales proceeds you are entitled to, but it is boring. Reading annual reports, news articles, researching new potential investments, confirming our reasons for holding our present investments is a bit more exciting, but still falls into the realm of “work”. Riding the ups and downs of the markets, listening to the mavens influence the directions of the market, winning on successful trades is a little more exciting, but for the serious investor still “work”. The most exciting aspect of our work is interaction with you, followed by our internal discussions and ponderings of where the future will bring us or which investments to make and then, of course, delivering to you great investment results. I was glad to read the above quote from Soros, as I love my work and was wondering if something was wrong with me during those moments of tedium. I reflected on my early years in the financial services industry in the late 1970’s when my district sales manager at Metropolitan Life frequently reminded me that “The successful man does the things that the unsuccessful man doesn’t want to do” during my recent moments of tedium. Boring is normal. Boring brings success. So with reassurance from successful mentors, I embrace tedium and am pleased to deliver great investment results to you this year.

We have been struggling since the fall of 2014, when the oil and mineral sectors fell out of bed, to deliver results that we could be proud of. It is most edifying to have them before us. Our belief in the investments we made and our patience in muddling through the soft times has paid off, once again. As we wrote over the past two years’ commentaries, we used the weakness to add to our positions. This has worked.

Our average return through September 30<sup>th</sup> for all accounts, large and small, “conservative” and “aggressive”, large-cap, micro-cap and small-cap, bond and fixed income, was 9.6%. Some were slightly negative (accounts with a large position in healthcare related investments) and some were super, with returns in excess of 30%. Our median return was 9.1%. Meanwhile, the DJIA rose +5.07%, NASDAQ +6.08%, S&P 500 +6.08%, Russell 2000 +10.19%, Vanguard Total Market ETF +8.2%, Vanguard Wellesley +8.77% and Vanguard Wellington +7.6%.

Our individual stock positions far outpaced our mutual fund investments. Such results have restored our faith in our work as stock pickers. In one account, for example, sporting a 15.3% overall return, had stocks (excluding dividends which added about 2%) advancing at 16.2%, while the equity mutual funds dropped -1.8 (due to healthcare funds). Another account, 100% invested in mutual funds, advanced at an overall pace of 5.96%, while the bond funds appreciated by 7.2% and the equity funds by 6.7%. In a third case, a 13.1% overall return resulted from individual stocks advancing 15.1% (excluding dividends of about 2%), bond mutual funds by only 4.7% and equity mutual funds by 6.2% (including dividends). The “robo-trading” and index fund passive investing enthusiasm that dominated investment media in 2015 has been silent this year.

We had several takeovers again this year that helped to boost performance. Those of ANAD, PMCS and EZCH finally culminated, and new ones, like Newport, Spectra Energy, Intersil and NXP Semiconductors contributed.

I NOTE THAT SOME OF US ARE STILL WAITING FOR OUR EZCH PROCEEDS. THIS HAS BEEN A LONG ORDEAL TO GET OUR MONEY FROM ISRAEL. I AGAIN REMIND THOSE OF US WHO HAVE NOT RECEIVED THESE PROCEEDS, THAT THE VALUE OF EZCH AT \$25.50 PER SHARE IS NOT REFLECTED ON YOUR SCHWAB STATEMENT. THE ACCOUNT VALUE ON YOUR SCHWAB STATEMENT LOOKS LOWER THAN IT ACTUALLY IS. (thus, the importance of our internal accounting and reconciliation of your account each quarter). THE VALUES REFLECTED ON OUR PERFORMANCE REPORTS INCLUDED IN THIS PACKET ARE CORRECT.

In addition to the takeovers, several individual stocks added significant appreciation to our overall returns. We regret, with the clarity of hindsight, that we did not “back up the truck” and very aggressively add to these when they were trading at rock bottom prices late last year and early in 2016. These include: Teck Resources up 367%, Penn West Energy up 116.4%, Companhia Siderurgica Nacional up 181.6%, Companhia Energetica de Minas Gerais up 72.6% and Companhia de Saneamento Basico do Estado de Sao Paulo up 101.3%, Pengrowth Energy up 116.9%. Our “This is your Templeton Moment, don’t blow it” advice of last January proved to have been “on the money”.

To summarize, we are very pleased, thus far, with our fortune during 2016. Going forward, we expect continued slow global growth. With the US elections upon us, we may experience some change in political directions, however this should not dramatically alter the economic winds before us. Businesses will always find ways to navigate over or around the regulations, taxes or policy change that our governments impose upon us. We do believe that with whoever wins the US presidency, we will see a more aggressive infrastructure policy in place and this will be great for US economic expansion. We also hope that more resources will be placed in retraining displaced workers and this should help develop a more efficient and productive work force, another positive. We hope that innovations in the medical field and successful policy directives will drive down the costs of healthcare in our country. We do not see interest rates rising aggressively in the US and oil prices stabilizing off at around \$50 a barrel or lower. Both are good for long-term, sustainable economic growth. So, as usual we are optimistic going forward. I note that research done by Marc Levinson, of the Wall Street Journal, uncovers that 1.5-2.0% annual economic expansion is the norm going back over 200 years. The post-WWII boom years created the aberration of higher growth that Americans have grown accustomed to.

All of the “noise” from the various “experts” makes discerning direction most difficult. We work to distill all the information before us down to relevant empirical criteria upon which to build our investing posture. In this letter, we look at five criteria that we see as precursors to a recession. None are hinting of a recession presently. These are:

**Accelerating inflation** is often a precursor to a recession. We do not see inflation accelerating presently. The Consumer Price Index (CPI) presently is only 1.1% above that of a year ago, well below the average gain of 2.1% over the past ten years. Additionally, while the unemployment is down to 4.9%, we still

have an underemployment rate in the US of 9.7%. This is an elevated number well above the 8.0% rate of ten years ago. We need more job growth, yes, but the high underemployment rate keeps a lid on wage inflation. When wage inflation begins to exceed the rate of economic expansion, we might see inflationary pressure mounting. Such is not in view presently.

**Payroll growth** is expanding which puts disposable cash in the hands of consumers. Despite the political griping about weak and low paying job creation, we note that this is the 6<sup>th</sup> straight year with two million more jobs created. Never in our history has this occurred. Median income rose 5.2% in 2015 indicating that the jobs created are not only low-paying ones. Presently, according to the Bureau of Labor Statistics, job openings and voluntary quits are at historic highs and layoffs at historic lows. We have three job openings for every four people unemployed.

**Rising new unemployment claims** is our third indicator of an oncoming recession, as a rising trend indicates a slowdown in hiring. Presently the four week moving average of 254,000 new claims is close to its historic low. This indicator is not rising.

**The inverted yield curve** comes next. Short-term rates are still below long term rates. We do not have an inverted yield curve presently. The 3-month Treasury Bill yield of .27% is well below the 30-year Bond rate of 2.33%

Finally we look at the **Leading Economic Indicators** compiled by The Conference Board. These edged down slightly 0.2% in August, however over a six-month span are still positive with an increase of 0.9%. Coincident indicators advanced in August by 0.1% and the housing sector remains positive.

Builder confidence, as measured by the NAHB/wells Fargo Housing Market Index (HMI) at 65 jumped six points in September to match its best level since October 2005. It presently will take 4.6 months to clear the current supply of new homes on the market, while a 6 month supply is considered a healthy balance between supply and demand. So, we have 1.4 months of catch up before we exceed the norm. In other words, we have room for housing construction to expand. Additionally in September single-family permits increased 3.7%.

In addition to our indicators, we have market psychological sentiment moving into positive territory, as November marks the beginning of the “six best months” for stock market averages, according to The Stock Traders Almanac.

Thus, overall we look for continued but slow economic expansion and moderate but higher stock prices. We like a slow growth, boring economic environment; as such has a longer sustainability than does a rapidly growing one. We do not see a recession on the horizon despite contrary opinions calling the present economic recovery “long in the tooth”. This expansion has lasted 29 months thus far, the 4<sup>th</sup> longest since the eleven expansions since WWII, and with a modest 2.1% average annual growth, the slowest since WWII. We expect it to continue. We will position our portfolios accordingly.

As always, thank you for your continued business and confidence and do call should you wish to discuss anything pertaining to your portfolio, your financial plans or anything in this letter.

