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2014 First Quarter Investment Commentary

May 5, 2014
Michael J. Porro, CFP, EA

Our average return for the first quarter for all accounts came in at 3.7%.

With the DJIA falling -3.1%, the S&P 500 falling -.85% and the NASDAQ falling -.28%, we are very pleased with these results. We've included in this package Progress Reports for the first quarter and for the past five years. The financial calamity of 2008 and the subsequent sell-off in equities reached its bottom during that spring of 2009, five years ago. So, the five-year report gives us wider perspective than that of the past three months. Investing, for us, is a long-term process. Long-term for me can last forever. When I look over some of our best performers over the years, many are those held for many years. For example, we originally bought Boeing in 2002 for $29.83. It's risen and fallen several times with the market averages and the good/bad news about its Dreamliner, but today trades at $128.37, a 330% gain, or about 27% annually over the past 12 years. Add dividends and our returns are higher. Another, Newport, was originally purchased in 1997 for $5.77. Today is trades at $18.60, giving us a 222% overall return, or about 13.87% annually. I could go on, but I think I made my point.

I reflect on positions I was shaken out of during the 2000-2003 bear market and regret to this day not having held onto them. Canadian Pacific Rail (CP) comes to the forefront of my mind, as this was one of our largest positions back then. Subsequently it split into Fording, Fairmount, Canadian Pacific Rail and two other companies. All of which went on to gain significant appreciation which we missed because I folded to market sentiment in 2002. Varian (VAR) is another. We originally bought this stellar company in 1999. This company subsequently split into Varian Medical Systems, Varian Semiconductor and Varian Inc. While latter two were eventually taken over at substantial profits above our cost basis, Varian Medical remains independent today and posts a value of $63,880 relative to our original cost of $3,120 for those clients fortunate enough to have held on.

I couldn't help but ponder the minds of younger Americans today when I listened to a younger portfolio manager tell his host on Bloomberg radio how he is a long-term investor who holds positions for three years. I juxtaposed this against reflections of the former Chinese leader, Deng Xiaoping, who answered the question when asked in the 1980's, "Was the (1948) Cultural Revolution a success?" He responded, "Too soon to tell."

The appreciation in the value of good companies and the accumulation of the dividends in your accounts each month, bring us superior returns over time. The compounding of dividends and sustainable stock appreciation doesn't occur over a short period, time is essential. Don't get me wrong. We will sell when our positions appear ripe and we find "better bets", but we prefer to err on the side of holding.

Some of the significant winners for us this quarter that lifted our overall returns are the following:

Fuelcell Energy (FCEL) up 75%. We bought this on December 17th for all accounts with cash and the "pop" in price arrived much sooner than we had expected. But, we'll take it!

Ion Geophysical (IO) increased by 27.6%. We still have a long way to go with this one and while it trades today at $4.17, we look for prices in the teens within the next five years.

Manitowoc (MTW) increased by 34.9%, Nabors (NBR) by 45.1% and Quicklogic (QUIK) by 31.9% are others that made up for the laggers.

Some of these laggers at least contributed their dividends to our overall growth even while their stock price fell. For example, Companhia Siderurgica Nacional (SID) of Brazil, while down 29% for the quarter, paid us .124 cents per share or 2.8%. Teck Cominco (TCK) was down 16.6% for the quarter, but kicked in a dividend of $.42 cents per share, or 1.9%. Both of these investments are mining related and as such are "out-of-favor". They will come around some day, patience is required, meanwhile we'll continue to collect the dividends and accumulate these "dogs". China, despite published fears of slowing down, will continue to grow, as this country of 1.4 billion continues its climb into greater wealth. This country will require greater amounts of steel, cement, copper, coal, zine, molybdenum and other raw materials and this demand will contribute to pulling up the price of SID, TCK and related stocks in this sector. Currently China consumes 33% of the world's steel production, 50% of the world's cement production, 50% of the world's coal and 10% of the world's oil. Furthermore, Brazil with the 2014 World Cup and the 2016 Olympics infrastructure requirements should contribute. Europe moving out of its funk and the US, IF we ever focus on infrastructure spending, will add to demand.

Our domestic economy continues to improve, however slowly, and such a slow grind leads to a more sustainable rise in equity prices, in our way of thinking. Leading Economic Indicators of The Conference Board increased .5% in February and .8% in March. Industrial production increased by .6% in February and .7% in March. Capacity utilization in February rose to 78.8% from 78.5% (a moderate increase and more sustainable), and the CPI rose only .01%. The April unemployment rate fell to 6.3% today, May 2nd, its lowest level in five years, and the Conference Board projects the US entering into a period of prolonged labor shortages that will drive the unemployment rate to 3.8% by 2030. (Remember to keep a long-term perspective). The Federal Reserve is committed to keeping the economy moving and has stated that its current emphasis in decisions is preventing the expansion from faltering. For the deficit worry-warts, The Federal budget deficit fell 24% year-over-year in February, down to $514 billion (the smallest since 2008). Federal revenue is up 11.8% over a year ago, while government outlays fell by 3.8%.

Prior to April 30th, The DJIA posted its last new high on December 31st, its 52nd. The S&P 500 caught up and passed the DJIA during the first quarter of 2014 by posting its 53rd on March 2nd. After the close of the quarter, the Dow Transports posted new highs, confirming the bullish trend. Shortly thereafter, on April 30th, the DJIA reached its 53rd high (matching the S&P 500). Our equity markets seem to want to move higher.

These markets have risen since that spring of 2009 without a meaningful, 10% or greater, pullback. We may be ripe for one this year. Yet, this is not certain and if it comes, we will take it in stride and use the opportunity to add to our positions. I seem to write this year after year, and may sound like a broken record, but this posture bears repeating, especially for new clients, who haven't heard it from us before, and long-time ones, who may have forgotten. We will use market weakness to add to our positions, not to panic and run.

Additionally, 2014 is an off-presidential election year. Such years have produced market corrections of at least 8% since 1960. So, we look for a pullback in this range before the year is out. This could occur over the summer months, probably in August. Humans seem to like shaking up our stock markets in August; an offset to summer doldrums perhaps. The Federal Reserve will most likely end its quantitative easing program during the fourth quarter. This could trigger a drop in both bonds (although not as severe as that of last June) and equities. Among other headwinds, Ukraine could blow up beyond current expectations. Those of you, who have been urging us to buy, getting caught up in the enthusiasm that has recently surfaced, are asked to be patient. We will move additional funds into equities during a pullback, not before. Cash is great to have at the ready when markets fall.

I have written in the past how GDP (Gross Domestic Product), the final value of all goods and services in our economy, seems an incomplete means to measure the economic health of a nation. While not going as far as to create a Gross Happiness Product, the Bureau of Economic Analysis will shortly begin to release its new Gross Output statistic. The GO will measure the steps that go into the making of the final products. Including these components in an indicator will uncover that consumption represents only about 40% of our economy, not the 70% that GDP indicates. Government outlays fall to about 9% instead of the GDP's 20% and business spending increases to 50% of our economic activity, instead of the 13% GDP indicates. Wow, what a difference! I suspect that much will be made of these changes in the 24/7 news chatter over the upcoming months. Enthusiasm in the changes alone may be enough to mitigate the economic headwinds and counter punch any severe market drop. I mention this so that you will take it all in stride once the newscasters make headlines over the changes.

Allow me to fill this final page with some thoughts about our Retirement Cash Flow Analysis. I mention this often in my quarterly letters because this is such a helpful tool in our planning work. In the RCFA (as we refer to it) we project the growth of all of your assets, income and expenses over twenty-five years. In collaboration with you, we illustrate how long your assets will or will not last in light of longer life-spans, emergencies, college tuition, entering a nursing home, discovering a shortfall in cash or many other scenarios that you can imagine. The numbers on the pages of this analysis put things into focus and allow you to take steps now, if necessary, to head off any potential financial disaster. If you haven't undertaken the process of preparing this analysis with us over the past three years, you may wish to do so this year. Give us a call, take the time, you will be glad that you did so, I'm sure. Additionally, working on this helps us and you update your inventory of assets, liabilities and expenses. Collectively, all of this is critical data to keep current for better financial planning. Furthermore, such accurate data allows for better estate planning and administration.

The phone and email lines are open.

In closing, I thank you again for your continued business and confidence. All of us, at Michael J. Porro & Co, honor your trust in us. We hope that you're as pleased with the first quarters' results as we are. Please call should you have any questions or concerns that you wish to discuss.