December 2015

Dear Clients and Friends:

There is something about that perfect sunset you are getting to see on that perfect beach *#nofilter*, or that amazing presentation of food you are enjoying at that newest trendy restaurant, something about your red-faced and sweaty self after a challenging workout and especially something about that one magical family vacation moment that makes it impossible not to post and share on social media. I share my moments and experiences and I expect most of you do so as well, at least at some level of social media. This is by no means a rebuke of me or others. I enjoy sharing my amazing experiences and I want to see the amazing moments that my friends experience and enjoy. But, as we all know, life is not always Instagram worthy. Some days would be a bit more like [Debbie Downer](#) if we posted the pics of real life. Womp womp womp. I sure don't post the picture of our messy house or Finn when he is pitching a total fit because the macaroni and cheese we made him is not the macaroni and cheese he wanted. I don't post the never-ending piles of laundry or the dead flowers in the hanging baskets that didn't get watered. Nobody wants to see that. Show me the good stuff. I will continue to share mine as well.

None of these were staged....Promise #lol

Flat tire moments after the above paddleboarding pic #truestory

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There is only one absolute truth about investing……it isn't easy—Howard Marks

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Just like we only expose a very small and perfect layer of our life on social media, the market and financial news media has been doing the same thing, and I don't think it is getting a lot of "likes". As I write this letter on December 4th the S&P 500 is up roughly 1% for the year, but that truly masks what is going on. There are really only a handful of stocks that make up the gains in the market this year. They are the so called FANG stocks (Facebook, Amazon, Netflix and Google). FANG stocks are up between 35-165% as of this writing. Side note: If a few stocks have an acronym does that make them overvalued? If I told you that many large well known blue chips are down as much as 30%

YTD would you believe me? Also, even after over 2 years of poor returns we are still seeing Emerging Markets down over -10% for the year so far and commodities are down over -20%. For the most part the only thing that has worked at all over the past 2 years or so has been large cap growth stocks of US companies. Problem is that many of those stocks would be considered overvalued by traditional metrics. But, they have absolutely been the only place that has worked in spite of those valuations. A lot can be said for investing in what has been working. Momentum investing works………until it doesn't.

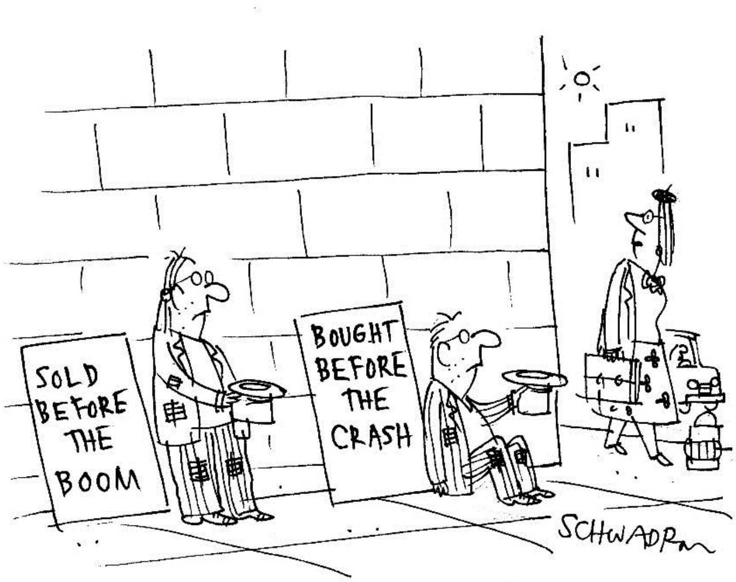
Never mistake a bull market for genius

I primarily gravitate to deep value managers and global tactical managers. The value managers look for good businesses with little to no debt trading at a discount to the market. Many of those companies don't have the glitzy stories of a Tesla. Global tactical managers can evaluate markets all over the world and allocate money where they see the best risk to reward proposition. I am going to briefly go over what each of those types of managers are currently seeing.

The value managers are absolutely finding some needles of undervalued good businesses in haystacks of overvalued businesses. The tough part is picking the bottom on those stocks. Good value managers know that they will never pick the bottom and will often be early. I recently read an article profiling the legendary hedge fund Baupost Group which is led by Seth Klarman. One of the partners wrote about how in the middle of the collapse of the tech bubble Baupost was seeing many stocks of great technology businesses trading at very attractive valuations. They said it felt like they were shooting fish in a barrel. Problem is that every day they would wake up and watch the prices drop further. The partner said it felt like the market was having a going out of business sale and Baupost happened to be the only customer who showed up. Ultimately Baupost was right and the market turned and the stocks they bought shot up. They had to have the nerve to stay the course in the midst of a market moving against them. *#determination*

It's hard for most people to grasp that a great company is not always a great stock, and that a great stock is not always a great company. Value investing works because you're consistently paying less to get more. Over time that works a lot better than paying more to get less—James O'Shaughnessy

My global tactical managers have all been seeing much better valuations in global and emerging markets that they have in the US. Unfortunately it seems that they have been early and we have yet to see global markets make the turn many expect. The team at GMO who manage the Wells Fargo Absolute Return Fund discussed emerging markets recently. They said that the pessimism on emerging markets is rampant and they liken it to "reverse shoe shine boy phenomenon". You may know the story of Joe Kennedy who said he got out of the market just before the Great Depression because even the shoe shine boys were giving stock tips. Emerging markets are possibly the most hated asset class on earth now and GMO says that may indicate some great bargains. They go on to say that emerging markets are trading at valuations similar to where they were in the early 2000s. At that time, emerging markets had just been through a terrible run. However from 2000 the Emerging Markets Index went on to deliver over 13% above inflation per year for the next 10 years while the S&P 500 was down. Essentially, the most hated asset class in 2000 beat the most beloved asset class (S&P 500) by over 15% per year for the 10 year period. *#PathLessTraveled*



I have discussed in these letters many times how markets move in cycles and how staying committed and not worrying about when to be in and when to be out is the best strategy. Tom Lee reported on CNBC in September that over the past 10 years if you missed the market's 5 best days, your return would have been negative in 7 of those 10 years, even though the market was only negative in 2 of those 10. Your timing essentially is irrelevant over longer periods of time. Financial blogger Ben Carlson (who I highly recommend you all read) had a great piece a few years ago that discussed a hypothetical investor who only invested at the top of the market. ARTICLE. In it "Bob" only had the courage to put money in the market when it has just had a big run up. As a new investor, he put $6,000 in the market at the end of 1972. The market then fell 48% in the next 2 years. Bob didn't have the courage to invest again until 1987. He put his $46,000 of savings in August 1987 and the market went down 34%. Bad luck Bob sat scared for the next decade or so and then felt comfortable to invest again at the end of 1999. He put in $68,000 just before the market went down nearly 50% over the next 3 years. Then he invested his final bit of savings of $64,000 in October 2007 just prior to the financial crisis where the market lost over 50%. Bad luck Bob had invested a total of $184,000 in the S&P 500 at the absolute worst times during the last 40 years, but he never sold what he had invested. He remained committed and that grew to be over $1.1 million for a 9% annualized gain. Not bad for someone with the world's worst luck!

In the spirit of the Christmas season you may be interested in the most unique financial index of all. For over 30 years PNC has calculated the Christmas Price Index. While not as popular as the Dow Jones or S&P, the "CPI", measures the cost of all of the items in the 12 Days of Christmas Song. So if you are looking at purchasing a partridge in a pear tree, a couple of turtle doves or even 9 ladies dancing you can expect the total cost of all the purchases to be up this year by only 0.6%. Not bad right? Much better than the near 24% the index went up between 2013 and 2014. For a grand total of $34,130.99 all of those great items can be yours. Although I wouldn't recommend the dancing ladies, lords leaping, pipers piping and all of those drummers drumming at the same time, especially with all of those birds all around. Could get a bit noisy. I hope you have a great Christmas. And for a laugh, please enjoy this always funny version of the 12 Pains of Christmas.