THE VIEW FROM PRINCETON

Market Commentary ♦ August 2010

WHEN?

- **When**, if ever, in the lifetimes of the living has there been a confluence of circumstances more favorable to long-term investment in equities than now? This question pertains to equities of enterprises in the United States, which in contemporary circumstances find support also from much of the rest of the world, where product sales are derived and equity markets are tracking rapidly growing economies. All together, stock markets are sympathetically helping each other, irrespective of temporary volatilities. It has become fatuously simple to form investment decisions only in the context of the American economy, as so many recently seemed to do in expressing concern regarding the slowing of the American economy. The major enterprises in America source and market on a global basis, as do also many major enterprises not resident in America. For the most part, it doesn't make much difference whether companies are headquartered on the Hudson River, or the Rhine, or the Yangtze River, for that matter. What matters most are the characteristics of their products and what is accomplished with these.

Our Firm is ever guided by global viewpoints; however, we invest beyond American boundaries according to intellectual property and proprietary products that provide more solid reasons than those provided by social data, national income changes, and currency incentives. In the present context of the apparent general disposition among analysts and observers, there is a tendency to pay too little attention to the influences that derive from beyond America's boundaries.

- **When** will such parochial observers integrate the advantageous influences that derive from marketing and sourcing in the rest of the world into their appraisal of equity shares of large multi-national American companies? The July flow of corporate reports of quarterly revenues and earnings were, for the most part, highly supportive, and were helped to a significant degree, directly and indirectly, from involvement beyond our shores. The strength shown in those reports belittles the "double dip" concerns that were causal to stock market weakness in May and June. That contretemps drop in share prices mocks the concerted perceptiveness of observers, and the attributions of collective sagaciousness to the market.

- **When** will so many concerned observers of the American scene accept the reality that for investors the so-difficult, chronic unemployment comprises (indirectly) a positive motivation toward owning equities? The advantage to investors is that unemployment imposes upon the Federal Reserve System to keep interests rates low in order to give encouragement to industries everywhere to expand and hire again. Such currently low interest rates comprise one of the most pervasive of forces possible, in both breadth and depth, in support of share valuations.

- **When** will this be generally acknowledged? It is not easy to tell. But, the following is submitted as a loosely relevant analogy: Take the example of the extremely low interest rates on the Japanese Yen that prevailed in the 1990s and for much of the first decade of this century. The low-cost Yen (allowing the so-called Yen carry for swapping into other currencies) contributed

massively to the expansion of the financial industry in New York, Chicago, San Francisco, London, Frankfurt, Tokyo, Shanghai, Singapore, and all other financial capitals around the world. If a near-zero rate of interest on a currency (Yen) that ranked third or fourth in line among the world's reserve currencies could have such an affect, what will near-zero rates of interest on the leading currencies of the world (the American dollar, Sterling, and the Euro) have on economic expansion eventually? If interest rates were to remain where they are, sooner or later all financial assets would be elevated in price, nominally speaking, and the effects would migrate out to materials, to products, to physical assets, and to everything else.

- **When** will observers, by and large, accept the simplest of facts? The question is not if – it is when.

- **When** will analysts, from the standpoint of corporate earnings, factor in the prospects for feed and food from field-crop sourcing into a supply that adequately constrains prices? Farmers will win on lower fuel costs and some other costs, and they will win on higher volumes; but, they will probably lose a bit on prices of corn, cereals, and soy beans. Combining with lower fuel costs, this would also find expression in lower prices for carcass meat, and for processors of table foods. Moreover, worldwide demand for American field crops is certain to be adding increments to exports year after year.

Among all the negative commentary that saturates established media, almost no attention is given contemporarily to the prospects that great stimulus is to be derived from prospective reductions in the cost of fuels. There are many elements working toward lowering fuel costs, such as more conservation in energy use, more alternative sourcing of energy, and, especially, the unsustainable elevated price of crude oil – a feed stock for fuels and chemicals. Not even the recent-year creation of the greatest industrial cartel ever in the oil industry can keep prices at present levels enduringly. In terms of converting coal to gasses and to liquid fuels, the cost of crude oil today is at least twice that for the cost of coal products processed as it is manufactured in certain plants in other parts of the world (using improved long-established processes for gasification and liquefaction of coal). Now that the ethanol boom has run its spurious course, we do not have that untoward prop, intended also as a support for the price of corn.

- **When**, if ever, has America had an experience of such aforementioned expectations? And, as one of the most unusual aspects for investors today, when, if ever, have capital markets been so out of sync in the pricing of financial assets? Mispricing of shares of enterprises in today's market exceeds anything experienced for long in the career of this writer. This is the opportunity: These miscalculations and this period of social dissent with its frustrating effects to the flow of intelligent analysis afford investors with most attractive opportunities. Moreover, this is especially attractive to investors as they deploy their cash accumulations (following the unsatisfactory experience of '08 and '09). The very large advance in share prices from the extreme lows in the first months of '09 have reduced, but by no means have canceled, the attractiveness of valuations of equities, especially of

many of the larger enterprises and of the young companies whose shares have yet to attain broad acceptance in the marketplace.

- **When**, if ever, has so much cash been parked on sidelines by investors waiting for stronger conviction? It is highly likely that conviction will be strengthened by ensuing progress; yet, waiting for conviction very likely will result in diminished returns.

No one needs to be reminded that the central orbit of difficulty in 2007-2009 resided in the excesses of the financial industry. The same could be said of the recent crisis within the European Monetary Union. This was primarily financial. In an attempt to place this in perspective, an American remarked (using an exaggerated analogy for force) that if the newspapers had reported that all of Greece had been suddenly destroyed (all buildings and all citizens), the scale of this disaster would have caused only a small ripple in capital markets compared to what widening spreads in credit-default insurance swaps produced. Accordingly, the financial markets demonstrated, yet again, how quickly a small-glowing campfire can be made into a massive out-of-control firestorm. The reform Bill just signed into law is a small step, leaving much still to do, especially in coordinating practices among international institutions.

Those who are deeply involved with the industries that are still impacted by surpluses and unemployment have much reason for skepticism, worry, and disappointment; but, for investors not so involved, it is quite a different matter. The slowing of the economy was expected as much as the next train due in on schedule. Emergency stimulus measures (not very well devised, to say the least) have spent much of their effects, and inventory building from the sharp reductions of ’08 and early ’09 could not have been a lasting force. Even casual observation would have lead one to expect the economy to slow as it has. The economy is not faltering. Slowing is favorable for investors. Recently, the slowing of growth in China was a matter of attention and concern in the media (notwithstanding the fact that such is a goal of national policy in China), while our national policy is to liven the pace.

The essential advantage that investors always have is that they need not own everything, not even an index for that matter. There is no need to be optimistic on everything. Select among the companies that are prospering and leave the companies that are not prospering to languish in the hands of the undiscerning. For large and small investors, today’s circumstances are encouraging for those who can see the world in the context of what human inventiveness and aspirations will make happen, irrespective of politics. Athletes, artists, entertainers, creative intellectuals, and commercial products everywhere are bringing the world closer together, while politicians and religionists are spewing their divisive attitudes. What a shame! Bet on growth in commerce prevailing in the long run, for it has in the history of the last several centuries.

The hot summer dog days of July and August have a well established place in the seasonal regeneration of the human psyche, allowed by alternating rests and ventings of accumulated displeasures. In the natural seasonal release from accountability, accept the herein uncaged

observations and surmises as a writer's venting of circumstantial pressures hoping, as writers often do, that any flow of unconstrained words might spark in another intuitive beneficial responses. So, from musings on the veranda regarding contemporary financial affairs, the thought track continues to run as follows:

- **When**, with all things considered, will our economy reach that inflection point when strength in a few large industries (communications, electronics, healthcare, agriculture) spreads to gains in other industries in a self-regenerative way? This is not happening yet very generally. It should not have been expected to happen yet. The inflection point in the economy will probably follow an inflection point in our equity market. That will happen when those who have withdrawn so much cash from the equity markets try to re-enter. The "follow the leader" re-entry from cash to equities will provide the inflection point in the American stock market (probably in Europe as well, as a follower) and that will be a causal influence in amplifying the expansive effects of monetary policy throughout households, persons, and businesses everywhere in a better frame of reference to a future that beckons as larger than ever. Prevailing circumstances for investing offer as much variety as ever at prices that are unusually enticing. This is not an opinion. This is a reference according to the customary metrics used to appraise financial assets for their own inherent values, and for their relationships to alternate investments. This moment of sourness in our national attitude finds expression in the mispricing of securities. Investors have the means to select and enjoy such a miasmic-like malaise.

- **When** will this sourness dissipate? I would guess this will be a hand-in-hand matter, joined with the market for financial assets regaining intelligence, and, in turn, providing supportive influences to commercial life and social wellbeing.

With all good wishes,

James Fitzpatrick