THE VIEW FROM PRINCETON

Market Commentary ♦ January 2012

<u>An Interpretative Prologue: 2011, The Year That Was; Wasn't</u>

Slow Systemic Improvement is Better than No Improvement; Slow Economic Growth Benefits Equity Investors, Keeping Interest Rates Low

Napoleon is sometimes quoted as having remarked, "When the enemy is making a mistake, don't tell them." Yet, Napoleon never had to face off against anything like an enemy such as an army of investors. For successful long-term investors, the enemy is ever the perceptions of the hordes of the majority of all other investors. In free markets, the majority viewpoint rules prices. And always when the majority ranks very predominately large, or holds a view for an excessive time, prices move over an excessive range. That phenomena conspicuously characterized 2011, imbued with a seemingly universal psychic quagmire of untrusting perceptions of improving circumstances. The year 2011 might advantageously be regarded as a mistake.

A mistake by the enemy is a gift to be recognized, and forthrightly put to advantage. The successful long-term investor must know when the majority must be feared, and when to be thankful for the misconceptions of the majority, which by the nature of free markets is commonly wrong in a long-term reference (not for short periods, of course). Long-term investors make a good portion of their satisfying investment results by recognizing the mispricing of securities when the majority has overstayed appropriate bearings.

During much of 2011, prevailing buffeting negative headwinds were like self-inflicted punishment, depressing markets to lows in the early autumn, irrespective of the evidence that underlining circumstances were forming support for a long improvement. This seems reminiscent of the lows in 1974, before a decade of advancing equity prices. Few could see such then, which, of course, increased the probability. Does this not also apply now? Negative views seem inconsistent with the added inherent values of most well run enterprises that have experienced ten quarters of extraordinary earnings increases, and are doing just fine.

It is difficult to tell when the majority will feel happier. The election campaign will probably be a deterrent. Moreover, no one can effectively advise the majority of its mistake, because most persons take comfort in knowing so many others feel likewise. Thus, the "wisdom" of majorities is too herd-bound to learn of their mistake. That allows others, Napoleon-like, to benefit from the gift.

Our fundamental advice to investors continues to be this: Do not become distracted by anxieties and inveterately negative commentaries. Keep your focus largely on the positive gains of commerce. However, keep also in mind the scary foolhardy anti-social activity of large financial entities. Try to balance scales such as the $250,000 billion of Greek debt instruments versus the reportedly five trillion dollars worth of derivatives (yes, five trillion) based on many securities reportedly originated or acquired by three of America's largest banks in the third quarter of 2011.

The fix that Greece requires could be appraised as not much more than a sponsored distraction to the massively greater fix the financial system needs — and must occur to avoid a number of successive sovereign debt crises imposed on other small nations, and the hazard of another (probably somewhat smaller rendition) of the 2008 financial collapse.

Similarly, the three credit rating agencies could have been useful downgrading national credits years earlier. Why now, when the hazards are generally identified, and amelioration has gotten intermittently underway. Take note: there was much progress in recent months, even though not yet visible in the form of results. This was made more likely by leadership changes. There is a new head at the IMF, Madame Christine Lagarde, at the European Central Bank, Mario Draghi, and governor changes at the Bundesbank. Cooperative willingness among related nations seems to also be improving.

Year-by-year, market activity has become evermore dominated by fund traders buying or selling derivatives of specific securities or of non-specific averages (risk-on or risk-off). The latter is indiscriminate insofar as selection from the variety of alternative share choices. Thus, distinctions between shares within classified categories get overridden. The gifts of market aberrations therefrom come in two unreasoned forms: 1) mispricing of shares relative to alternate share choices, and 2) generally cheapened shares owing to the prevailing depressive attitudes formed of apprehension, and of dismay, distrust and fear among so-called rank-and-file investors. Such incredulous attitudes would have been appropriate in 2006 and 2007, but now seem to be in denial. Those who dismiss the evidence that the American economy is on a self-sustaining growth pattern miss an opportunity. Later, on more general recognition of the mistakes of 2011, the majority will have the problem of so many trying to reenter stock markets simultaneously.

The postscript that follows was written out of provocation two years ago in listening to a well-known economist predict a slowdown at best, or a double dip. The person spoke in the traditional terms of the National Bureau of Economic Research, as though America were still in the late 1930's. There was no mention of the new industries (entirely new products) of which scale of revenues today towers over all the present revenues of those industries that were in being in the 1930's. The negative mindsets of so many give little or no heed to the basic drivers of growth; such as (1) innovations, (2) aspirations of societies given means of expression by recent year communications systems, and (3) the newly formed closer and larger matrices between nations, now especially important as the more populous nations are growing faster than the more industrialized nations from years gone by.

This simple postscript seems to comprise overwhelming antidotal evidence that the world is not in a stagnation mode. Though it is unnecessary (and not possible) to like all aspects, it is necessary to assay the aspects and factors that affect investment results. Accordingly, we try to align client accounts with an emphasis on the enterprises in new industries with new products, the uses of which are growing because of the very usefulness and attractiveness of the products. Most importantly, the availability of present-day communication devices and systems reform the means of massive social expression. Not so many months hence, the whole world will be on Facebook, Twitter, U Tube, and native versions thereof, as well as texting and searching via very large providers of facilities. These complement the best created in the years gone by from the hard-wired telephone, the published printed pages, theater stages, movie houses, radio, and all media that draws the world into closer community with itself, and asks (begs) politicians to get on with it.

The Sciences as Driving and Guiding Forces

Why is "scientific" a centerpiece in our deliberations in behalf of client service? Why is so much of our distinctive value-add for clients derived from scientific factors?

Think: During the lifetimes of living persons, the industrial revolution of our textbooks exploded into

- the passenger airplane (not 1% of Americans had entered a plane by 1940)
- astonishingly advanced military and transport planes
- atomic energy defined, released, and harnessed
- the basics of physics and chemistry were redefined, and enabled therefrom
- the cathode ray tube imaging device (say television) was developed (largely in New Jersey)
- the transistor was created (in New Jersey)
- the computer was created (in the Delaware Valley)
- photo composition for printing (in New Jersey and Ohio)
- the charged-coupled device (image capture) was created (in New Jersey)
- cmos, and broad ongoing developments in solid state physics
- the laser was created (in New Jersey)
- fiber optics for communications, and for other applications
- electrostatic printing, scanning, and facsimile transmission were created from newly enabling understandings
- polio paralysis was conquered
- antibiotics were developed (first in New Jersey)
- DNA was defined (in the UK)
- antibodies were defined (in the UK)
- DNA was recombined (in San Francisco)
- radio frequency developed out of its infancy in communications into a multitude of applications, including very high-energy applications
- digitization allowed compression of binary impulses into extreme miniaturizations and transmission speeds.

Each of the above was world-moving in its import, influencing most aspects of our lives, and adding immeasurably to the wellbeing, and therefore wealth, of societies. This is only a partial list. Millions of other new products sprung therefrom, as discoveries propagated other discoveries.

As a subset, notwithstanding the contributions from the Delaware Valley, the Hudson Valley, and the UK, California stole the credit for creating the modern world under the catchy name of Silicon Valley. Where could you match that one for creativity?

Science drives value creation in specific terms and aspects, as nothing else does, allowing dependable analysis out of its very specificity, and owing also to the endurance of new knowledge of nature. This is why our Firm incorporates scientific achievement, as few others do, into product analysis, which, of course, builds into enterprise analysis, and product-pricing freedom for profitability. Proprietary products and profitable product pricing are the commonly used, worthy catchwords of investment analysis. The analyses require vast knowledge bases, the awareness of our limitations, and the ability to draw recurrently upon human resources beyond ourselves.

In a larger, societal scene, applied sciences drive value creation in:

- increased efficiencies – for everyone and every enterprise
- new products – for everyone and every enterprise
- new functionalities ever reforming personal and societal character and behavior

Accordingly, our understandings and responsiveness to the forces and influences therefrom are vital to our top-down as well as our bottom-up appraisals, which together guides all that we do in our enterprise analyses, and in providing our value added for clients.