THE VIEW FROM PRINCETON

Market Commentary ♦ July 2012

For American investors, there is an observable recent change in the fickle weather that nurtures investments, as incursions of doubt and apprehension again obscure vision. It is not easy to grow accustomed to such contra recurrences. These are enough to cause many a person to keep close at hand throughout the prospective summer a storm coat and boots, as well as an umbrella. Our own strategy for coping is that of staying invested in the best of enterprises in their respective fields, and allowing those able managements to pull shareholders through successfully. Their progress, past and prospective, gives strong encouragement to our hypothesis and our faith.

There are several primary and persisting forces – or factors – that undergird our strategy for such long-term oriented investing. These are so omnipresent, so gentle; and, as the air we breathe so apparent, little or no consideration is given to their presence, or so it seems. Take a moment for comprehension of the effects of just these four:

(1) Generally speaking, shares of thriving enterprises are uncommonly cheap compared to commonly-used metrics, and relative to the very low yields from investment-grade bonds.

(2) There is a massive economy-based downward trend now underway in prices of fossil-derived fuels and feed stocks that is washing out the political support that fueled the huge price advances in recent years. This should act as a stimulus from top to bottom for most of the world.

(3) There is a moderate slowing of economic activity in most leading nations (and weakness in some smaller nations) that should be providing a great gift of assurance to investors. This acts in concert with the other factors tending, as mentioned, to lower the prices of fuels, and acts also to extend the duration of the truly extraordinary low rates of interest on money for most of its uses or applications.

(4) Very importantly, most well-managed major enterprises have been prospering without setback for thirteen quarterly reportings of revenues and earnings. Of course, incremental gains are diminishing, owing to the increased heights for base comparison, and to the contemporary slowing of growth for many nations. However, rarely have these major enterprises been so self reliant in financial resources, in universal presence, in power of product positions, and in intent. Most understand that when the economic pace slows, the strong get doubly stronger by assuming increased market share. Such is no time for their retreat, which is broadly recognized. Their vigor is undiminished while lowered costs of money and fuels aids them, as it does for everyone else.

Given such beneficial effects of this moderation in economic activity, it is amazing to see how often this breeds anxiety among investors instead of embrace. So, the stock market interplay of the constancy of rationalizations vis-à-vis the volatility of emotional responses goes on.

This year's progress, thus far, appears to be dismayingly like a redux of 2011 – a strong and pleasing first quarter followed by take-it-all-back sequential months, that led through a dry bones valley of doubt. Subsequent events showed such anxieties to be unfounded. Thus, the second quarter of this year leaves little or nothing to cheer one's soul, or to excite hopes. And dismal dread-of-dreads, this is a Presidential election year in which the priceless reminders of the blessings of a benign constitutional democracy, sustained by an open election process, get overwhelmed by the noise of contest. The winds of change in immediate months are likely to be more gusty than directionally prevailing, heated also by the volatile emotions that arise from some of the provisions of the Health Care Act.

The message for investors is largely this: Attitudinal funks are not the stuff that supports proper appraisal of specific enterprise worth, or the appraisal of forces derived from commerce and from societal factors that influence valuations of financial assets. Today's apparent discounted mispricing of equity securities makes prospective appreciation of prices appear to be larger and more likely.

Perhaps something is to be gained toward perceiving contemporary reality and prospective opportunities in juxtaposing these seemingly morose, and sometimes phantasmagorical, interpretations against the solid real world evidence of significant contra trends. Some of the larger ones are listed. For pervasiveness and for force of macro influence accord top ranking to the now-visible unfolding of a long downtrend in the cost of fuels. All are affected, from the cost of fuel used in climate control of homes to nearly all forms of transportation and industrial activity.

This especially pertains to electric utility companies that thermally transform energy bound in fossil fuels into electric energy, and to chemical plants that convert coal, oil and gas into materials. Selective recent price changes in certain shares seem to be intuitively influenced by such. The effects of cheaper fuels and feed stocks can prove much greater than the stimuli of tax cuts, for cost benefits are so general, so immediate, and so tangibly specific. The unrelenting economic competitive pressures of alternative sourcing of energy, the more efficient use of energy, and the recent-year discoveries of gas and oil all act to overwhelm the political price of oil that elevated prices by more than five times, from the twenties of dollars a barrel to top one hundred and twenty dollars. An enduring downtrend seems probable.

Electric utilities have begun to experience another long enduring beneficial trend in the way electric energy is used to drive automobiles and other vehicles, whose batteries are charged while their owners sleep, lights are off, and most factories are slowed or closed. The economies from daily load leveling derived therefrom for their massive generating facilities could prove to be very beneficial. Earnings would be supported throughout the industry.

Likewise, similar beneficial earnings effects would extend to most industrial companies for whom use of oil or gas are a large part of their costs: noteworthily, these would be airlines, trucking, rails, and chemicals. Farm income, too, will have significant, though lesser, benefits over this broad-population spectrum. Including the many not mentioned aggregates to a very significant factor.

For the enterprises whose shares we have selected for clients, there is a very minimum of scattered adverse occurrences. For market share prices, the score differs. The correlations between corporate progress and share price changes are disproportionate owing largely to the hyperkinetic activity of overgrown financial markets worldwide. Strategically and proverbially speaking, bet on the steadiness of the tortoise to win the race against the speedy, but distraction susceptible, hare.

As ever, with earnest intent and best wishes,

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