THE VIEW FROM PRINCETON

Market Commentary ⬩ May 30, 2012

Concerns, Yes; Anxieties, No: Commerce is Prevailing over Financial Aberrations

Having sustained a few bruises and skin-deep contusions through recent weeks by the brute force of a tough, rough and hyperkinetic stock market, it is not so easy to maintain a focus upon the more important factors. As the foremost distraction, it's all about Greece again!! And in the very beginning, the writer must acknowledge how very, very little he knows about Greece. I fondly remember a few days in Athens several years ago, lodged in one of the very finest of hotels; and, of course, in many years ago from school-time readings finding Plato, Aristotle, Homer and Socrates. For those thoughtful Grecian forebears, all of us who live in democratic societies are in their debt for having laid the philosophical foundation for institutions supportive to social conduct.

The contemporary Greek situation — now two years old — is something else. It has been made into more than "a tempest in a teapot"; it is a small teapot around which financial tornadoes have swirled. With odds so nearly even, we would not care to bet on whether or not Greece leaves the monetary union, bringing another whirlwind. We only know that the GNP of Greece is less than one quarter of Germany's, about the size of Exxon's revenues, or Wal-Mart's revenues (America's two largest by revenues of publically traded companies). The imputed sum of its total national debt of 425 billion Euros is no great matter in the grand scheme of things. Most issues are political, and more troubling others emanate from the financial system where created paper for trading relative to Greece might be some unknown multiple of Greece's debt. After so long a topical matter of discussions and after preparations (partial or possibly sufficient) to contain consequences, there can scarcely be events beyond those already imagined. This probably gives some inurement to shock, yet the remedies are not visibly convincing. Someday, however, it will feel so good to be beyond these hyperventilating stresses.

We again hear the echoed words that all politics are local, as now reverberates through native politics of unlike national constituents of Europe. And we hear again descriptions that financial systems have become destructively self-serving, notwithstanding their *raison d'être* is that of service to societies. Finance and politics have become much more important than the physical forces of whatever happens within entities so small as Greece in the total scheme of things.

For American investors to allow the Greek affair to form their strategic viewpoints is a stretch beyond reason, though "the affair" can produce still more jarring road bumps along the way because of leveraged financial instruments throughout banking and trading entities. Conspicuously, JP Morgan revealed within past weeks some of the unforeseen expensive consequences that can come from participations in derivatives so arcane, opaque, and complex.

Meanwhile, in the Congress of the United States there is a response (formally stymied) in attitudes toward protective supervision of financial activity. Understandably, banks do not wish to be returned to being banks again by force of law, for this would severely impose upon earnings following such tremendous perennial advances in internal costs (noteworthily salaries and expansion of quarters). Indeed, earnings would be problematical if banks were only commercial banks again. This explains why we have not preferred banks for clients, even though we acknowledge there is an opportunity to selectively choose in this industry and do well. Further reason for our disfavor is that there are higher degrees of assurance in investing beyond the financial industries.

Congress is still deliberating regarding the provisions of the Dodd-Frank law, especially pertaining to the "Volker rule". This would restrict the trading of a bank's own account, which required large support for many not so long ago by American tax payers. Though it does not prevent banks from trading in the account of their customers, this would not be so lucrative, for the profits would accrue to their customers. It is moot whether or not this would be sufficient in making the system safer, but it would certainly act to make some banks safer.

In avoiding risk, it is so easy to avoid investing in financials, whose earnings are not easy to perceive, and assets can flow in and out according to daily perceptions. Interest rates are too low to allow institutions to earn much on high-grade debt securities, while higher internal costs constrain earnings for banks, and other financial institutions alike. This very low level of interest rates (not simply in America, but around the world) importantly supports a persistent, powerful universal force forming a preferential proclivity toward equities generally — and away from financial institutions. Like air and water, this is so powerfully and obviously important only few seem to notice, as one would not notice a clear sky or a neighboring ocean. Furthermore, shares of so many stalwart companies provide very competitive levels of dividend returns compared to that available from investment-grade bonds. The choice evidently is made for us.

Serious long-term investors should form their guiding hypotheses by focusing upon the growth of revenues among major corporations of the world, here and elsewhere. For American corporations, and for many others, revenues and earnings have advanced for the eleventh consecutive quarterly reporting. Generally speaking, more companies surprised by exceeding expectations than by disappointing in their reporting for the first quarter of this year. Once again, our Firm has recently experienced an exceedingly small percentage of disappointment among the reports of the corporations owned by our clients. Opportunities are plentiful, especially among industries that are growing well, and from the astute companies participating in those industries. For American strategic investing, we would take the political catch phrase that dates back to the first campaign of President Clinton, "It's the economy, stupid", and rephrase that to say, "It's the focus, stupid". Intelligent focus commonly trumps diversification in risk minimization, and in the providing of satisfying gains. Contemporaneously, this seems wiser than anxiety prompted withdrawal.

Even among our universe of interesting young companies (that are still so small they are hyper responsive to external events), there was a very minimum of disappointing quarterly results. Very weak share price behavior was a very different matter, as a baneful market phenomenon only.

Vodafone's revenues are universally descriptive in the reporting by the world's largest mobile phone system operator. Based in the UK and also owning a 45% stake in Verizon wireless here in America, the Company reports in this fashion: Revenues are down from the year ago and profits slipped owing to conditions negative in Spain, Italy, Greece and Portugal where consumer spending was weak generally. In others nations performance came through well: In Germany, the UK, the Netherlands and in the Company's reach into fast-growing markets such as India, the Middle East, Turkey and parts of Africa. Moreover, results from America were also good. There: You have the world's landscape — sketched and validated in the reporting of other companies.

Our interest in Vodafone is sustained. The growth of message sending is one of the broadest and most persistent of all user demand phenomena. It is unusual to see a down year even in the countries listed, notwithstanding the difficulties now faced. Vodafone is soon to be receiving a large internal dividend from Verizon, which suggests the Company will have a very substantial additional sum of money to use in a variety of applications including dividends and share buy-ins. Vodafone is the most well established among mobile phone operators and certainly one of the best of long-term investments that afford also a high current yield.

As our Firm has reiterated in our occasional commentaries, the following huge industries are doing very well in America and in advancing nations elsewhere: (1) Agriculture and food, (2) energy, (3) life sciences and health, (4) communications electronics, (5) tourism and lodging, and (6) entertainment. And persistent growth among these industries has given a demonstrable spreading effect to other industries. The overall American growth rate is still unacceptably slow, but it is still positive, and so long as it is slow, interest rates will stay low. This is better support for equities than faster growth accompanied by higher interest rates. Thus, general circumstances seem to continue to be highly supportive to selective equity investing. Count on the best of companies and the best of managements to provide the satisfactory results that measure up to the traditional experience of Americans over a long period of time.

If risk be defined as anything that might happen in addition to that which will happen, concerns are justified, to be sure. Concerns and anxieties, though associated, are quite different in their effects. Concerns are useful in investment policy determination; anxieties are anathema to rational deliberation. At this time, concerns should not be the overriding guides in attempts to visualize what will happen, given the innate strengths of most major enterprises, and the sponsorship stemming from cheap and abundant money.