



The behavior of the markets over the course of the last six weeks has reminded me of the phrase “getting your ducks in a row.” While I know the analogy may not be a perfect fit for what I perceive is occurring in the markets, to me, it nevertheless feels right. “Getting one’s ducks in a row” is an idiom for getting one’s affairs organized and at times, preparing oneself for tomorrow’s inevitable storms.

After lagging the overall indices for the past twelve to eighteen months, energy, materials, and industrial stocks – the market’s “ugly” ducklings in recent history - have been playing catch up to the market’s healthier sectors. It almost feels uncanny, but as the S&P 500 index level has approached all-time highs, it’s as though the leaders that have propelled the index to these highs have paused at an invisible line that shall not be crossed, allowing the laggards some time to play catch up.

Why might this be the case?

While I’m not entirely sure, there are two plausible explanations for me, one that is technical in nature and the other perhaps more fundamental. On the technical side, while any new high in the index may simply represent just another number in market history, fears of being the investor that top ticked the markets just prior to a major collapse in recent decades has perhaps endowed these “numbers” or “levels” with special powers.

In the absence of bullish new economic data, these index highs represent special zones not to be crossed, or at least not lightly. Rather than buying the stocks that have powered the indices towards prior highs and are themselves near all time highs, investors get squeamish and begin looking for value in places where it has been absent in recent quarters.

---

Nothing contained in this document including any reference to the purchase or sale of a security, or a strategy, is intended to constitute personalized investment advice. Personalized investment advice is always dependent on individual factors, involves risk and is not a guarantee that any investment will produce favorable results.

While it may not be the perfect analogy, I see ducks getting in a row precisely at these new index highs, which depending on your bias, could represent a finish line for a race that is nearly over or quite simply a new starting line to its future.

Of course, the technical arguments driving the image of the stock market “getting its ducks in a row” could also have a basis in the fundamental outlook. On this front, a lot has changed in recent weeks, at least with respect to central bank policy.

A few weeks ago, after sensing a potential crisis brewing in the world’s credit markets, our Federal Reserve expressed greater caution about raising rates into a global economic environment that appeared increasingly fragile. Even we became concerned about the potential for a credit induced recession, as credit default swaps on some European banks flared out, reminiscent of what occurred just prior to our own housing crisis.

With the Fed’s more dovish comments about the global economy, the dollar started to weaken and the rapid decline in energy prices was arrested. While low oil prices are generally a good thing, oil prices that are too low are not, particularly if it is reflective of global economic weaknesses. For many of the world’s emerging economies, oil is the elixir that pays the taxes and makes things go.

While significant new energy production levels in the United States have played a roll in the decline in oil over the last eighteen months, supplies are correcting as rig counts have plunged to historical lows. At the same time, we believe that changes in demand have also played a role, particularly in China where the efforts of a twenty year industrialization process have contributed to a long term bull run for the commodity complex. Over the last eighteen months, as China’s rate of growth has begun to slow, the fifteen year bull market in commodities has begun to show its cracks.

For years, we have heard about how great China is at capitalism and that aside from their pollution, they are a country that perhaps our leaders could choose to emulate. On more than one occasion, I heard people in our country say that if the Chinese wanted something done, they just did it. They didn’t have the gridlock we experienced so often in the states. Incidentally, I also heard the same arguments and love for Japan during my college years during the 1980’s; that our country’s government and business leaders could learn a thing or two about doing business the right way, keiritsu style.

While our country’s automobile industry was getting its head handed to them by the Japanese during the 1980’s, I knew one thing, and that is the forces of capitalism and the freedom of consumers to choose the cars they wanted to drive would affect the long term change we really needed far more than the government or a keiritsu style of capitalism. Today, Japan has faced nearly three lost decades of little economic growth, while our country’s automobile industry has excelled.

To be an effective long term form of capitalism, competition among businesses and political parties must remain vibrant along with the freedom of consumers to choose. Rather than

---

Nothing contained in this document including any reference to the purchase or sale of a security, or a strategy, is intended to constitute personalized investment advice. Personalized investment advice is always dependent on individual factors, involves risk and is not a guarantee that any investment will produce favorable results.

throwing money at our failures, we must allow them the opportunity to die, so that the fertile soil of these failed experiences can give birth to new and more competitive ideas.

Over decades, U.S. investors have learned time and time again not to “Fight the Fed.” In other words, while one may take issue with the politics of the Fed’s actions, we’ve learned that it rarely pays dividends to invest opposite an entity with an unlimited checkbook

While it may not seem like it at times, the objectives of the Fed are also in competition with one another. They are tasked with the job of creating an environment conducive to full employment as well as price stability, the dual mandate. For many monetary policy unions around the world, this dual purpose does not exist, and is singular in nature, focused simply on employment levels or price stability, but usually not both. Inherently, this produces a one sided environment that is socially much less stable, either promoting labor at all costs or owner’s capital at all costs, but not both.

The great question for me today is this. While I know it never “pays” to Fight the Fed, can the same be said of the People’s Bank of China? China has tried pulling several levers in its monetary and fiscal policy toolbox, including changing interest rates and margin requirements on loans. Last year, they even encouraged stock market speculation, hoping the wealth effect would boost the consumer economy. So far, each of these moves has done little to arrest the slowing growth rate in the Chinese economy, regardless of what the official data may say.

Of course, my objective here is not to take issue with the Chinese people, but merely to suggest that in the absence of healthy competition – among businesses and political parties – efforts at resource allocation to areas where people need it the most can be even less effective than more capitalist systems like ours where recessions are the necessary clearing mechanism. For more socialist and communist systems, the outcome is long term economic stagnation as in the case of the Japanese or even worse, outright revolution as it was with Communist Russia.

The market’s ugly ducklings – energy, materials, and industrial stocks – have come to life in recent weeks on the heels of a hoped for cyclical uptick in growth from China. On their recent earnings calls, companies like Caterpillar have expressed hope that renewed Chinese efforts at fiscal stimulus aimed at even more building projects will be more successful than recent failures to stimulate the economy through housing and the stock market. While spending more money will work in the short run, it only compounds the problem in the long run, making the excesses that need to be worked through even worse. It’s no wonder that CEO’s at companies like CAT remain hopeful, but hardly optimistic.

Just as Japan’s stock market has enjoyed many rallies in the past few decades, the overall trend has been unremarkable. In a similar fashion, throwing more money at areas which will help them achieve 7% GDP rates of growth in a command style economy may do little for the long term trajectory if such efforts aren’t what the Chinese people really need or can afford.

Does it Pay to Fight the Fed? No. But I’m not yet convinced that the same can be said of the PBOC as their system really isn’t a competitive one. My views of the materials and energy sectors remain trendless at this point in time. In my career, it has been a standard occurrence for the areas that have experienced a bubble in spending to enjoy powerful yet temporary

---

Nothing contained in this document including any reference to the purchase or sale of a security, or a strategy, is intended to constitute personalized investment advice. Personalized investment advice is always dependent on individual factors, involves risk and is not a guarantee that any investment will produce favorable results.

rallies from new lows in price. Eventually, these areas may be a buy, but my personal experience suggests that it takes far more time, even more so when your solution is to throw more gas on the fire rather than work through the excess.

It's not that I don't think there will be value in these areas – I do own housing related stocks today – just that it will be a period of years before the environment for materials, energy and industrial companies truly stabilizes. Could I be wrong? Perhaps. But at this point, I'm going with what my experience suggests.

While a recession may be off the table, I remain relatively cautious on the outlook, more so than normal. The Fed may have helped avert a potential crisis in the European banking system from becoming widespread, but I'm not convinced that the underlying problems that caused the scare have truly been resolved. This can only come with time and structural change rather than a "more of the same" mentality.

Caterpillar and Google are both admirable leaders in their respective sectors, but I see Google's path as being far less dependent on overall economic trends longer term. In a slow growth economy for as far as the eyes can see, I have chosen those that can grow in spite of the environment.

Innovators deserve a premium not because their stocks have price momentum, but because their financial results merit it quarter after quarter and year after year. Our portfolio is well positioned for exactly the environment we foresee.

Kindest Regards,

**Doug**  
Doug MacKay  
CEO & CIO  
[dmackay@broadleafpartners.com](mailto:dmackay@broadleafpartners.com)

**Bill**  
Bill Hoover  
President  
[bhoover@broadleafpartners.com](mailto:bhoover@broadleafpartners.com)

---

Nothing contained in this document including any reference to the purchase or sale of a security, or a strategy, is intended to constitute personalized investment advice. Personalized investment advice is always dependent on individual factors, involves risk and is not a guarantee that any investment will produce favorable results.