Quick Thoughts July 17, 2014

The past month and a half have been crazy, personally and professionally.

We made a final trip to Latvia to complete an adoption, had a graduation party for my high school senior, and attended orientation weekend at *The* Ohio State University. In between all that, we squeezed in no fewer than sixty baseball games for our three boys. I think I have a daughter too, but I'm not entirely sure if she lives with us or her girlfriends.

As much as I love summer ball, the season ends this weekend and I'm hoping life will settle down to a more sustainable pace and not one reminiscent of a minor leaguer with four kids, a mortgage, and a full time business.

Yeah, absurd high class problems. But I'm still beat.

On Monday, I'm leaving for vacation and plan to do nothing but sit on the beach and stare at the trunk of a palm tree. My children will have to live off the ocean or eat coconuts because, until I decide otherwise, I'm not moving.

Before I skip town, a few quick thoughts:

- **The Economy**. After a difficult winter quarter, employment, GDP, and other leading indicators of economic activity have improved. The question, of course, is whether and to what degree the second quarter bounce sustains itself through the remainder of the year. We believe it will.

- **The Fed**. Barring a disaster, there will be a shift in Fed policy over the next twelve months. Whether it occurs in nine months or eighteen months shouldn't matter to the long term investor. The Fed will only increase rates if the economy is on solid ground with regards to both employment and inflation.

- **Valuation**. In Tuesday's testimony to Congress, footnotes to Fed Chairwoman Janet Yellen's speech suggested the market was fairly valued but that certain areas, including small cap, biotech, and social media stocks, were overvalued relative to historical norms. While that may be the case, Google's experience shows that new industries can be very difficult to value in the early stages and those investors who aim for too much precision often miss the bigger opportunity. To us, the Fed should stick to comments on monetary policy and its dual mandate. It seems odd that they would use three years of near zero interest rates to encourage full employment and yet at the same time jawbone the valuations of the sectors creating the most jobs!

- **Earnings.** It is very early in the earnings report cycle, but recent commentary supports the notion that the economy is improving off its winter lows. JP Morgan's CEO specifically noted that business had improved in recent weeks and Intel's results and guidance indicated an improving CAPEX environment for PC's by the commercial sector. For the first time in years, M&A activity and capex are joining the discussion in corporate board rooms as viable alternatives to stock buybacks and dividends in driving future earnings.

- **Commodities.** After increasing in response to heightened geopolitical risks in Ukraine, Russia and Iran, oil and gas prices at the pump have been falling from their recent peaks. In addition, agricultural commodities like corn have plunged in price following bumper crops in the United States. Lower commodity prices are central to our thesis for a manufacturing renaissance in the United States. Prolonged periods of non-inflationary domestic growth, this time catalyzed by a shift in China's economy similar to that of Japan's twenty years ago, have historically been the very best environment for the stock market. Cheap energy sources could be as significant to the stock market as Reagan's tax cuts were in the Eighties.

- **Disruptive Industries; "Making Old Things New".** The valuations of high growth companies have come under investor scrutiny ever since the Fed first hinted at rate hikes. While it is entirely logical that high growth companies should see valuations compress in the face of improving cyclical trends, innovation that is independent of the economic cycle usually drives far more value for the long term investor. The proliferation of mobile devices and apps continues to shift the way consumers get their information and the way in which location is relevant to where one does business. While newspapers, magazines, and brick and mortar shopping will continue to exist and may even enjoy a cyclically induced bounce, there is no doubt that the future will look different from the past. Twenty-First Century Fox's bid for Time Warner yesterday is likely a sign of significant forthcoming change in the cable and media industry, which could mimic those in newspapers over the past few years. To us, a 140 character "Tweet" is the modern day equivalent of yesterday's newspaper headline and who could have guessed how valuable that industry would ultimately become.

- **Indexing & Exchange Traded Funds.** Along with government bonds, index and exchange traded funds have been the go to choice for retail and institutional investors in a risk on, risk off environment. Following a decade where an advisor could lose a client over a single poor stock pick, investors have flocked to prepackaged and more diversified offerings where little homework seems necessary and there is more comfort in going with the crowd. In this morning's earnings call, BlackRock confirmed the trend, saying that fund inflows were strong across all of its asset classes and types but one, active equity, which experienced continued outflows. What could change this trend? As is always the case, one word - pain.

- **LeBron and the RNC.** In a well-worded and heart felt essay –at least to Ohioans - LeBron James explained why he was returning to the Buckeye State during the same week that the Republican Party chose Cleveland over Dallas for their national convention. One of the world's wealthiest citizens of all time, John D. Rockefeller, once started Standard Oil on America's North coast roughly 150 years ago. With our southernmost counties rumored to be sitting on the world's largest oil reserves and a manufacturing renaissance in the making, the positive tweets on Ohio could just be getting started.

That ought to cover things, at least for the next week.

Coconuts, out -

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