THE VIEW FROM PRINCETON

Market Commentary ♦ September 2015

A PANOPTICAL VIEW THROUGH THE AUGUST TEAR IN THE CANOPY

In August, **WHEW!** financial markets delivered such a down thrust that thundered so loudly around the world this will remain in investors' memories. The sharp, deep, sudden drop was seemingly on the verge of going out of control. Only a few shares were unscathed. Share prices for many of the best and of the "who-cares" stripe were traded off twenty percent, and in intraday trading, some prices were down fifty percent from the week's beginning. This was a <u>sudden</u> market response to <u>slow</u> developments of lassitude in economies of several major nations. Attributing the initiation and cause of such to China has some truth, as the plunge erased much of the amazingly steep preceding rally. For America, this was largely another stock market eruption out of the "modernized" attributes that allow swiftness of opportunistic trading that can be deployed in many billions of dollars in the blink of a hawk's eye. Often, the discovery of a big order by one large trading firm actuates quickly a similar trade from another fund to better exploit the increased scale of opportunity of self-fulfilling gains.

Trading in huge volumes is commonly done with the buying or selling of indexes (of the general market, or specific to industries or nations) which affects all stocks in these indexes. The trading by indexes includes shares of companies not-cared-for or to the trader anonymously in the bundle. All in the bundle get pushed by such trades. The good and the bad get traded similarly.

A 360-degree scan through the tear in the canopy would see these itemized unusual aspects protrusively showing in the landscape as harbingers of change.

- Buy-ins, specifically company-by-company; yet, applied by so many the market effect becomes general in large scale. Typically, companies authorize their buy-ins in dollar amounts; thus, the drop in share prices allows an increase in the number of shares bought as well as incentive to companies to buy on the price breaks.

- Mergers and acquisitions have never before been conducted on so large a scale. These exert a lifting effect not only on the shares of the acquired companies, but tangentially to others when the premium on the shares of the acquired company have been so large as to imply cheapness to the acquired company – and to others similarly priced.

- Increases in the relative value of the dollar (and the sustaining of the gains) are an unusual phenomena, and one which has had a significant effect on volumes of materials and commodities in the traded markets, and especially transnational purchases and sales. In commodities, this applies to virtually all, notably, wood pulp, metals, fuels, and cereals (corn and wheat). Comparatively, soy bean exports by Brazil are doubly sponsored vis-à-vis American exports by the large drop in value of the Brazilian Real. For countries exporting these commodities, these would normally be advantageous to the foreign buyer and generally disadvantageous to America. The relative strength of the American economy seems likely to make up for these effects.

- The drop in pricing of fossil fuels has an enormous effect in rearranging sourcing of energy (drastically so for ethanol) and in shrinking any advantage in economic terms of alternative sources (so-called renewable sources as solar and wind).

- Notwithstanding the lower interest rates in America, and the strength of the American dollar, money inflows continue (on top of an American abundance) as foreign owners of wealth move from the domestic risks that surround them to the security of America, preferring real estate (already benefitting) as well as benefitting tradable financial assets.

- A raucous and rancorous background in the relationship between Congress and the Presidency has rarely been so persistent, evident, and dismaying. Lobbying by special interest groups overrides decisions by politicians. Attitudes appear as a quagmire of ill intent, and a mosaic of misconceptions, which has become so persistent as to appear to be America's new temperament.

- The media — television most conspicuously — plan their concentrations and amplifications of bad news, let it be anywhere and for anything, from train wrecks to fear of rampant spread of an untreatable disease. Catering to fear grabs attention more readily than normal events. Altogether, this is not the stuff that makes people feel better, or more optimistic.

- Financial gains and executive compensation seem to so many to be askance to inbred concepts of democratic government representing the interest of all, with equity and justice. The way in which both Donald Trump and Bernie Sanders, coming from the opposite extreme ends of the political spectrum, attract crowds of dismayed persons is background noise that requires attention, given the possibility that vocalization of dismay could swirl into very critical changes in the political landscape.

After interest rates have been perennially maintained at extraordinarily low levels, prospective normalization will be healthy and gently effective in the sponsoring of reality — and in the revealing of reality. For the last five years or so, the expectation of this normalization has subdued interest in tradable equity instruments as well as in owning long-term credit instruments. So, so many persons have worried about this for so long, the arrival of normalization will be about as exciting as watching grass grow. Accordingly, how should one deal with this incubus of normalization? The answer is: do nothing. It has already had full effect through perennial expectations.

Beginning in late 2009, this Firm has consistently pronounced that under contemporary circumstances one need not feel bullish, but better advised to be bullish — bullish as never before. It is difficult to feel bullish, but investors are advised to stay on the train. The flows of funds and the relative cheapness and dividend yields of shares of the larger established companies shall likely prevail over contemporary emotions. Memory can find no parallel in this land of opportunity of so many persons having withdrawn with chronic dyspepsia, or seemingly worrying for the sake of worrying.

There are industry-specific incipient concerns that might well find reality in disappointing effects. There is a lot of inventory of materials, food stuffs, metals, and finished products. Also in vehicles and equipment — new and formerly owned — used especially for mining, agriculture, and for automobiles — bigger and more costly than the mix of models ever before presented. In driving this summer, from Vermont to the farthest reaches of southwest North Carolina, views through the windshield and side windows showed the largest inventory on the lots of dealers ever. Indeed, the auto industry seems to have been "cruising toward a bruising." This was preceded by large increases in purchasing, making use of an enormous amount of short-term credit. The auto industry has provided strong general upward effects for America, and now casts shadows that darken also the exporting from Europe and Asia.

Along the lines of responsibilities, we are ever engrossed in efforts to perceive the differences and tensions between concepts and reality. We bet on realities to the best of our ability, and with enduring intent. Experience validates our expectation that reality eventually wins, while many concepts distract and fade.

During the past several years, the advancing share prices have not called for "corrections," as so often heard or read. Rather, these advances have made follow-on advances more probable by way of making persons feel wealthier and optimistic.

Stay the course. One of the broadest expansions of the American economy is now unfolding. This will not be the most vigorous of expansions, but it seems likely to be one of the broadest. It will have the pervasive sponsorship of the price drop of oil and gas for fuels, and for feed stocks for chemical manufacturing.

Prospectively, increased tax receipts will help sponsorship at all levels of government to improve the infrastructure of transportation facilities, releasing to all of us the time wasted at 5 MPH on 65 MPH freeways. The economic gain in social terms dwarfs the comparative financial cost in getting this done. For America, this is of great significance and there is plenty of opportunity, of grass-roots strength, of innovation, and of entrepreneurial spirit to prompt investors to align with these opportunities. Hopefully, this would help them sleep well at night, not fearing the Boogie Man of an economic stall that would precipitate another financial disturbance in immediate months.

As always, with appreciation for your trust in us,
and for the pleasures endemic in our efforts to serve your objectives,

Alfred R. Berkeley
James Fitzpatrick
Hugh Fitzpatrick
Steve Reynolds
Ken Berents

AN EPILOGUE

"Blowing In The Wind"

(Circa Mid 1960-1970)

A Plaintively Beautiful, Sensitive Lament for the Vietnam/Nixon Years)

Artist: Bob Dylan

How many roads must a man walk down
Before you call him a man?
Yes, 'n' how many seas must a white dove sail
Before she sleeps in the sand?
Yes, 'n' how many times must the cannon balls fly
Before they're forever banned?

The answer, my friend, is blowin' in the wind
The answer is blowin' in the wind

How many times must a man look up
Before he can see the sky?
Yes, 'n' how many ears must one man have
Before he can hear people cry?
Yes, 'n' how many deaths will it take till he knows
That too many people have died?

The answer, my friend, is blowin' in the wind
The answer is blowin' in the wind

How many years can a mountain exist
Before it's washed to the sea?
Yes, 'n' how many years can some people exist
Before they're allowed to be free?
Yes, 'n' how many times can a man turn his head
Pretending he just doesn't see?

The answer, my friend, is blowin' in the wind
The answer is blowin' in the wind

Artist: Jim Fitzpatrick

ADDED VERSE

Re Regulation of Financial Markets:

How many times must persons be sacked by
traders predatorily
Before constraining surveillance will again be
employed as once was intended to be?
Yes, and how many times must experience be
ignored in the name of efficiencies?

And will efficiencies thrive without regard for
traditional equity
Yes, and how many freedoms must be abused
Before impunity can't be bought for a price?

Yes, will equity receive sufficient appeal to
prevail over greed in our life?

The answer, my friend, is blowing in the wind
And huge profits have bought control of the wind.

With thanks to Bob Dylan, and with all due apologies.
Jim Fitzpatrick