

# THE VIEW FROM PRINCETON

## MARKET COMMENTARY: CLOUDS OF WORRY ENSHROUD THE LANDSCAPE

### THIS FORMIDABLE WALL OF WORRY

This decades old industry adage, “sell in May and stay away,” might seem to have appropriate widespread adoption this year, as investors and traders are daunted by their perceptions of all the negative aspects of worldwide circumstances confronting each and all. For those for whom worry chronically comprises a large part of their motivations, they certainly do not need to spend much time searching for justification. Unemployment is intractable in so many areas of America (and in a few other nations). Meanwhile, certain industries and the cascading financial calamities of '08 are not yet fully healed. Remedies to prevent another financially provoked disaster have yet to be installed.

The worry list expanded as Mother Nature acted with uncharacteristic violence, and with distressing disregard: The disaster of millennia was visited upon Japan, a flood-of-the-centuries visited the Mississippi basin (still swelled by the large late snow melt that boosts flow in the Missouri), and a record-breaking occurrence of devastating tornadoes touched down in many states (including Massachusetts for the first time in memories). Transportation and supply chains were frequently disrupted, subduing activity broadly. Foreclosures on homes are still running at high rates. Though household stress is much improved in some locales, it is unmitigated in others, and housing prices are slow to recover. Surely, there is plenty to worry about, and the broadcast media amplifies the distressing, knowing they can get more attention with descriptions of disasters than they can get from the presentation of happier scenes; or from seasonal uplift in baccalaureate addresses to young graduates. So America has not outgrown its negative obsessions, and these are likely to be intensified in some respects as preparation for the next Presidential election builds henceforth. Amid this contemporary corrosive state of mind it should not have been surprising that the impositions of extraordinary acts of nature upon activity of all sorts could be interpreted by so many as a slowing of economic growth of lasting proportions and meanings.

### SCALING THE WALL

The analyses that guide our decisions is more specific and relevant, differing from subjective assessment, such as the glass is half-full; not so, half empty. We choose to invest in strong enterprises believing these will prevail over weakness elsewhere. Investors can easily avoid involvement in the weak sectors, and invest in the strong. We are guided especially by the quantitative (we sometimes say the physical) characteristics of the capital markets, not the emotional. The holdings we have selected for our clients seem likely to be stronger and of more inherent worth in the Fall, with minor exception, than these were in the Spring of this year. All are adding to their inherent value, and their addressed market opportunities are unimpaired. In most instances, their products have attributes that attract new customers, and expand their markets as they go.

Importantly, the abundance of money presently within our capital markets and inflowing to the capital markets is highly supportive (the cheapened dollar is attracting foreign resources to boost the inherent domestic inflows). The prosperity of most major nations is helping America correct the disappointing areas. The BRIC nations (Brazil, Russia, India, China) are affected very little adversely by the unbounded explosive expressions of social aspirations throughout much of the Middle Eastern world, and will withstand the stresses and uncertainties emanating therefrom. There is no question whether or not this is rewriting the map of the world in socio-political terms, and is having worldwide effects, most notably in raising the prices of fuels. Brazil still imports some of its oil to meet internal consumption, and more so for India. Russia gains as an exporter of oil and products, and China is not so much affected. China has its alternates, and it has deliberately and assiduously worked toward self-sufficiency for its giant economy. The stressful consequences will show especially in the national economic accounts of those smaller nations that have to import most of their fuels, and in the negative repercussions on their currencies.

**TRAVEL  
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AND  
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COMMERCIAL  
POWER**

The critical distinguishing element of our view to remain invested in those companies that are creative and vigorous is simply that we draw our expectations (largely positive) from the strength and vigor and presence of these mighty companies. These have never had so much cash. In fact, when the consolidated commercial and industrial sector of America is calculated, one comes inescapably to the extraordinary revelation that their product pricing is so satisfactory, and their revenues prove to be so much above their need to spend, that they have tens and tens of billions of money in their tills. Part of this returns to the capital markets, in one way or another. Beginning in 2004, corporations for the first time since World War II began to send money toward the capital market, instead of withdrawing money for their physical expansion. This reversal of money flows is a stunning phenomenon.

And much beyond that in import, for the first time since the early years of the 1930's American households are returning financial capital to the markets. The much enlarged scheduled repayments (boosted by the aberrantly huge uses of mortgages in the ten years or so before the 2008 collapse) now exceed all records for repayments versus new mortgages obtained. The mortgage sector has been the largest single user of long-term credit - by far - throughout the professional lifetimes of all of us now engaged. For some years, this exceeded all other uses of long-term credit combined. Now, it is supplying money into the capital markets. The answer is found therein to the concerns that long-term rates will rise sufficiently to be a challenge to the stock market as QE2 ends (the argot terminology for the participation of our central bank in the longer maturity sector of the Treasury market). Looking around gives an opposite impression of the landscape.

There is an adequacy of financial capital still within the system that spells super abundance. This abundance of liquidity has evidently fueled upward moves in certain commodity prices. This is so different from an upward pull on prices of materials from user purchases. Financial speculative demand sooner or later exhausts itself. Someday, speculative investible monies will flow out of commodities and primarily into the equity markets, as real estate is in a long slow recovery mode and national policies and corporate cash levels will continue to keep a lid on interest rates. Money, in search of a better return, will be invested in equities, a high percentage of such sums can not reenter at present prices.

We spend no effort building economic models; rather, employ our scholastic and long experience toward developing what we term realistic hypotheses. These are derived more from paying attention to the activities of commercial and industrial companies, especially those of formative force, than from government figures (always late and suffused with imputations). We do not completely ignore the parochial talking heads from Wall Street that broadcast television dredges to scatter viewpoints incoherently into the listening populace. In the short run these are also depressing market influences. In the long run, it is the pull of human aspiration that wins over all else.

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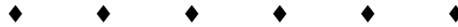
As we appraise overall circumstances, we are not relying on "sell in May and stay away". Rather, we are trying to select those individual enterprises that are strong, focused, vigorous and equal to the task of growing on their strength and on the worthiness of their products. We like to select those that also have what sailors seek and hope for: a persistent, or following, wind. While concerns dominate the decisions of so many others, we are letting the positives lead our determinations. This strategy has functioned most beneficially since 2008, notwithstanding a disheveled and confused body and spirit among persons involved in, or analyzing, financial matters.

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(CONT'D)**

A few of these metaphorical breezes, topically speaking, can be illustrated as follows:

- Agriculture, still America's trump suit, has never been better positioned on a fundamental basis
- General lighting, new light emitting materials, and energy saving
- Displays for electronic devices
- Mobility and connectivity in communications devices
- Internet security, requiring increased remedial effort
- Cloud-computing and storage
- Rising use of electric motors for vehicles
- New materials formed at the point of atomic energy
- Instrumental tools to provide such new materials
- GREEN, alternate, cleaner, and more efficient use of energy
- Life sciences that perennially provide so much that is new that investment opportunities never cease to spring from selected dedicated companies

Electronic communications systems (comprehensively defined including equipment and the geography of users) grow ever in greater volumetric increments upon an ever-expanding base, and especially in the high clouds of storage and at the lowest *terra firma* paths of human conduct. All is connected; all is universal, the colossal system "never sleeps" (along with a different Citi). These conceptual terms that provide wind into the sails of the vessels that we choose are not wafts of wind that soon leave one dependent upon an internal propulsion system. These are like the trade winds that merchants have used for centuries to form the ocean pathways, and combine now with good propulsion systems. This mitigates anxieties that allow us to accept a calm, or maybe even a stormy, summer as we approach the months thereafter.



**POSTSCRIPT**

P.S. Accept the best wishes of a personal postscript:

*"I've looked at clouds from both sides now  
From up and down and still somehow  
It's cloud illusions I recall  
I really don't know clouds at all"*

In the quiet hours of the summer, let the familiar dulcet lines and tones of Joni Mitchell now stored in your memories engage you, and please you, and beneficially cause you to let the illusions and ambiguities of life excite your curiosities. That should, I believe, form pathways toward wisdom, peace, and gratitude. Enjoy!