October 20, 2015

## Q3 2014 Commentary: Interest rates going nowhere

Rarely do macroeconomic or political events exert significant influence on our investment decisions. We construct portfolios with a bottom up approach, finding good companies at a discount price. Over the long term, economic conditions have far less impact on results than disciplined selection of individual securities. Specific company performance will ultimately determine its stock price. It is a good idea, however, to be aware of changes in the global arena because they can guide us to opportunities. A strengthening US dollar and collapsing inflationary pressures are two current changes that must be acknowledged in the global investment environment.

Since 2008, governments the world over have provided massive amounts of stimulus to the global economy. All the while, investors have been terrified this monetary stimulus would ignite inflation. However, no inflation has appeared and recent signs point to disinflation. In Europe, governments are more concerned with deflation and there is little to suggest inflation will turn higher anywhere. Growth is meager outside the U.S. and commodity prices are plummeting. The price of oil has collapsed and the price of gas in the US is at a four year low. Wages, another significant component of inflation, are stagnant. Average hourly wages are up 2% over the past year despite the improving labor market. There is little to fear from inflation.

The US dollar appreciated 7.7% against world currencies in the third quarter. The Euro stood at 1.37 versus the dollar at the beginning of the year and now stands at 1.26 to the dollar. The strong dollar impacts the price of international goods and services. Imported goods will be cheaper, while US exported goods become more expensive for purchasers outside the US.

In a low inflation and a strong dollar world, interest rates will remain very low. Cheap imports and lower gas and heating bills will benefit the consumer. Companies that sell directly to the US consumer should have the wind at their backs. On the other hand, companies with a high percentage of international earnings may find themselves less price competitive in international markets because of the strong dollar. As investors, we try to put as many factors in our favor as possible when we construct a portfolio. By stacking the odds in our favor, we create an advantage. Given what's going on in the world, we would prefer to add a domestic company whose business benefits from low inflation and a strong dollar. The retail sector, mentioned as an attractive sector for investment in our last letter, fits this profile and we expect good things from the positions we have added in this group.

Reported earnings for the S&P 500 companies in the third quarter have been good. Employment reports indicate the economy is on firm footing. The recent downturn in the market is the first meaningful sell off in the stock market in a year. With stocks off 7% from the September high, we have been able to put cash to work at attractive prices or reposition portfolios for the turnaround to come. We have been waiting patiently for lower prices and are taking advantage of them now that they are here. Bear markets result from excess, yet market dynamics are hardly excessive and prices are fair. Our expectations for the stock market remain positive for the year ahead.