

2016 CHALLENGES SET UP 2016 OPPORTUNITIES

“The stock market has been using the same gambit in the perception (market is up), but the reality is different (stocks are down).”

– Pring Turner Client Newsletter, “Perception Versus Reality”, December, 1999

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Speculative market behavior may look exciting for a while... but history shows a conservative, high quality, investment strategy will outperform with less risk and volatility in the long run.

2015 Déjà vu. The perception is that the stock market averages were little changed in 2015. In fact, the typical stock was lower for the year. The reality is best described as a “two-tiered” market where the average stock struggled relative to the “averages”. One measure of stock prices reveals by year-end that nearly two-thirds of stocks on the New York Stock Exchange were down by more than 20% from their yearly highs. “Value” stocks in particular, were an unusually weaker segment of the market. For example, legendary value investor Warren Buffet’s flagship Berkshire Hathaway’s shares declined more than 12% last year. Similar to the 1999 experience, referenced in the excerpt above, the reality is that stocks had a much more challenging 2015 than the market indexes reflect. However, in our opinion the good news is the table appears to be set for value investors to achieve superior performance in subsequent years, just as it occurred during the post-1999 period.

In the chase for performance last year, speculators poured into a few high-flying, overvalued, large capitalization growth stocks and this skewed the major market indices with a misleading upward bias. Similar to 1999, when hot money

2015: A Misleading Year	Total Return
S&P 500	1.3%
New York Stock Exchange	-6.4%
Berkshire Hathaway	-12.2%

speculators chased the performance of a narrow group of overpriced growth stocks, value stocks became ever more attractive. Sure enough, it turned out to be quite painful for the speculators of the day, but value investors prospered for years to come. Today, as speculation has ramped up, many high quality companies have been ignored or sold down for the past year and a half, creating some very attractive bargains. We cannot say for certain how much longer this two-tiered market may be with us, but history does show value investing, in the long run, outperforms with much less risk and volatility. Now, in the opening volatile days of 2016, it appears the pendulum is swinging away from speculation and back toward our more conservative “value” approach.

In last quarter’s newsletter, entitled *Reducing Risk to A Safer Portfolio Speed*, we used a metaphor of reducing risk by slowing down your portfolio driving speed due to less favorable visibility. The New Year begins with a continued defensive profile, holding high quality, above average income-producing stocks, bonds and a healthy cash position. We admit to getting more excited as the market presents us with better low risk opportunities in many high quality or ‘core’ holdings that have been passed over during this speculative period. We define a ‘core’ company as one that is a leader in its industry, in strong financial condition and also demonstrates a history of rewarding shareholders with an ever rising dividend income stream. A core company is most assuredly an ‘investment’ and not a speculation. These core holdings, when added to your portfolio at very reasonable valuations, can generate above average returns over the long run. Your patience will be rewarded as relatively high cash balances in your portfolio will be used increasingly in 2016 to add to investments, not speculations.

“An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative.”
— Benjamin Graham, *The Intelligent Investor*, 1949

THE FEDERAL RESERVE INTEREST RATE HIKE

What does the first increase in interest rates by the Federal Reserve mean to investors and savers? First, don't get your hopes up when you check out CD rates at the local bank—you will still find measly returns offered. As the economy continues on a very slow growth path, we do not expect to see much higher interest rates for this year. The economy is not overheating and actually appears to be softening. Inflation is not a problem, so there is no reason for rates to move much higher. It will take many years and much higher economic growth for interest rates to have a sustained and meaningful rise. Our opinion is interest rates will stay lower for longer than most observers expect. In fact, we would take advantage of any rise in bond yields over the next few months to add to bond holdings that boost income to portfolios.

CONCLUSION

Speculating in excessively priced growth stocks may be exciting for a while, but manias always result in disappointment. History shows that a conservative, high quality investment strategy will outperform with less risk and volatility in the long run. Back in 2000, Pring Turner's conservative strategy of value investing ushered in a lengthy period of attractive risk-adjusted performance. We are convinced the same will hold true today.

For conservative investors, 2016 opens as a year of with both challenges and opportunities. Our aim is to protect you through volatile down periods, while the higher cash levels you hold temper any further market declines. Importantly, cash will allow you to take advantage of increasing number of core value investments throughout the year. We look forward to meeting the challenges and taking advantage of an opportunity to set the foundation for solid long-term returns. Notwithstanding current troubling headlines, we are believers in the dynamic American entrepreneurial spirit. This spirit continues today, forging the next level of innovations that will lead to higher standards of living for all and importantly profits for long-term investors.

This year marks Pring Turner's 39th year of helping clients protect and grow their wealth. We have experienced many bull and bear markets, and learned many things through these interesting decades. One lesson especially tops the list: Financial markets move from greed to fear and back again, and again, driven by the ups and downs of the always progressing business cycle. Successful investment outcomes depend upon a disciplined decision making process that takes advantage of ever changing financial market swings. When you add high quality income producing companies at the right price to that mix, you increase the odds of a successful investment experience. Following this patient and proven process has helped us protect and grow our client's valuable assets for the past 39 years. We give thanks for the confidence and trust you have given us to support you on your financial journey.



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