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OBSERVATIONS ON THE MARKET

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If you want the benefits of vitamin C, you must keep taking it because our bodies can't store it. We should treat our investment philosophy just like vitamin C. Each new day the markets do whatever they are going to do, and the media is constantly reminding you of everything we are doing wrong. Without a constant reminder, your investment discipline will just become a reaction to daily events. We need a continual reminder of how we should be investing. At the beginning of last year, the 2017 earnings estimate for the S&P 500 was $136. They are now expected to be about $125 with just one quarter left to report. It is fascinating that earnings projections have come down by 8% in the last year. However, the market is up by 15% this year anticipating better earnings. It doesn't hurt to have Warren Buffett come out and state that the market isn't over-priced based on current circumstances (i.e. low interest rates). OK, that is what he says, but what is he doing with his money?

In the latest Berkshire Hathaway quarterly report, which was for June 2017, he had $99.7 billion in cash and short-term investments. Shareholders' equity (the company's net worth) was $300 billion. Mr. Buffett had 33% of the company's net worth in cash. This hardly seems like a position of an optimistic investor, it appears to be something a cautious investor would do. On a similar note, several years ago at a Berkshire Hathaway annual meeting, Buffett said this: "But seriously, the airline business has been extraordinary. It has eaten up capital over the past century like almost no other business because people seem to keep coming back to it and putting fresh money in. You've got huge fixed costs, you've got strong labor unions and you've got commodity pricing. That is not a great recipe for success. I have an 800 (free call) number now that I call if I get the urge to buy an airline stock. I call at two in the morning and I say: 'My name is Warren and I'm an aeroholic.' And then they talk me down." In the latest SEC filing, two of Berkshire Hathaway's larger holdings are Delta Airlines and American Airlines. Mr. Buffett must have misplaced his 800 number. Is it productive to second guess one of the world's best investors? No. It is wise to not take everything at face value, no matter who says it.

It has been interesting to see some very successful investors question what the current logic is in the stock market, and why value investing has been out of favor for so long. One comment regarding Amazon and Tesla is that just because a company is a disruptor in the market place with their technology, doesn't automatically imply that the profits of the disrupted will flow to the disruptors. The stock market currently thinks they will.

In a study by Hanson and Dhanuka titled; *The "Science" and "Art" of High Quality Investing*, they conclude that one of the best predictors of long-term investing success is return on invested capital, or ROIC. This is simply what a company earns on the capital that has been put into the business. It seems sort of obvious that success eventually follows companies that are profitable over a longer-term time horizon. The problem with the current market disruptors (the four big ones are Facebook, Amazon, Netflex, and Google) is that their valuations are based on profits that have yet to materialize, and if they do, they are far out in the future.

There seems to be a lot of short-term expectations riding on corporate tax reform. Lower corporate tax rates do immediately boost corporate profits. However, it seems the market has already discounted that, and many of the best performing companies currently are the ones where taxes are a small factor for them because they don't make much money. So, then you should ask yourself; is tax reform really the main market driver currently? If you are a value investor, this is a wonderful time to remind yourself that paying a reasonable price for current profits is a great reason to invest, and someday it will again matter. If you don't review your investment approach often, it will do about as much good as vitamin C that sits in the cabinet.