The Long & Short of It

Quarterly Newsletter
Second Quarter 2011

During the second quarter of 2011, stocks rose, fell, and recovered, ending the quarter close to unchanged. These gyrations—resulting from political posturing about the Greek debt crisis—left investors a bit frazzled and worried that Greece, along with other European countries, may initiate a full scale European banking crisis. U.S. budget negotiations and some slowing of our economy added to the uncertainty. It seems U.S. Treasuries remain an option for safety for some investors, as the increased fears were helpful for U.S. debt markets causing interest rates to fall and bonds to turn in a reasonably strong performance. Gold continued to outperform, continuing to show little regard for the fluctuations of one paper currency versus another.

The Power of Political Parties

At the beginning of the quarter, a mere three months ago, it appeared that the U.S. government's published numbers were showing improved health. Yet the soundness of the policies behind the numbers continues to leave investors less certain. The majority of fiscal policies implemented over the last decade have generally been less than helpful for the process of wealth creation. As for monetary policy, dollars have been printed primarily to fund the fiscal deficits, while banks have sought more money without having ready borrowers. The activity and sway of government feels larger and less predictable than ever.

In light of today's uncertain and delicate condition, we turn our thoughts to one of history's great political commentators, Cicero:

> *"The budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed lest Rome become bankrupt. People must again learn to work, instead of living on public assistance."* - Cicero, 55 BC

If history does not repeat itself, it certainly has a cadence. The world appears to have become the Rome of old. Today, "political investing" and speculation is pursued by most investors rather than "economic investing." For many, the ongoing and potential impacts of an over-active, over-large government have become greater concerns than corporate innovation, management, or profitability. As for those who decry the special interests running our country, there seems to be no greater special interests at work than the political parties themselves. The needs and desires of all others, including the country itself, are left playing second fiddle. Over time, while each party jockeys for power, little results except to increase the power of each at the expense of authority of citizens, states, and branches of the federal government.

Here, we remain impressed with the wisdom of George Washington who wanted to keep parties out of government. Power, he believed, should reside with individuals and ideas judged on their merits, without party associations to claim, dilute, or distort their meaning.

The Power of Data to Distract

Before the information revolution, the practical limits to gathering and processing information provided a cap on our aspirations for more data. Medical forms have since exploded from half of one page to several pages. Phone bills, now the size of a small pamphlet, itemize each call. Junk mail arriving at most addresses has only increased while email has grown from non-existent to overwhelming. Tax returns have become depressingly complicated. In the past, politicians experienced significant practical limitations because of limits to the gathering and processing of information. Currently, thousands of pages of new rules are written each year, each to be followed and tracked with more data gathering and reporting requirements. Today, the approach is "Since we *can* track the information, surely we *should*" as if some good is guaranteed to come from it.

342 WEST WOODLAWN AVENUE, #201, SAN ANTONIO, TX 78212 P 210.490.2545 F 210.490.2353 WWW.ROBINSONVALUE.COM

For us, the impact is *TMI²*: Too Much Information; Too Much Involvement. As a country, we have majored in minors at an epochal scale, creating tremendous administrative complexity and paying insufficient attention to the major “hitching posts” that create and sustain American exceptionalism. We can gather, measure, and discuss millions of facts that are mainly symptoms, but conversation and consensus regarding meaning and the causes of the illness elude the country.

Maintaining Perspective

While we follow the macro-level economic and political events closely, history has shown that purchasing power can be grown without having to form investment hypotheses around which party will prevail or the potential outcome of budget talks. We continue to maintain inflationary and deflationary hedges in our client portfolios: investments that can be used tactically to benefit the portfolios when uncertainty delivers a nasty outcome. Over time, valuation matters most—so we keep our eyes fixed on the investing issues of profitability, sustainability, and valuation.

Importantly, lending standards have begun to relax and demand for loans has finally begun to improve. We will assert that the economy appears to be gaining a bit of traction, but external shocks—like a European banking crisis or a U.S. Treasury credit quality downgrade—could create some significant market weakness.

Among the abundance of fairly priced and over priced stocks, we are finding a few dozen stalwarts that are extremely attractively priced—names that we have wanted to own for a decade or more, but prior to now never traded at sufficiently attractive valuations. These include stable, industry-leading companies with sales all around the world and products that people will continue to buy even if trade is conducted in silver coins or shark teeth. Moreover, the large dividend yields on many of these companies are greater than the yields of U.S. Treasury bonds. Unlike bond coupons, these company dividends are very likely to increase over the long run.

Many of these very large, multi-national, mega-cap companies are the same ones that were so popular in the March 2000 bubble. They have been neglected for too long and now represent a significant opportunity. Of course, crises will occur. In response, these companies’ prices may drop over the short term. Any selloff will only add to their appeal.

At this time, there is no such thing as a riskless investment. Keeping one’s money safe or “under the mattress” means having it denominated in dollars which could quickly diminish in value. European government bonds and even U.S. Treasuries are now backed only by over-indebted governments with thoroughly modern printing presses ready to print more currency. Simple loss aversion will not do.

Successful investing is first and foremost about survival: about not experiencing a permanent, unrecoverable loss of purchasing power. With that as the foundation, risk must be taken—not avoided, but controlled. Adding value means taking prudent, calculated risks, typically risks to which others are extremely averse. It is through their aversion that the price of a solid investment becomes a bargain, setting up a low risk/high return opportunity. This is what we are called to do at Robinson Value Management, seeking both ballast as well as upside for client portfolios.

Charles W. Robinson III, CFA
