



## The Long & Short of It Quarterly Newsletter First Quarter 2012

### **Relief Rally**

The first quarter of 2012 brought exceptional results to investors, as consensus seemed to form that Europe was coming to grips with the severity of its sovereign debt crisis and appeared to be taking the necessary actions to alleviate market anxiety, while China would likely avoid a hard landing. During the quarter, the Dow Jones Industrial Average (DJIA), S&P 500, and NASDAQ 100 returned 8.9%, 12.7%, and 18.7%, respectively. The media quickly proclaimed that stocks had their best first quarter performance since the 1990s, though a healthy skepticism is warranted when three fourths of the data are left out. Including the other three quarters of each year, the S&P 500 and DJIA performances for the first quarter of 2012 do not place in the top decile over the last 15 years.

Seeing an 18.7% return during one quarter when the broader market returned around 10% is enough to make any investor who received close to 10% (most investors) feel a bit deflated. So, let's look at the details. During the first quarter of 2012, one component accounted for nearly all of the difference between these indices: the common stock of the Apple Corporation (AAPL), which returned 48% during the quarter. AAPL is not one of the DJIA components. However, AAPL makes up a significant 4.45% of the S&P 500 and added more than 2% to the return of that index. At a foolish 17.2% of the NASDAQ 100, AAPL added 8.3% to the return of that index.

Why foolish? Certain indices have always had a flair for the dramatic, and too often a corresponding dramatic swoon. It always is best to understand what is driving these movements and whether or not it seems a prudent way to invest. Basic trust law guidelines traditionally place concentration limits at 10%-12% of a portfolio. With a single stock position permitted to be 17% of the NASDAQ 100, the architects of the index do not appear to have risk management at the forefront of their thinking. As for the longer-term numbers, \$1 invested in the NASDAQ 100 index in March of 2000 (hypothetically, with dividends reinvested) is now worth \$0.67, while the same investment in the S&P 500 or DJIA would now be worth \$1.17 or \$1.61, respectively. With the significant decline in the value of the NASDAQ 100 since March of 2000, investors in that index are not being adequately compensated for the risk that they have taken.

### **Bad News Still Sells**

While the pessimism surrounding the global economy abated somewhat during the first quarter of 2012, there remain significant impediments to the resumption of healthy growth, namely the aging populations of the U.S., Japan and Europe, and the debt problems faced by their governments. In fact, Egan-Jones Ratings Company just downgraded the debt of the United States government from AA+ to AA with a negative watch, stating that "Without some structural changes soon, restoring credit quality will become increasingly difficult."

Although the ramifications of this downgrade are significant, the credit quality of the U.S. Treasury remains just one metric and only one component in a comprehensive investment research process. As humans, we have a tendency to focus on the negative and the challenges ahead, and ignore the progress made and under way. *Abundance* by Steven Kotler and Peter Diamandis presents a more rational view of events taking place around the globe than what is delivered by the media each day. With the information age now in full-swing, people in remote places around the world are gaining access to educational materials that empower their productivity. Today, "(A) Masai Warrior with a cell phone has better mobile phone capabilities than the President of the United States did twenty-five years ago. And if he's on a smart phone, with access to Google, then he has better access to information than the President did just fifteen years ago." Worldwide communication and information abundance, transformational technologies, a "do-it-yourself" revolution where individuals and small groups can now accomplish what only large corporations once could, massive philanthropic giving from high-tech billionaires, and the poorest of the poor plugging into the global economy are some of the many factors that will be making the unimaginable possible. Essentially, what Kotler and Diamandis describe is a world positioned to achieve labor specialization and utilization with an inclusive scope and pace that Adam Smith could have barely



imagined. So far, most of what we experience in the U.S. has been the new competitors in the global labor market, and the resulting slower domestic economic growth. Over time, this evolving global workforce becomes customers to the world - and the wealth of nations continues to expand.

In *Why Nations Fail: The Origins of Power, Prosperity and Poverty*, Daron Acemoglu and James Robinson offer the keenest insights from their research into exactly which countries experience economic growth and why. This is some of the best economic research and writing in recent history and they succeed by throwing out the econometric models of the last 30 years and replacing them with a large dose of common sense. Studying areas with similar populations and geography, but different political and economic institutions, they find that it is not so much the geography, disease, or culture, but man-made political and economic institutions that underlie economic success (or lack of it).

Acemoglu and Robinson's research asserts that the more people are able to keep what they produce, the more they are inclined to produce. Whether the product of a citizen's labor is taken from him by a benevolent or menacing dictator, elite club, or seemingly well-intended institution for noble or ignoble causes seems to matter very little. More important to economic growth is the existence or absence of inclusive, representative political institutions that permit inclusive (or participative) economic institutions, most significantly private property and competition.

### **So, What's New?**

While both federal and local governments are economically vulnerable today, corporations are showing no such weakness, with strong balance sheets and innovation running at a healthy clip. With investing in large domestic versions of these companies currently out of favor due to more than a decade of poor performance and some very public scandals, the future may indeed be brighter than most would estimate. At Robinson Value Management, we continue to find significant opportunities to participate in these resilient wealth-creating companies through prudent risk-taking and a traditional, bottom-up investment approach. Although we remain committed to this investment approach as the primary means for wealth creation, we recognize that today's government policies, intended to stabilize the economic cycle, are different from those encountered by Benjamin Graham and other investment pioneers in the early 1900's. In 1934, when *Security Analysis* was first published, government spending was 3% of our country's Gross Domestic Product (GDP). Today, it is 24% of GDP. Government activities are, and will likely remain, an exponentially larger portion of our economy. Our inquiries into its impact have inspired the development of investment strategies specifically designed to take advantage of its larger footprint. We will have more on this topic next quarter.

Charles W. Robinson III, CFA

---

This newsletter is furnished only for informational purposes and does not constitute an offer or solicitation to sell or buy securities mentioned herein. Although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed. Opinions expressed herein are subject to change without notice. Past performance cannot guarantee comparable future results.

Robinson Value Management, Ltd. (RVM) is an independent investment management firm, not affiliated with any parent organization. Founded in 1997, Robinson Value Management, Ltd. is registered with the SEC and serves both individual and institutional clients. The name was changed to Robinson Value Management, Ltd. from Robinson & Wilkes, Ltd. on December 31, 2008.

Robinson Value Management, Ltd. claims compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of our composites and/or a presentation that adheres to GIPS, call (210) 490-2545, email [amy@robinsonvalue.com](mailto:amy@robinsonvalue.com), or go to our web site at [www.robinsonvalue.com](http://www.robinsonvalue.com).