THE LONG RUN

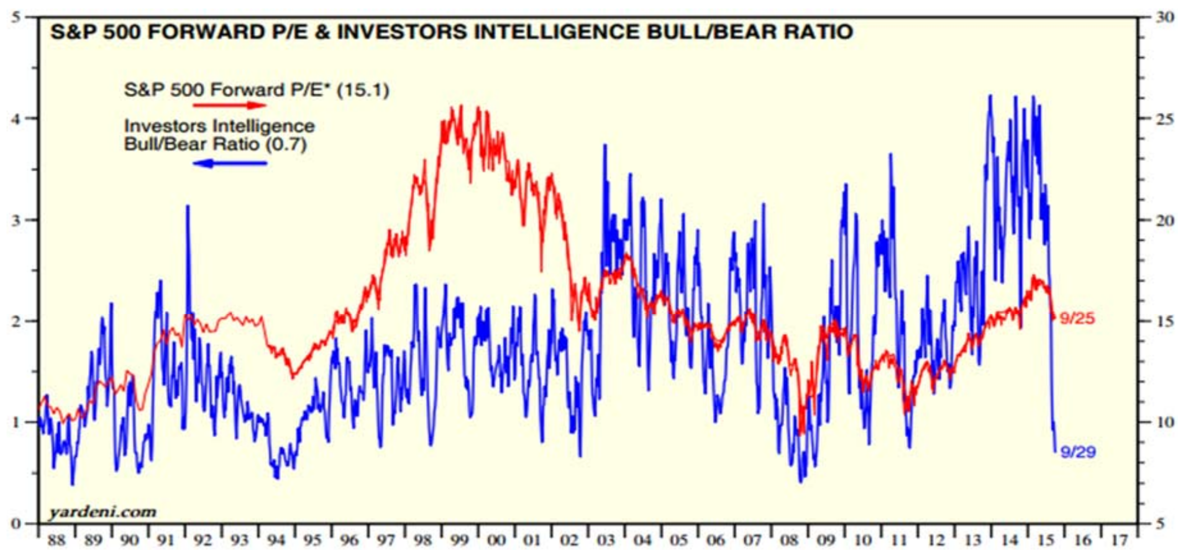
Reynders, McVeigh Capital Management, October 2015

"The future ain't what it used to be." ~ Yogi Berra

Even from our perch in Boston, we will miss the uncommon wisdom of Yogi Berra. The future may well not be what it looked to be in the ebullient days before the financial crisis and great recession. After years of stimulus and zero-rate policy, the FED finally believes that a modest lift in interest rates can be achieved without sinking the U.S. economy. Europe has, after years of talk about austerity, ramped up stimulative monetary policies of their own in order to encourage growth and combat the threat of withering deflation. This picture of committed policy action may offer the promise of reasonable – if not exciting – growth to come, but it does not capture the vision of a global market juggernaut that many investors imagined a decade ago. Add the economic slowdown in China -- borne of overinvestment and now demanding a massive readjustment toward a more self-sustaining consumer economy – and investors today begin to wonder if the globe can produce any growth at all.

This threat of structural weakness in emerging economies challenging the policy-anchored, muted growth in developed economies has finally led to a significant global market correction. We warned about the imbalances in China, witnessed the implosion in commodity prices that followed, and watched commodity-tied currencies including the Canadian Dollar, the Australian Dollar, and the Brazilian Real fall 28%, 35%, and 59% respectively against the dollar over the past three years -- and yet stood surprised *not* to see a formal market correction amidst the damage over this period. (We expect to see 10% market corrections every year to eighteen months even in the best of times, and the developed markets enjoyed more than four years without a correction before this quarter.) It was not until this year, when the troubles in the emerging economies, commodity markets, and currency markets started to seep into other industries and to impact operating performance across a wider set of companies, that investor fear was kindled. Specifically, investors were surprised at the negative impact that U.S. Dollar strength had on the sales of many multi-national companies. Suddenly, it wasn't just oil companies and some industrial suppliers feeling the pain. It was also defensive names like Procter and Gamble and 3M, doing business all over the world, who were feeling the pinch of the strong dollar on overseas sales.

So what does the future hold from here? If one were to focus on investor sentiment, the answer would be that this correction has very quickly created a bearish measurement echoing the lows of the 2008 crisis and the post-recession lows of the early 1990s. The suggestion in the Bull to Bear measurement chart from Ed Yardeni below is that investors have thrown in the towel and believe that there is no hope for global growth ahead:



* Average weekly price divided by 52-week forward consensus expected operating earnings per share. Monthly through April 1994, then weekly. Source: Standard & Poor's Corporation, Thomson Reuters I/B/E/S, and Investors Intelligence.

Of course, such bearishness has -- without exception -- presented an excellent *entry* point into markets for investors over the last 25 years. Shallow confidence seems to be the hallmark of the post-crisis investor psyche: Any significant economic headwind is seen by investors as a return to the abyss. We saw it in 2011. We saw it in 2012. And now, after a three-year blush of bullishness, we are seeing it again. The difference between the collective investor's view of the future ten years ago and today is that, ten years ago, momentum and seemingly limitless economic potential led the herd to discount troubling data and to focus only on opportunity. Today, investors discount good data and focus only on the potential for crisis. Somewhat paradoxically, this gives us some confidence that there are excellent investments available at reasonable discounts today for selective long-term investors.

There is certainly trouble in the world, and earnings have been under pressure throughout the year. Growth will be a challenge in an uncoordinated global environment and deflationary pressures are a significant threat, so we remain vigilant about monitoring economic and earnings data regularly. What we see today is enough gathering strength and stimulative support in the world to counter emerging market weakness, to keep us clear of a global recession, and to accelerate flagging corporate earnings growth as we head into 2016. At the same time that investor sentiment in the U.S. reached bearish lows this quarter, consumer confidence in the United States (where the economic rubber meets the road for 70% of the U.S. economy) rose to post 2007 highs as present indicators for job prospects, spending plans, and income expectations improved. Allen Sinai of Decision Economics points to aggregate consumption in the U.S. (the total demand for all goods and services), running at an extraordinary 3.3% over the last three quarters as a resounding sign of strength. As he puts it, "These are "go-go numbers." Francois Trahan of Cornerstone Macro argues that significant improvements in the NAHB housing Index, U.S. Real Consumer Spending and U.S. Consumer Real Income Expectations show that the U.S. Consumer – a powerful driver for global growth -- '"is on solid footing." And the U.S. is not the only country showing economic resilience in the face of global uncertainty. European Purchasing Managers Index (PMI) releases which capture business conditions in the manufacturing sector have been strong across much of Europe. Germany, the central driver of the EU, reported record exports and imports growth in July -- the highest values since records started after the German reunification in 1991.

So we suspect that the market is going through a comprehensive, natural, and much needed P/E correction in order to consolidate the significant gains of the last five years and to recalibrate equity pricing that had moved ahead of earnings that were challenged by the global events of the last two years. (Thus far, in this correction, the forward P/E on the S&P 500 has moved from just over 17 times to a more palatable 15 times.) There are three basic drivers for corrections and bear markets: Rising inflation, rising bond yields, and global financial crisis or contagion. As we work to gauge the length and depth of this correction, we see little or no sign of inflation on the horizon and see little likelihood of significant advances in interest rates. The economic contagion coming out of China has worked its way now through multiple sectors of the global economy, and we believe that we may be nearer to the end of the discounting than to the beginning. So we expect more volatility and adjustments as we head into the end of the year – and we suspect that global markets will not find solid footing for a next leg-up until they have absorbed an actual rate hike from the FED. But as we look into 2016, we believe that corporate earnings should do well against the weak 2015 quarterly comparisons and point out that earnings expectations have actually been rising for 2016 throughout much of 2015. We recommend keeping balance in this complicated global landscape but see an expanding number of reasonably priced opportunities in sustainable growth investments as we look into the future.

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In company news, we are very excited to announce that Reynders, McVeigh Capital Management was selected by *Barron's* as one of the top 100 Independent Financial Advisors of 2015. This would not have been possible without the dedicated commitment, trust, and support of our clients. We thank you and will work hard to continue earning your confidence in the years ahead.