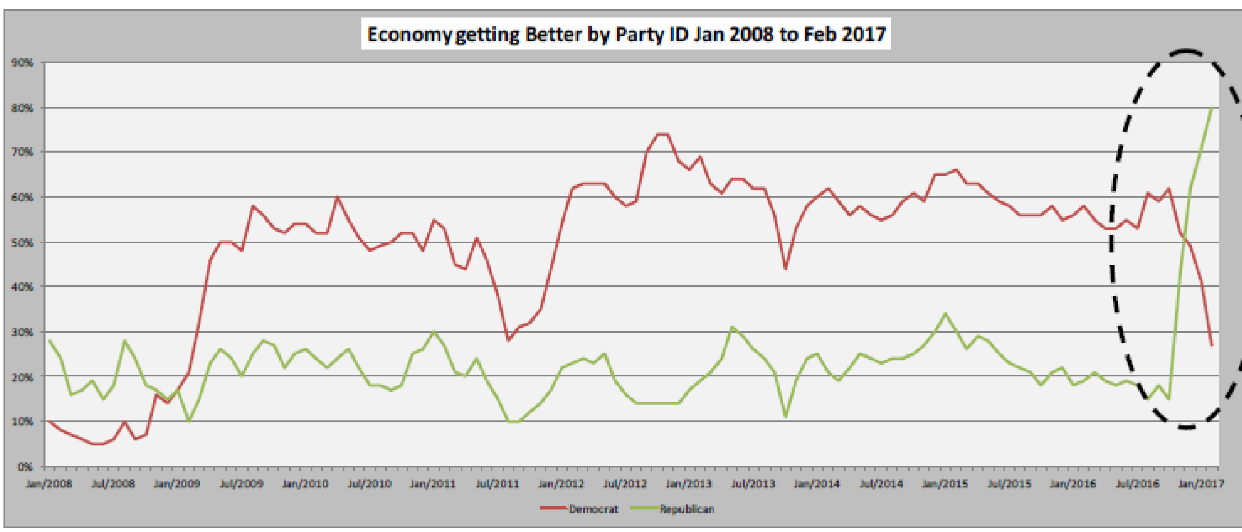
THE LONG RUN

Reynders, McVeigh Capital Management, July 2017

What makes the desert beautiful is that it hides, somewhere, a well.
--Antoine de Saint-Exupery

While braced for yet another dry year, California has been so unreasonably wet that its deserts this spring experienced what's called a 'super bloom.' After years of drought, the arid land became lush with flowers. Seeds that laid dormant for decades, if not a century or more, became a blanket of flowers.

Though stocks did not exactly replicate this super bloom, their flowering did surprise most investors who expected the political divide parting our country to leave stocks very much in the red. As the following chart indicates, since the November election, those on the Democratic side of the political wasteland have seen their views of the economy quickly evaporate. Instead, the S&P 500 sprouted about 8% this year, its best first six months since 2013.



Source: Gallup, SISR

We get lots of questions about how stocks can grow in such an uncertain habitat. Our response is generally that companies need earnings and innovation, which act as the water and sunlight, for growth. And earnings have been flowing quite nicely over the past six months due to lower energy prices and interest rates that had been in place for some time. In fact, earnings for the S&P 500 companies spurted 14.5% in the first quarter of this year versus last year, a sizable improvement from the 4.2% and 5.9% growth rates of the third and fourth quarters, respectively. Given that the U.S. and the four largest European countries have all shown a pickup in growth this quarter, it is not unreasonable to assume that chances of a recession to dry out earnings are low.

As with all outlooks, however, not everything is equally rosy. There are still many conflicting pieces of data that give us some pause. Primary among them is that consumers are acting very differently than they have in the past. With job growth relatively strong, wages rising faster than inflation, consumer debt burdens reasonably low and unemployment rates down to 4.4%, we generally would expect to see spending stronger across more sectors of the economy. But as the following chart shows, despite consumer confidence that is broadly higher over the last year, consumers' plans to buy homes, new cars, and even appliances are *down* from a year ago. We do not remember ever seeing this before. Rising health care costs seem to be impacting the aging parts of our society while education loans are slowing down expenditures for those typically at ages of starting families. Seventeen percent of respondents told Gallup that healthcare costs were the most important financial problem facing their families, more than any other option, and well ahead even of having too much debt (11%) and not earning enough money (10%). For those aged 20-29, birth rates are at record low levels. Clearly, it is still a difficult environment.

Consumer Confidence Index

United States (1985 = 100)

Posted on WSJ: The Daily Shot 01-Jun-2017

	May	Apr	Mar	May 16
Consumer Confidence				
Confidence Index	117.9	119.4	124.9	92.4
Present Situation	140.7	140.3	143.9	113.2
Expectations	102.6	105.4	112.3	78.5
Employment	(percent reporting)			
Jobs Hard to Get	18.2	19.4	19.0	24.5
Jobs Plentiful	29.9	30.3	31.8	24.5
Net Jobs Hard to Get	-11.7	-10.9	-12.8	0.0
Plan to Buy				
Homes	5.8	6.4	6.2	5.9
New Autos	4.6	4.9	5.1	5.3
Appliances	48.7	52.9	51.5	50.8

Source: BMO, @joshdigga

Our response is to look not only for investments that have the well water to support current earnings growth, but also the sunlight of innovation to make this growth sustainable. What particularly interests us at this time may seem like the driest of deserts to many. Following the United States' withdrawal from the Paris Climate Agreement, there has been great angst that global warming trends could only accelerate. Our view is that there continues to be a great opportunity for investments to fund technologies and efforts to not only arrest, but to reverse global warming.

For those interested in a little summer reading on this topic, we highly recommend *Drawdown* by Paul Hawken. The book presents the top 100 viable solutions using available technology to draw down our greenhouse gas emissions from the current 402 parts per million (ppm) in our atmosphere to below 350 ppm, a safe level at which we can sustain our environment. While the expected investments in alternative energy, such as wind (#2 among the solutions), rooftop solar (#10), and biomass (#34) thrive on the list, the number one impact we can all have on global warming is through better refrigerant management. By replacing HFCs from air conditioners with natural refrigerants such as propane and ammonium, we can reduce carbon emissions by nearly 90 gigatons and save a projected $900 billion. These are but a few of the perennial opportunities we will seek to support within your portfolio.

While stock prices will no doubt be volatile in the coming months after performing so well in the first part of this year, we will continue to invest where we see reasonable valuations and long-term opportunities. We hope to have Paul Hawken speak in our newly expanded office this Fall and hope you may be able to join us. We will provide further information as it becomes available.

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