Prepared Comments from 7/15/2015 Conference Call

The S&P 500 is down less than ½% from three months ago, but remains up over 200% since its March 2009 low.

US stocks fell a little in the 2nd quarter, with large-caps and smaller stocks each losing about 0.1% while mid-caps lost 0.7%. Health-care stocks continued to outperform, rising 4½%, while financials rose 3%. Natural resource funds lost 1.1%, utility funds lost 4½%, while real estate plummeted 9¼%. Utility stocks and real estate stocks were punished by the concern over upcoming interest rate increases, which make their dividend yields less attractive.

Growth stocks outperformed value stocks this quarter, after outperforming strongly in the 1st quarter. Like utility stocks and real estate stocks, many value stocks have a meaningful dividend yield, and these yields are less of a benefit in a rising interest rate environment.

Most foreign stocks made money during the quarter, with large-caps gaining 1.1%, and smaller companies gaining 3.6%. Emerging market stock funds gained less than 0.7%, however.

Most bonds lost money during the quarter, with longer-term bonds losing more money than short term bonds. Long-term bond funds fell 5.9%, while short-term bonds lost less than 0.1%. High yield bond funds managed a slight, 0.1% gain.

The S&P 500's earnings fell for a second straight quarter, but are expected to more than fully recover later this year. The pressure comes from the energy sector, while gains in health care and telecomm are solid. US companies continue to sit on large amounts of cash, and are boosting their dividends and share buybacks. Capital expenditures are very strong, which can lead to better future economic growth.

The US dollar's rise has stalled, and fallen back a little. Given how sharp it has risen in the past year, this is welcome, for it has made it difficult for US companies to sell overseas, and it lowered investment results for investors' holdings of foreign stocks. Sharp changes are rarely good news, and a pullback is a positive development.

Similarly, (Brent crude) oil prices have recovered this year, ending the month above $61 a barrel after falling below $49 in January. Again, the sharp decline last year caused much turmoil, and a partial recovery is good.

US consumer confidence rose steadily. The Conference Board notes “Overall, consumers are in considerably better spirits and their renewed optimism could lead to a greater willingness to spend in the near-term.” I noted in April there are many solid reasons for consumer optimism in the US.

One of them is employment. Over the past quarter the unemployment rate fell from 5.5% to 5.3%, which is well below the 6.1% average for the past fifty years. Job gains averaged 221,000 per month.

Another factor is inflation, which remains quite low. Even without the impact of lower energy prices, core inflation stands at only 1.2%, versus its 50-year average of 3.5%.

One big story at this time is the Fed, and the coming increases to interest rates. It is critical to note that the Fed only controls the Fed funds rate, which is essentially at zero. They expect to boost it to about 5/8% by year-end, and to 1 5/8% by the end of next year. Intermediate and long-term interest rates depend on investors, on the bond market.

To me the bottom line is that the Fed expects to boost the Fed funds rate this year, and to do so in a very deliberate, gradual fashion. Importantly, they would do so based on one major belief, that the US economy is on a solid enough path that it no longer requires their support.

The US economy is not setting any speed records, but it has recovered nicely from the 2008-2009 meltdown. The United Kingdom has recovered similarly. The Eurozone, however, has not; it has largely been treading water economically in the past six years. The recent events in Greece aren’t helping confidence in the Eurozone.

Overall, foreign stocks markets haven't recovered to their October 2007 pre-crash high, nor to their March 2000 pre-dotcom-crash high. This is no single foreign economy nor a single foreign stock market, and the collection runs the range from weak to strong. Currently, the energy-rich economies are hurting a lot, economies such as Australia and Russia. Many European economies are faring well, even those which were troubled in the past few years, Ireland, Italy, and Spain. Even Japan appears to be finding its legs, with wage growth in Japan hitting positive territory for the first time in about eight years.

The China stock market news you hear is predominantly tied to the local stock markets, which are closed to foreigners. As such, you and I have been unable to ride the roller coaster straight up in the past year, or straight down in recent weeks. Fine with me!

The Chinese government continues to strive to weave a capitalist system with their Communist system. It is quite a challenge. They have been able to post attractive economic growth for many years, although the pace is slowing it remains well above the global average.

The significance of emerging markets cannot be overstated. Through 2005, household consumption from emerging markets made up less than 25% of global consumption, well below US levels. It now stands at close to 35% of global consumption, above US consumption, which is less than 30% now.

India and China are the most notable emerging markets. An explosion in their middle class is coming. The Brookings Institute expects India's middle class to rise from 7% current levels to 79% by 2030, and in China from 18% to 72%. A global company without a significant plan for these trends will be swept away. A global investor without a significant plan for emerging markets is dangerously short-sighted.

Emerging markets are quite heterogeneous. Commodity-rich EM economies are more volatile, and are faring poorly at this time. Asian emerging market economies and are more diverse, are holding up well and expected to continue to do so.

Valuations matter. One primary concern is rising interest rates. This leads us to believe that bonds are overpriced, and should be held at lower-than-normal levels. Rising interest rates due to policy decisions based on a solid economy lead us to prefer a significant use of what we call opportunity bonds, including high-yield bonds, emerging markets bonds, and unconstrained bonds.

With bond prices worrisome, and commodity prices under sharp pressure, we are left with stocks. While stocks are not cheap at this time, they also are not expensive, and we feel that the level of bond prices and energy concerns combine to justify stock prices. We feel that we have already received the bulk of US stock market and US company recovery benefits. For this reason, we are using a higher-than-average level of foreign stocks at this time. This is designed to take advantage of lower relative prices for foreign stocks, and greater expected, and unexpected, growth opportunities overseas.

The past quarter delivered little to investors, and the trailing one-year gains are generally quite low. Nonetheless, we find there to be under-appreciated promise in the markets today. This includes specific types of US stocks, foreign stocks, and even bonds.

The best approach that we know is to adopt a globally-balanced allocation for your portfolio, and to regularly rebalance to limit drift. You will neither hit the highest highs, nor suffer the worst lows. But a lifelong dedication to this tried-and-true approach has provided the most dependable path to long-term investment success that we know, far more dependable than approaches driven by your gut, doom-saying newsletter writers and TV 'experts,' or any get-rich-quick schemes.

What is the best way to get to Carnegie Hall? Practice.

What is the best way to be a successful investor? Adopt a steady, disciplined approach, and stick to it.

Questions?

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