THE LONG RUN

Reynders, McVeigh Capital Management, July 2015

"You can't stop the waves, but you can learn to surf."

~ Jon Kabat-Zinn

As someone who is lucky enough to be able to rent a cottage near the ocean over the July 4th holiday, I can attest to the beauty and the power of nature. The rhythm of the waves soothes the soul, yet one can never forget the power of the occasional rogue breaker.

The force of the waves hitting financial markets certainly feels like they have accelerated recently. Sluggish global economic growth, the specter of a Fed rate increase here at home, corporate corruption in China and Brazil, and likely defaults by the debt-heads (Greece, Puerto Rico, and others to come). Against this relentless backdrop, financial markets have stalled. Over the past quarter, the S&P 500 and the MSCI World indices advanced by only 0.28% and 0.31%, respectively. The Barclays Intermediate Government/Credit bond benchmark declined by 1.10%.

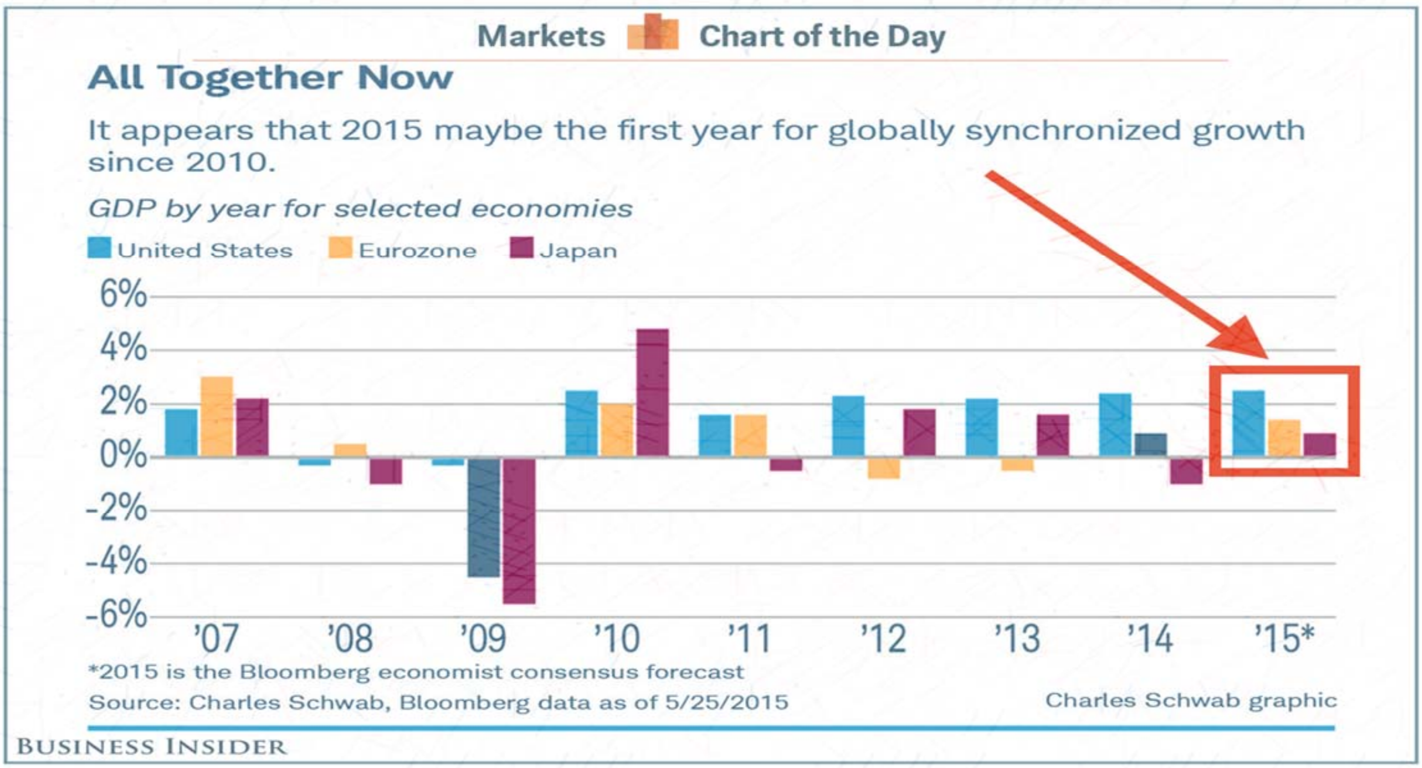
Investing isn't easy. Feeling like a small speck in the middle of a big ocean can be overwhelming. That is why, given the current uncertainty, a near record percentage of investors report to be neutral or negative in their outlook on the markets. Learning to surf, however, can give you a different vantage point on these powerful waves. Rather than have them crash on you, instilling fear of economic ruin as you struggle to stay afloat, you can hopefully ride them to a new place. We keep a few surfing posters up in our office to remind us of this approach.

Apart from keeping your balance, a key to surfing is learning to read the ocean. Waves travel in groups with the middle one in each pack being the largest. They build in size and then recede. Rather than seeing each wave individually, it is important to see the longer-term movements and trends that link them.

For example, there have been significant reports of corporate corruption lately in emerging markets. China has reported that fourteen state-owned companies falsified records in order to seem healthier. Petrobras, the largest company in South America, wrote off $17 billion in losses due to graft and over-valued assets. Each wave of news in itself is worrisome, but what is important is the surfer's viewpoint that financial transparency is still lacking in most emerging markets and growth expectations are outpacing reality. As a result, we are still not comfortable investing directly in these regions.

Foremost in the press and most investors' minds are whether defaults by the so-called debt-heads (Greece, Puerto Rico, and other heavily leverage countries) are the rogue waves to disrupt the world economy. Again, we don't view either of these impending defaults as large enough to be a major concern. The world has been preparing for six years for Greece to default, and little of its debt is owned by banks and individuals outside Greece. While plenty of investors and bond funds were lured by Puerto Rico's siren song of AAA-insured debt, the reality of how risky their debt is should have been obvious to most. The message from these events is that the world is still over-leveraged and individual country risks are higher than interest rates are indicating. Longer-term bonds still look somewhat risky to us.

While excessive debt and corruption are headwinds to economic growth, it does appear that there are other forces beginning to overpower them, leading us to believe that world economic growth could pick up somewhat this year. The double impact of lower oil prices and interest rates should be enough to offset the cross currents to growth. Oil prices are still nearly 50% below where they were a year ago and eighty countries have lowered interest rates recently. Lower commodity prices and interest rates have always been very powerful winds behind new waves of growth. Evidence of this is already emerging. In April, 50% of countries were reporting that their economies were contracting. As of June, less than a third were showing decline. As the following chart indicates, this could very well be the first year since 2010 in which all the major developed countries experience growth.



While we will continue to focus on developed economies as the centers of growth in the world, we also continue to work to identify those waves of sustainable growth that will power our individual investments. We have highlighted some of these in previous reports, but repeat a few of them here. Demographics are quickly changing the face of our economy. While the 78-million Baby Boomers have historically driven our growth, they are now being supplanted by the 83-million Millennials. This is the most powerful wave running through our economy. We also look at the emergence of the New Climate Economy as consumers, governments, and corporations look to lessen their environmental impact, but, in a way, that can lead to more sustainable growth. We recently studied our 25 largest holdings and found that they were able to cut their carbon emissions by 3% last year and grow their revenues at a pace that was double the country's growth rate.

Keeping fully aware of the cross currents, we believe investors should keep their balance and continue to surf the positive trends we see in the investment markets.

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In company news, we welcome Kathryn Egan to the company. Kathryn will be supporting us on client communications, so please say "hi" if you hear her voice on the telephone.

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