Then and Now

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by Jeffrey Saut

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> At a meeting the other day, I was introduced as "a formerly notorious short seller." A friend asked, "Whatever happened to the old Shad? You never seem to have anything mean to say anymore?" ... Could it have something to do with interest rates? In our short selling days in the 1980's, we looked for poorly managed companies that burned cash, faced brutal competition, and engaged in dubious accounting. Interest rates were infinitely higher than today, and between interest on collateral and short credits, you could make high-teens rates of return if your short sales did nothing. All income was taxed at the same rates with no preference for long-term capital gains or dividends. Finally, if you sold short something that went to zero, you never had to close out your short sale and had the use of the money tax-free. All that has changed and new ways to make short sellers miserable seem to come along every day. With interest rates close to zero, it has become an almost impossibly difficult game. Conversely, the tax-efficiency of owning growing, brilliantly managed, cash generating, competitively dominant, global companies is an idea that has somehow been lost upon the investing public. I suspect the idea will be rediscovered, perhaps by the investment world equivalent of the Bedouin goat herders, who in 1947 recovered the Dead Sea Scrolls with all of their ancient biblical history.... Frederick "Shad" Rowe, Greenbrier Partners

Dallas-based Greenbrier Partners is captained by my friend Frederick E. Rowe, who is fondly referred to as Shad. Now anyone from Virginia is familiar with the fish known as a shad, and are probably familiar with the political event known as the Shad Planking. Shad, the fish, is unique because it has developed the ability to detect ultrasound (frequencies greater than 20 kHz, which is above what humans can hear). Similarly, Shad, the man, has developed the ability to find "growing, brilliantly managed, cash generating, competitively dominant, global companies" and invest in them. I, however, am not as certain as Shad that his investing philosophy has "somehow been lost upon the investing public." Rather I think it is the simple fact there are not many of us left that have experienced a secular bull market like the 1982 to 2000 affair. Shad clearly has since I first encountered him when he was a contributing editor to *Forbes* magazine some 30 years ago and scribed some of the most clever and keen-sighted commentaries on Wall Street. Shad understands that in a secular "bull market" one of the most important things to know is not to lose your entire position because stocks tend to go higher in such an environment than most investors think. Yes, you can trade around that position, but don't lose the entire position! Over the years I have quoted Shad's prose in many of my letters, just like I quoted some verbiage from his July monthly letter in today's missive. I also remain impressed with Shad's stock picking. In the aforementioned letter he discussed a few of his positions that are from Raymond James' research universe and are all rated Outperform by our fundamental analysts.

He had this to say about Apple (AAPL/$101.66), "Apple has the most desired digital ecosystem in the world and it trades at a discount in comparison to its peers, the market, and its intrinsic value on virtually every metric. Two key investor worries were lessened: 1) gross margins do not seem to be cratering and 2) 28% revenue growth in China suggests that it is not too late for AAPL in the emerging markets. This is obviously not definitive, but it is encouraging and helped drive 20% earnings per share growth." On Bank America (BAC/$16.79) Shad writes, "Bank of America represents a proxy on an improving domestic economy and a company that still has vast room for operational improvement. The company's steady turnaround continued in the second quarter despite its continued legal/regulatory challenges. BAC remains cheap at 0.7x book value (1.1x tangible book value)." On Facebook (FB/$77.48) he notes, "Facebook is the backbone of the social media experience for more than one billion connected users around the world and provides the means for marketers to reach these potential customers with more efficiency and precision than has ever been possible. In the stupendously understated words of Mark Zuckerberg, Facebook 'had a good second quarter.' Revenue increased 61%, while 68% EBITDA margins drove 121% earnings per share growth compared to last year's second quarter."

I think these names should be on your "watch list" for any impending decline in the equity markets since this continues to be a secular bull market.

Speaking to the equity markets, the D-J Industrials (INDU/16987.51) have failed to confirm the new all-time high by the D-J Transports (TRAN/8552.28). As repeatedly written, that's an upside non-confirmation under Dow Theory and a reason for caution in the short-term. While the S&P 500 (SPX/1985.54) has indeed recorded a new all-time high, it too has been

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unconfirmed by a number of other indices. Nevertheless, the SPX's recent pullbacks have been able to stay above its 1980 – 1985 near-term support zone. I have written that I would be much more comfortable if the SPX would come down to its 1965 – 1970 support level so that I could see how it acts at this much more important level, but they don't operate the equity markets for my benefit. Also of interest is that while the SPX managed to tag a new all-time high, the average stock in the SPX is 7.5% below its respective all-time high. Moreover, as previously written, the average stock in Raymond James' research universe of more than 1,000 stocks is down 23.3% from its respective 52-week high. Outside of stocks, the yield on the 10-year T'note has risen to 2.61%, crude oil/gasoline prices have declined (bullish for stocks), commodities are swooning, and the U.S dollar is on its best upside tear in 17 years (bullish for small cap stocks). All of this is equity market friendly in the intermediate/long-term, even though in the short-term things are sketchy. In fact, as I wrote last week, there was a speculative trader's very short-term "sell signal" registered on September 4th when the 14-day Stochastic fell below its moving average. That signal was reinforced last week when the short-term Trading Index lost six points. Keep in mind, however, none of these short-term signals impacts my secular bull market "call."

The call for this week: I am in the San Francisco bay area speaking at various events and seeing accounts. I continue to find it fascinating that the portfolio managers (PMs) want to know what our advisors and their clients are thinking/doing, while our advisors/clients want to know what the PMs are thinking/doing. I believe this speaks to the fact that most are confused with the markets and that 77% of all active PMs are underperforming the S&P 500. This is likely because the surprise of the year has been the tremendous outperformance of the defensive sectors. To wit, Healthcare is up 14.70% YTD and the Utility sector has risen 10.35%. While we targeted Healthcare as a favored sector, we totally missed Utilities. I have also liked Technology, but recently I am hearing from tech companies their business with Russia has fallen off a cliff and I did not realize how big a consumer of U.S. technology Russia has become. This week investors will put on "rabbit ears" for statements out of the Fed meeting. Will Janet Yellen drop the phrase "considerable time?" Will she continue with "data dependent?" Or will she say "the FOMC's view is that there is considerable slack that remains in place?" Accordingly, all eyes will be on the bond market to see its reaction to the Fed's words. The other charts worth watching are crude oil, gasoline, and the U.S. Dollar Index. Also of note are Scotland's independence vote and this week's option expiration, both of which can be market moving.

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