SLOCUM, GORDON & CO. LLP
INVESTMENT MANAGEMENT AND COUNSEL

VIEWPOINTS

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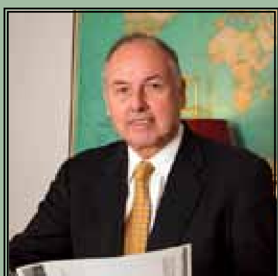
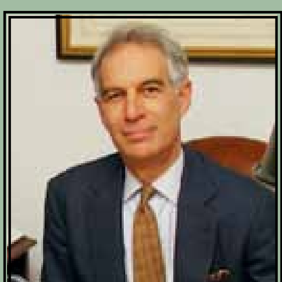
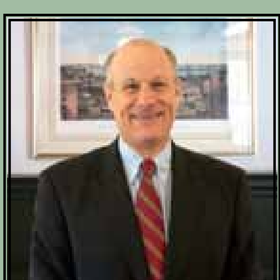
This Economic Commentary is designed to present the Firm's current views on timely topics that we feel may be of interest to our clients. Viewpoints is also available electronically on our website: slocumgordon.com.



JOHN J. SLOCUM JR.



JEFFREY L. GORDON



BARCLAY DOUGLAS, JR.

KENNETH M. P. LINDH

Recently, we were invited to offer some comments and a presentation to an audience at the semi-annual meeting of one of our institutional clients. To set the stage for our current economic view, we reminded our listeners what we had said to the same audience back in December 2013, which we quote here:

It is not as easy being as bullish today as we have been for the last 5 years, but we still think there is more long term potential in the companies we own as we look ahead from here. Risk has risen as prices have risen, but we still haven't seen anything close to a capitulation by the bears. All the investment strategies defined by professional asset allocators of the last decade or two seem to be still in vogue in the institutional investment world: hedge funds, emerging markets, commodities, natural resources, and gold, which are basically counter-productive in a market that has favored old fashioned equity ownership, particularly of large cap dividend-paying U.S. companies. The evolution of asset allocation away from these esoteric assets in favor of large capitalization US equities may take years to play out, which, if it happens, will be very good for our clients' portfolios.

We still believe that perspective has merit, and while market swings up and down are often accelerated by current economic and geo-political news, we continue to favor US companies in an otherwise slow-growth global economy. Numerous studies show that despite the dramatic increase in US equity prices over the last few years, major institutions and high-net-worth individuals have remained skeptical of this asset class, mainly because of the poor experience of domestic stocks that began in 2000 and was magnified further in the 2008 collapse. That ten year period has been referred to as the "lost decade" for US stocks.

The recent economic period we have been in and should continue to experience for some time yet is defined by persistently low interest rates because of minimal inflation, in fact, deflation in some parts of the global economy. As we have written many times, there is no shortage of anything at the moment: labor, commodities, manufacturing capacity, and money. There is, however, a major shortage of one important component: income, in the form of wages and investment income.

So with the only real shortage being income in this near-zero rate environment, we have focused on large cap US companies that not only pay dividends, but have the capacity for increasing them over time. Historically, dividends tend to provide about 40% of the total return from invested assets, and dividend-paying stocks are only recently becoming the asset of choice for investors. With an aging cohort of baby boomers needing income in retirement, and non-profit institutions and pension funds requiring increased reliance on their endowments to throw off more income, this shift in emphasis toward traditional income is glacial and should last for years.

While demographics in the Eurozone, embedded unemployment, and a slowing in the less-developed countries may hinder global economic growth, the US has an important engine that the rest of the world does not: the emerging large population cohort called the "echo-boomers," children of the baby boom generation. Just as the baby boomers are entering retirement, the echo-boomers will be entering the family-formation cycle where traditional consumption patterns take hold, enhancing the potential for a new leg up in an otherwise slow growing economy.

While the popular press and the investment "experts" on the business talk shows seem to prefer a negative bias and alarmist forecasts, the economy is, in fact, healing. Corporations and financial institutions are healthier than they have been in years with less leverage and excellent cash flows; merger and acquisition activity has increased; dividends and stock buybacks put more of that corporate cash in the hands of investors; and the consumer balance sheet has markedly improved. With little or no inflation in the real economy, the Fed will probably keep its interest rate policy steady for quite a while yet so that higher rates do not disrupt the forward momentum in the US economic recovery.

Clearly, the market rightly worries about geo-political events getting out of hand at some point where an unknown event shakes the equilibrium of global investors, but that is always the case, particularly when markets are at high points as they are currently. Corrections will occur, no doubt, but we are trying to focus on larger investment themes that have the duration potential for our clients. Among those that we have recently indentified, we would add US energy independence, pharmaceutical and technology advancements, and the reinvigoration of a more competitive US manufacturing presence.

We have been around long enough to know that forward-looking thinking in the investment business is fraught with risk. This *Viewpoints* edition would not be complete without at least one quote from Churchill which is particularly apt for arrogant economists who boldly predict the future: “It is always wise to look ahead, but difficult to look further than you can see.”