

July 4, 2016

Dear Friends and Clients,

I have claimed several times on these pages to have predicted The Beatles *White Album*. This boast is of course a joke but apparently not a very funny one because I've been cracking it for 21 years and have yet to get a laugh. Actually this "joke" was intended to produce more than humor, it serves as a reminder of how hard it is to predict specific events...months or even years down the road. Generalities are much easier targets: the market will go higher over time, interest rates will work their way lower, and of course the ever popular cyclical nature of the economy. Good prognosticators will usually throw a few dillies into the mix just to keep things light....enter the *White Album*. Byron Wein of Blackstone Group is as good at this as anyone I know. He tells us the items on his list qualify because he thinks they have a 50% probability of success while the average investor only gives them a 30% chance. It's always a luxury to have your own scoring system. Here is his list for 2016:

- | | |
|---|--|
| 1) Hillary Clinton wins and the Dems take back the Senate | 6) The refugee crisis pushes the EU to the edge of a breakup |
| 2) The stock market declines for the year | 7) Oil "languishes" around \$30 |
| 3) The Fed only hikes once | 8) New York and London real estate prices crash |
| 4) Foreign investors leave the U.S. | 9) 10-year Treasury yield stays below 2.5% |
| 5) China has a dismal year | 10) Global GDP growth slows to below 2.0% |

I've seen Byron go 7 for 10 and I've seen him go 3 for 10. This year he's off to a good start and has less than six months of exposure left. His list always adds a few potholes to my radar screen. It's not a simple game; I can usually feel my running mates cringe when I cast predictions about in our quarterly letters. Like Mark Twain said, "Why just sit there and look stupid when you can open your mouth and remove all doubt?" What the heck, investing for the long term is our bread and butter and because it's long term it's also a lead pipe cinch. So why shouldn't our clients hear some of our short term thoughts as well? My favorite rearview mirror comparison period is my lifetime. The dates only change a year at a time and my memory casts a familiar background on the waypoints...girlfriends, hit records, the first color TV, and of course that 1954 Ford. With that in mind, we've scratched out a fairly chronological list of watershed events that have occurred since 1948. I remember most, perhaps you will too. There is a trend here you shouldn't have too much difficulty spotting. We'll call the milestones on the left, Column A, and the quotes and bloopers on the right, Column B.....pretty original, eh?

1948-1960

The advent of nuclear power
Invention of the solar battery
Creation of the integrated circuit
A/C in cars & garage door openers
Frisbee/Hula Hoop/Barbie Doll
Mimeograph machines
Main frame computers
45 RPM records/Interstate highways

"I have traveled the width and breadth of this country and talked with the best people and I can assure you that data processing is a fad that will not last the year." - Business books editor, Prentice Hall, 1957

"We will bury you." - Nikita Krushchev, 1956

"People don't realize that the future is just like now, but later." - Yogi Berra

1961 - 1970

Etch-A-Sketch/Lava Lamp
Smiley Face/Super Ball/Veg-O-Matic
Microprocessor/computer mouse
TV dinners/birth control – “the Pill”
4 on the floor/Southwest Airlines
Radial tires/credit cards/direct dial LD
Cable TV/FM radio
Photocopies (Xerox)
Man walks on the moon/Viet Nam
Play Dough

1971 - 1980

Microwave oven/bottled water
CB radios/discount brokers
Handheld calculators/IRA accounts
Karaoke machines/e-books
Post-it Notes/Rubik’s Cube
Personal computers (Apple)
Dyson vacuum/Trivial Pursuit
Pop top cans and twist off bottles
Cordless TV remotes
Bloomberg machines/fax machines
Airbags/radial tires

1981 - 1990

Cell phones/boom boxes
Personal Computer (IBM)
Soft contact lenses/disposable cameras
MS-DOS/double-digit inflation
Windows
Doppler Radar/Prozac
Hi-Def TV/break dancing
Nintendo
GORE-TEX/Thinsulate

We don’t like their sound, and “guitar groups are on the way out.” – Decca Records rejecting The Beatles, 1962

“The concept is interesting and well-formed, but in order to earn better than a C, the idea must be feasible.” – A Yale University management professor in response to Fred Smith’s (founder of FedEx) paper proposing a reliable overnight delivery service.

“I believe that things seem to find their own level. A long time ago an asteroid hit our planet and killed all our dinosaurs. In the future we will probably go to another planet and kill all their dinosaurs. It all evens out.” – Harold Kuyper, 1963

“This is a bad time to be starting in this business.” Dr. Robert Cole, one of my professors offering an unsolicited opinion on my career choice – Pitt 1971

“So, we went to Atari and said, ‘Hey, we’ve got this amazing thing, even built with some of your parts. What do you think about funding us? Or we’ll give it to you? We just want to do this thing....pay us a salary, we’ll come to work for you....Ok?’ They said no. So then we went to Hewlett-Packard and they said, ‘Hey, you two haven’t even graduated from college yet.’” - Apple founder Steve Jobs

“What are you going to do with that?” – Julie to Pitt on greeting an Apple II in 1979

“There is no reason anyone should want a computer in their home.” - Ken Olsen, Digital Equipment founder, 1977

“640k RAM should be enough for anyone.” – Bill Gates, 1981

“I was a peripheral visionary. I could see the future but only at a long distance and off to the side.” - Bob Uecker, 1986

1991 - 2000

Lithium-ion rechargeable batteries
Online shopping and email
Web browsers: Mosaic/Netscape/
Internet Explorer
High speed broadband service
Laptop computers/DVDs
Beanie Babies
eBay/Amazon/Google
Online universities
Voicemail/Xbox/DirecTV

“The internet will go spectacular supernova and experience a catastrophic collapse.”
Dr. Robert Metcalf, PhD, founder 3Com, University of Texas and Harvard, 1995

“I took the initiative in creating the Internet.” Al Gore to Wolf Blitzer, March 1999
a choice of words that would haunt the future Apple board member.

“Do you mind if I sit back a bit, your breath is very bad.” The Donald to Larry King 1993

“Y2K will be a crisis without precedent in human history.” Edmund X. DeJesus,
Editor, BYTE Magazine, late 1990s

2001 - 2016

3D Printers/Scanning
Gasohol
Hand sanitizer
Smartphones/apps/mobile broadband
Surgical robotics
Texting/Skype/Facetime/Smart TVs
YouTube/Facebook/E-readers
iPod/the Cloud
GPS/drones
Completion of the Human Genome Project
Hybrid cars/electric cars
Netflix/Uber

Warren Buffett gives away his estate and encourages others to do the same.

“Our observations also suggest that home prices are not likely to plunge in
response to deteriorating fundamentals to the extent envisioned by some analysts.”
Alan Greenspan at the end of his Fed Chairman career, 2006.

“The U.S. will collapse and become occupied by Japan, China, Canada, Mexico and
the European Union.” Igor Panarin, Russian political writer - 2008

“I guess I should warn you, if my remarks appear to be perfectly clear, you’ve probably
misunderstood what I’ve said.” Alan Greenspan, 2010

Good stuff, eh? There weren’t a lot of positive quotes confusing the issues and the negative position always seems to be most emotional...it typically attracts the most press. Moore’s Law has triumphed during this period and shows no signs of abating. Derived by Gordon E. Moore, the co-founder of Intel and Fairchild Semiconductor, he observed that the number of transistors in an integrated circuit was doubling every two years, increasing the processing power exponentially. Moore thought that trend would continue for a decade when he first advanced his findings in 1965. It has actually persisted well beyond that date. The long and short of it is a self-fulfilling prophecy...faster computers allow us to produce still faster computers. The same thing happens in miniaturization, robotics, chemistry, genetics, etc.

Since technology and progress have not been standing still for the last 67 years, you might think it would be harder to find a naysayer. Unfortunately, that is not the case. It’s safe to assume there will always be issues born of personal sovereignty, NIMBY-ism, and below-the-line thinking. Brexit seems to be a sterling example of that. Resisting change while searching for handouts and silver bullet solutions can become very expensive habits. Think about the changes incorporated in the following phrases and how they touched all of our lives: 78 rpm,

45 rpm, 33 1/3 rpm, 8-track, cassette, CD, download, and streaming. You don't even need to be told the subject matter. Ponder how you (all of us) resisted these changes. My first phonograph had 2 speeds, 78 and 45, I didn't have access to 33 1/3 until my parents bought a console stereo...I had to play rock in the living room! The 8-track was a continuous loop and had a nasty habit of eating itself. I salvaged one out of a demolition derby car we had and hung it under the dash of my '57 Chevy. Those 8-track cartridges were expensive and I really didn't develop much of a library before the cassette arrived on the scene. I loved this format, cheap, reliable and you could flip it over and play the other side...everyone had cassettes. The CD format was a little more expensive but a mega leap in quality. Easy to use, copy (with a PC), store and catalogue, it was a big hit. I had a pretty good investment in cassettes but the CDs won me over. Then came a real killer app..... the download. No physical dimensions, high quality, cheap and they lived comfortably on your smartphone (did Al Gore predict the smartphone?). Now there's streaming... it lives in the cloud, appears in audio and/or video and is accessible with all kinds of mobile devices.

Think about it, how did you greet this musical evolution? All of us had an economic stake in the preceding technology. Although an early adapter, I remember a reluctance to give up my LPs, loved those cassettes and then grudgingly transitioned to CDs. Steve Jobs made the transition to downloads almost seamless. I loaded all my CDs onto iTunes while buying new music via downloads....a true marketing genius. Each of these adoptions of format change was accompanied by an economic event. We all had to make the conscious decision to give up the old in favor of the new. Now look at the events described in Column A above. They are more eclectic than our musical example but reflect a similar requirement for change and the friction charges that go hand in hand. It's natural for individuals to dig in their heels when they get tired of paying these tariffs....all part of behavioral finance. But don't we make or save more money when we triumph over these issues?

An investor could have participated in the success of Column A by owning names like Motorola, Phillips, IBM, Seagate, Western Digital, Apple, Amazon, etc. You could have avoided the pitfalls of Column B by focusing on the horizon instead of the hood ornament. Actually, all you had to do was be smarter than Decca Records, Igor Panarin, or my marketing professor. Brexit or no Brexit, at the current time I find myself feeling pretty smug. My family, co-workers, and friends all seem to have won the geographical lottery. We live in or have migrated to the country with the most powerful economic engine the world has ever known. The events in Column A are long term and show no signs of abating. As Timbuk 3 said in 1986, "I'm doin' all right.... gettin' good grades.... the future's so bright.... I gotta wear shades!"

So how bright is the future? 2015 and the first half of 2016 have been subpar, so look for the market to revert to its long term mean....that's a good thing, almost 12%. What kind of drivers will move it in that direction? I'll offer a few predictions that everyone, including my partners, can throw darts at:

- 1) Wearables yield to embeddeds....golf balls, baseballs, pets, children....anything you can lose track of....2017
- 2) Voice operated household robots, a marriage of Siri, Echo and Roomba....2017
- 3) Cell phone/PC miniaturization. Expect to arrive for a meeting and connect your phone/watch to a monitor or printer....2017
- 4) Bluetooth and Wi-Fi will yield to more powerful wireless connectivity allowing the transmission of thoughts....2019
- 5) The two-party political system we know today will not exist in 2020
- 6) More surgical robots. Expect doctors in your future to have a strong video game backgrounds....2016
- 7) Improvements to athletic helmets, shoes and turf will drastically reduce injuries.....2018
- 8) Battery technology will continue to evolve with 2nd and 3rd generation lithium-ion producing 110 volt performance....2019
- 9) GMOs will expand similar to fracking. Crops will gain drought resistance and significantly reduce global starvation...2018
- 10) Lady Gaga will release the "Blue" album....2020

If we get 5 out of 10 of these predictions correct I will be pleased, but the mental gymnastics of pondering them will be beneficial to all. I wish our list included something that would have caught the interest of two P&A heroes, Richard Kneer and Arthur "Spud" Melin. Their future must have been a joy to behold when they burped a company that prospered on plastic tubes, bean bags and curve balls. The two founded WHAM-O Mfg. in Woodland Hills, California back in 1948. Together they created one fad after another: Wham-O sling shots, Hula Hoops, Frisbees, Slip'N Slide, Super Balls, Trac-Ball, Silly String, Hacky Sack, Boogie Boards, Wheelie Bars (featuring Rat Fink), and about 10 other also-rans. If you think it's easy to create a fad just give it a try, most of us can't get our wife and kids to buy in on a vacation idea let alone start a fad. If left to their own devices, would Dick and Spud have invented the PC? If born in another generation would Steve Jobs have invented Hacky Sack and Hula Hoops? My guess is these guys and the others like them would have left a dent regardless of their time or place. There's a lot more to come.

So the future shines a pretty bright light from our point of view. Brexits, Dot Com bubbles and big shorts will always haunt the horizon. Some events will eclipse others but all will be relatively short term in duration. I guess the trick is to stay off Column B and get on with Column A. Long term investing can be pretty easy when you celebrate success and shun the nattering nabobs of negativity.

The World According to Dan and Pitt...

The markets have been flat and by their nature they want to go up. Imagine trying to hold a watermelon underwater....it's pretty tough to do. We have a couple of hard to love candidates running for President. Fear not, Congress will neuter the victor. The economy is growing slowly and interest rates are more like oil than friction....almost non-existent. Hang in there baby, we still "Really Like" equities.

As Always,



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