November 6, 2015

You **Can** Handle the Proof

Over this past year, I have felt compelled to share a great deal of data about both historical market returns as well as many of the lessons I have learned over my career since becoming an equity analyst slightly more than 30 years ago. Over my career, my thinking about how to invest successfully has evolved considerably. There are of course some important constants. For instance, I have always believed that paying attention to valuation is a good starting point and I have also believed that is important to think and invest with a long-term view. I simply have never had the mentality of an active trader. Instead, I believe that stock investing really should be on the basis of the owning, not renting the underlying businesses. Furthermore, empirical research that I have shared with you demonstrates that most investors fail to time in and out of securities and markets effectively – especially net of taxes. However, where my thinking has evolved the most is my belief that successful investing is not so much about focusing on upside potential as it is about managing risk. Indeed, I have developed a keen appreciation for the need to focus on aggregate results as opposed to adopting a more narrow focus on individual stocks.

Over long time periods (decades), there has been a persistent trend of growth in aggregate sales, earnings and cash flow earned by publicly traded companies. In turn this has translated into higher market value and dividends paid. However as illustrated in my most recent letter, the lion's share of the growth is driven by a relatively small number of underlying companies. That is precisely why we advocate and rely on long-term ownership of broadly diversified portfolios. This helps ensure long-term ownership of the outliers that generate so much of the underlying economic growth and value for shareholders. Because in the long run the market is a price discovery machine, investor returns are supported by underlying fundamentals. This can translate into success without the risks inherent in timing in and out the equity market and individual stocks.

The reason I dive rather deeply into market data is because I have found that it helps me make more intelligent decisions. While it is true that market cycles do not repeat, history can nevertheless inform our understanding of what may lie ahead. If you don't know the rules of the game, it is hard to imagine that you will be a skilled practitioner. For example, I find that emotionally charged headlines tend to cause many investors to do the wrong things at the wrong times. Conversely, a more clear-eyed understanding of history and basic math principles can help ensure we stay rational.

Perhaps you are familiar with Angus Deaton. He is a tenured professor at Princeton University who recently won the 2015 Nobel Prize in Economic Sciences for his analysis of consumption, poverty and welfare. Indeed you may enjoy reading his 2013 book entitled ***The Great Escape: Health, Wealth, and the Origins of Inequality.*** Although I have not yet finished reading it yet, I am finding it to be both really interesting and well written. While not on the topic of stock investing, Professor Deaton wrote something that really strikes a chord with me. Specifically on page 16 of ***The Great Escape***, he wrote, "The need to do something tends to trump the need to understand what needs to be done." Often times, we need to refrain from the urge to "do something" in the face of market volatility. On page 16 he also wrote, "And without data, anyone who does anything is free to claim success." We also need to be wary of theories that are not supported by empirical data. We need to be as objective as possible; hoping isn't a strategy.

We are Paying Attention, but Most Times, We are Not Active

Our oft stated admission that we don't know what the near term future holds combined with our aversion to actively trading is likely uncomfortable for some of you. As a species, we are hardwired to take action and it is understandable; we feel anxiety when markets are performing poorly and headlines are disconcerting. However, the best response is to recognize that markets can move dramatically in both directions and often, our emotions make us want to flee when we should stand pat and vice versa.

Throughout my career, I have been very aware of the many highly compensated, articulate Wall Street prognosticators. I know quite a few that I find thoughtful, hardworking and truly desirous of helping their clients. Of course that's what people who seek and pay for advice want. Notwithstanding good intentions by many strategists, firms and active managers, the empirical data simply does not support the notion that market seers can consistently add value net of fees and taxes. Sadly, despite their earnest efforts, I have found that ***many forecasters are, as often as not, frequently in error but never in doubt.***

We invest against the backdrop of an unknown and unknowable future. Therefore, we believe risk management via diversification is a superior alternative to professing an ability to accurately and consistently predict and act appropriately vis-à-vis a great deal of trading and wholesale changes in the underlying composition of the portfolios our clients hold. Change can be costly in terms of fees, taxes and being poorly positioned. Seldom do we believe that our emotions and desires help aid results. More commonly these actions can prove costly.

I believe that 5, 10, 20+ years from now we will be able to identify the rare managers, stocks, or sectors that have delivered highly favorable returns. However, I simply believe that most managers, stocks and sectors will not be above average and many will provide results that are unacceptably too low. For a variety of reasons, I consider ownership of highly concentrated portfolios to be imprudent and risky for most investors. First, there is always some real possibility that your investments, even those with enviable track records and bright prospects will not prove to be superior investments in the foreseeable future. I recall roughly 15 years ago when GE, Cisco and some other darlings were considered to be "risk-free growth" vehicles by many investors. Today, their share prices are still appreciably lower than they were in early 2000.

The greater risk in my view is timing risk. Over my career, I have seen more than a few instances where highly concentrated positions have suffered irreversible declines which in turn translated into a permanent decline in these families' wealth and often general well being. You may know some friends or relatives who suffered significant and permanent declines in various banks, tech companies, consumer stocks, automobile stocks, etc. Conversely, I have also encountered instances where investors sold formerly large positions at substantial loss of principal only to subsequently witness a dramatic recovery. It is truly painful and I do believe there are healthy and prudent alternatives. The truth is with concentration comes an increase in the range of future outcomes. Sometimes the concentrated position continues to be beneficial or even highly beneficial to own. Too often that is not the case. The good news is, proper diversification provides a healthy and prudent alternative.

I believe that if an investor plants lots of seeds and then exercises patience by resisting the urge to “do something”, that she can enhance her prospects for success. One of our chief aspirations is to help you achieve peace of mind during the inevitable periods of duress and glee that lie ahead.

Inside Baseball/Underneath the Seemingly Calm Surface

I want to share some high level data on the markets generally and our portfolio holdings thus far this year. An explorer, who went out on trek at the start of the year and then checked prices for the first time on the last day of October, would likely conclude she hadn't missed anything. That is because price levels for the S&P 500, the extended market (e.g. U.S. mid & small cap) and the Developed World excluding the U.S. vehicles we use were **up** 1.2%, **down** 1.9% and **up** .4%, respectively. The emerging markets solution is the exception; down nearly 13%. However, those figures belie what has very much felt like a roller coaster for those of us who have been attuned to the headlines and the market prices themselves. Indeed, while many of the stocks that we own in our diversified 50 stock solution are near where they ended in 2014, quite a few have travelled far. Please see the table below.

Company Name	Sym	Last	Annual High	Annual Low	QTD %	YTD %	12 month%	% change from high	% change from low	Ann hi date	Ann low date
TIME WARNER	TWC	177.99	184.89	128.78	5.59	***24.56***	***28.66***	(3.73)	***38.21***	8/5/15	11/11/14
BROWN FORMAN CORP	BF'B	106.18	111.06	85.43	9.58	***20.88***	14.58	(4.39)	24.29	8/6/15	12/17/14
MCDONALDS CORP	MCD	112.25	113.96	87.50	13.92	***19.80***	***19.76***	***(1.50)***	28.29	10/26/15	8/24/15
ELI LILLY & CO	LLY	81.57	92.85	65.91	***(2.53)***	***18.23***	***22.98***	(12.15)	23.76	9/17/15	10/30/14
HOME DEPOT INC	HD	123.64	125.75	92.17	7.06	***17.79***	***26.78***	***(1.68)***	34.14	10/23/15	8/24/15
UNILEVER NV NEW	UN	44.98	46.53	37.51	11.89	15.22	16.14	(3.33)	19.91	8/10/15	1/6/15
MARATHON PETROLEUM CORP	MPC	51.80	60.38	37.62	11.81	14.78	13.97	(14.21)	***37.69***	7/13/15	1/15/15
GENERAL ELECTRIC CO	GE	28.92	29.83	19.37	14.67	14.44	12.05	(3.05)	***49.30***	10/23/15	8/24/15
MICROSOFT CORP	MSFT	52.64	54.37	39.72	***18.93***	13.33	12.12	(3.18)	32.53	10/27/15	8/24/15
DOW CHEMICAL CO	DOW	51.67	53.80	35.11	***21.86***	13.29	4.60	(3.96)	***47.17***	11/21/14	8/24/15
BRISTOL-MYERS SQUIBB CO	BMY	65.95	70.54	51.82	11.40	11.72	13.34	(6.51)	27.27	7/20/15	8/24/15
SANOFI	SNY	50.34	54.98	43.57	6.05	10.37	8.87	(8.44)	15.54	8/10/15	1/5/15
PFIZER INC	PFE	33.82	36.46	28.47	7.67	8.57	12.92	(7.24)	18.79	7/31/15	8/24/15
APPLE INC	AAPL	119.50	134.54	92.00	8.34	8.26	10.65	(11.18)	29.89	4/28/15	8/24/15
PEPSICO INC	PEP	102.19	103.44	76.48	8.37	8.07	6.26	***(1.21)***	33.62	10/23/15	8/24/15
KELLOGG CO	K	70.52	72.34	61.13	5.97	7.76	10.26	(2.52)	15.36	10/22/15	6/8/15
ANHEUSER-BUSCH INBEV SA	BUD	119.33	129.24	102.52	12.24	6.24	7.52	(7.67)	16.40	7/20/15	8/24/15
SYSCO	SYY	41.25	41.45	35.50	5.85	3.93	7.03	***(0.48)***	16.20	10/22/15	7/7/15
CISCO SYSTEMS INC	CSCO	28.85	30.31	23.03	9.90	3.74	***17.90***	(4.82)	25.27	3/2/15	8/24/15
KIMBERLY CLARK CORP	KMB	119.71	122.73	103.04	9.79	3.61	9.31	***(2.46)***	16.18	10/23/15	9/10/15
HONEYWELL INTL INC	HON	103.28	107.41	87.00	9.07	3.36	7.45	(3.85)	18.71	8/10/15	8/24/15
JPMORGAN CHASE & CO	JPM	64.25	70.61	50.07	5.38	2.67	6.23	(9.01)	28.32	7/23/15	8/24/15
COCA COLA CO	KO	42.35	45.00	36.56	5.56	0.31	1.12	(5.89)	15.84	11/28/14	8/24/15
VERIZON COMMUNICATIONS I	VZ	46.88	51.73	38.06	7.75	0.21	(6.71)	(9.38)	23.17	11/14/14	8/24/15
AT&T INC	T	33.51	36.45	30.97	2.85	(0.24)	(3.82)	(8.07)	8.20	6/25/15	8/24/15
PNC FINANCIAL SVCS GROUP I	PNC	90.26	100.52	81.84	1.19	(1.06)	4.48	(10.21)	10.29	7/23/15	1/14/15
WELLS FARGO & CO NEW	WFC	54.14	58.76	47.75	5.43	(1.24)	1.98	(7.86)	13.38	7/23/15	8/24/15
BLACKROCK INC	BLK	351.97	382.84	275.00	***18.32***	(1.56)	3.18	(8.06)	27.99	2/17/15	8/24/15
NOVARTIS AG	NVS	90.43	106.84	88.89	***(1.62)***	(2.41)	(2.44)	(15.36)	***1.73***	7/20/15	9/29/15
YUM BRANDS INC	YUM	70.91	95.90	66.35	***(11.31)***	(2.66)	(1.28)	***(26.06)***	***6.87***	5/20/15	10/8/15
OMNICOM GRP INC	OMC	74.92	80.98	64.12	13.69	(3.29)	4.26	(7.48)	16.84	3/2/15	9/29/15
JOHNSON AND JOHNSON	JNJ	101.03	109.49	81.79	8.23	(3.39)	(6.26)	(7.73)	23.52	11/13/14	8/24/15
VODAFONE GROUP PLC	VOD	32.97	39.46	30.58	3.88	(3.51)	(0.75)	(16.45)	7.82	5/22/15	10/2/15
MERCK & CO INC	MRK	54.66	63.62	45.69	10.67	(3.75)	(5.66)	(14.08)	19.63	1/13/15	8/24/15
3M COMPANY	MMM	157.21	170.50	134.00	10.89	(4.33)	2.24	(7.79)	17.32	3/2/15	8/24/15
FORD MOTOR COMPANY	F	14.81	16.74	10.44	9.14	(4.45)	5.11	(11.53)	***41.86***	3/23/15	8/24/15
M & T BANK CORP	MTB	119.85	134.00	111.50	***(1.72)***	(4.59)	(1.91)	(10.56)	***7.49***	7/23/15	10/2/15
US BANCORP NEW	USB	42.18	46.26	38.81	2.85	(6.16)	(0.99)	(8.82)	8.68	7/16/15	8/24/15
INTEL CORP	INTC	33.86	37.90	24.87	12.34	(6.70)	(0.44)	(10.66)	36.15	12/5/14	8/24/15
ASTRAZENECA P L C ADS	AZN	31.89	37.97	29.50	0.22	(9.38)	(12.56)	(16.01)	8.10	11/19/14	8/24/15
DU PONT E I DE NEMOURS & CC	DD	63.40	76.61	47.11	***31.54***	(9.74)	(3.49)	(17.24)	34.58	3/13/15	9/29/15
EXXON MOBIL CORP	XOM	82.74	97.20	66.55	11.28	(10.50)	(14.45)	(14.88)	24.33	11/21/14	8/24/15
HERSHEY COMPANY (THE)	HSY	88.69	111.35	82.41	***(3.47)***	(14.66)	(7.53)	(20.35)	***7.62***	1/20/15	8/24/15
PROCTER & GAMBLE CO	PG	76.38	93.89	65.02	6.17	(16.15)	(12.48)	(18.65)	17.47	12/24/14	8/24/15
HSBC HOLDINGS P L C	HSBC	39.07	51.20	36.78	3.14	(17.28)	***(23.42)***	(23.69)	***6.23***	10/31/14	9/29/15
EATON CORP PLC (IRELAND)	ETN	55.91	73.82	49.21	8.99	***(17.73)***	(18.25)	(24.26)	13.62	5/14/15	8/24/15
CHEVRON CORP	CVX	90.88	120.17	69.58	***15.21***	***(18.99)***	***(24.24)***	***(24.37)***	30.61	10/31/14	8/24/15
CATERPILLAR INC	CAT	72.99	107.12	62.99	11.67	***(20.26)***	***(28.03)***	***(31.86)***	15.88	11/21/14	9/28/15
CONOCOPHILLIPS	COP	53.35	74.68	41.10	11.24	***(22.75)***	***(26.06)***	***(28.56)***	29.81	11/21/14	8/24/15
EMERSON ELECTRIC CO	EMR	47.23	65.94	42.21	6.93	***(23.49)***	***(26.27)***	***(28.37)***	11.89	11/25/14	10/2/15

As you can see, there are numerous data points for each of the 50 stocks in our high quality dividend stock portfolio. The companies are sorted from largest to smallest price change on a ***year to date*** basis (YTD) through October 30th. As you can see, the top five, namely Time Warner Cable, Brown-Forman, McDonalds, Lilly and Home Depot are each ***up*** at least 17% thus far this year. Conversely at the other end of the spectrum, Eaton, Chevron, Caterpillar, Conoco and Emerson are each ***down*** at least 17% (price only). In keeping with our commitment to provide transparency, the average and median price change for all 50 was .4% and -.65%, respectively. In other words, like most managers, in most years, we are trailing the S&P 500 which was up 1.2% through October 30th. However, on a total return basis, our roughly 1.2% higher annual dividend yield narrows the gap considerably.

Notice that the other columns show things like the share price at the close on October 30th, the 52 week high and low as well as the percent price change in the most recent month (e.g. October), the last 12 months and also the percentage change from each stock's respective 52 week high and low. Notice that if the figure appears in bold italics, that means that that particular stock fell into the top or bottom five for that particular category or time frame. For instance, Du Pont, Dow and Chevron are among the worst performing on a YTD basis but they are in the top 5 for the month of October. Furthermore they have performed quite well since their respective 52 week lows as these three are **up** 34.6%, 47.2% and 30.6%, respectively from their lows.

It is worth remembering that the sentiment for each of these "cyclical" stocks was decidedly negative just a few short weeks ago. It was tempting for many investors to throw in the towel on these and other energy and basic materials stocks and then wait for conditions in their respective industries to improve. In other words, what may have felt prudent and comfortable would have proven costly in these instances. That said, it is not hard to imagine that they could have continued to perform poorly these past few weeks. Most importantly, **what the near term future holds for any of these 50 stocks is always hard to know, even when it seems or at least *feels* obvious.** Also included is the date for each company's 52 week high and low. Interestingly slightly more than 60% of all them (e.g. 31 of 50) share the same low closing date (e.g. August 24th).

Before moving on from the topic of recent results, some comments on the emerging markets are important as these investments likely remain the least comfortable for many of you. The vehicle we utilize to provide this exposure was actually up quite nicely when I provide an interim performance update in my May letter which I called *A Snapshot in Time.* Specifically at that time, this investment was up 9.8% through the close on May 18th. Since its year to date high on April 28th, the emerging markets index sold off roughly 31% to its low on September 29th. Since September 29th, it has risen approximately 10% and as mentioned above, it was down nearly 13% (price only) on a YTD basis.

Public markets are wonderful as they give us the ability to commit and withdraw capital on a daily basis (and indeed throughout the various markets' trading hours) and they give us a scorecard each day (if we so desire). That said, I also think this ease of access to making change and monitoring the score causes many investors to make poor decisions including buying high and selling low, selling and then being on the sidelines when markets rebound significantly and quickly, etc.

Our lack of activity in response to headlines and significant price change does not mean we are not staying informed or that we do not care. We care deeply, but our belief is that less is more. Specifically we advocate less guessing, less recognition of capital gains and less in the way of investment costs. Conversely, more patience, more diversification and more acknowledgment of all the unknowns lie at the core of our disciplined approach. Furthermore, I hope the data contained in the table I have shared today helps you to embrace my ***deeply held belief that price movements are extremely unpredictable***. Otherwise we would not see a nearly 50% spread between the best and worst performing stocks in our diversified in just the past 10 months. Specifically on a YTD basis, Time Warner is **up** 24.6%, while Emerson is **down** -23.5%.

Other Reflections on this Year

Time flies. I say this because my colleagues and I have just passed our one-year anniversary with Raymond James. This past year has been interesting, fun and not without its challenges. All told, if I could rewind the clock a number of years (wouldn't that be nice), the only thing I would have done demonstrably differently is to have gone this route sooner. I have found this move to Raymond James and the formation of our Harmony Wealth Partners team to be very rewarding.

Most importantly on behalf of our whole team, ***I express our sincere thanks to all of you have entrusted us to manage your investment portfolios and to otherwise advise you on matters of importance to you and your family.*** It is our pleasure to serve you. We also want to thank you for referring family, friends, neighbors and colleagues to us. We are also highly appreciative of the referrals we have received from a number of attorneys and accountants that we have worked with over the years. Our success has been greatly enhanced by your support and we are sincerely grateful.

There are other topics that come to mind that I want to share in the weeks and months ahead. First I think I may take a deeper dive on some of the potential risks investors should consider with respect to highly concentrated portfolios. Therefore, I will likely write another letter between now and year end. We do this because we trust that you can indeed handle the proof so that you are better able to withstand the inevitable ebbs and flows of the economy, news headlines and the financial markets. Please feel free to share any topics that you are interested in. We will do our best to provide perspective that will hopefully prove beneficial. In the meantime, we hope you have a wonderful Thanksgiving with family and friends. More broadly, we wish you a merry time over the upcoming holidays.

Warmest regards and our sincere thanks!

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