Investor Psychology and Temperament Trump Fundamentals

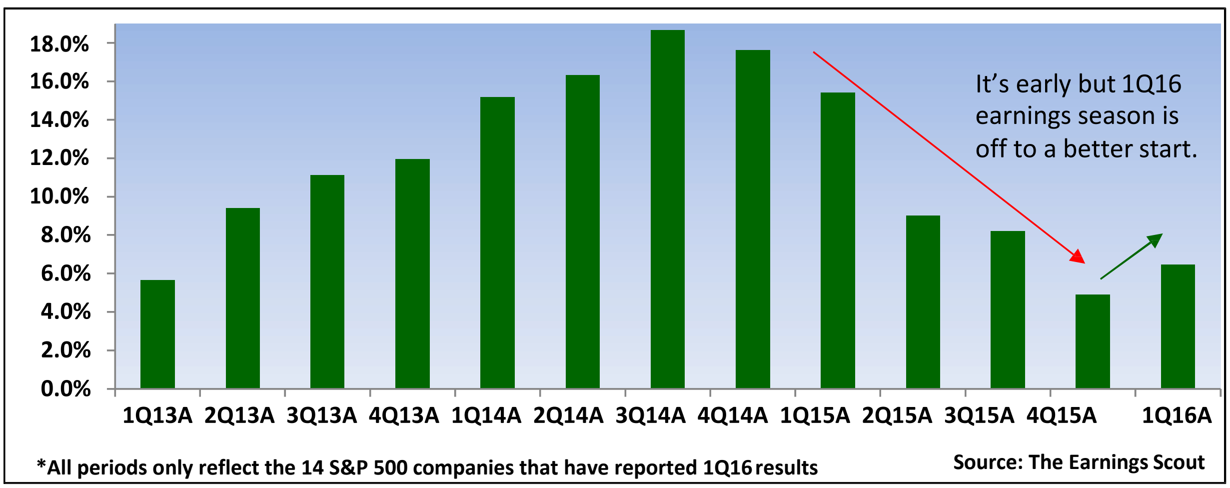
In almost an unbelievable fashion, the worries that were front and center during the first 6 weeks of the year have been almost wiped out over the last 6 weeks of Q1 this year; or at least in terms of the U.S. equity market performances.

Not too worry, the same worries that most people were concerned with have actually not abated so what has led to the turn in stock performance? Two likely scenarios are, more accommodating central banks and potentially less bad news with company sales and profits.

A more accommodative European Central Bank (ECB) + a "Lower for Longer" Fed = Less bad negative EPS (earning per share) estimate revisions with this ultimate solution leading to higher stock prices.

But as we have talked about in previous newsletters, companies cannot continue to cut their way to prosperity and/or financially reengineer their EPS through stock buy backs forever. Eventually the market is going to need to see some real revenue growth to not only support higher stock prices, but also the increases in jobs.

According to Nick Raich at The Earnings Scout, his firm saw companies reporting earnings for this current quarter falling at a lesser rate which should be good news for stock prices.



However, Nick along with myself, are both cautious on whether or not this rally can be sustained. I am particularly focused on companies' ability to drive higher revenue growth which has always been a key investing tenant of mine at TAMMA. To take that a step further, I will be interested to see if we get any slowdown in job growth and if there is a delayed correlation between the high job creation numbers we have seen over the past 12 months vs. the decline in company revenue.

State of the Portfolio

It appears as though our strategy of holding a higher level of cash than normal paid off during this tumultuous quarter. However, if you look at the quarter within a quarter you would see two distinct stories play out.

During the first 6 weeks of the Q1, stock prices were heading lower in what appeared to be a sheer panic, the cash portion of our portfolios were completely outperforming the market.

But as stocks rebounded in the back half of the quarter, our cash position began to once again underperform, that's the bad news. However, as stock prices recovered so too did our individual positions, especially our smaller cap companies. Within weeks, some companies saw 20%, 30%, or even 40% increases in their prices without any fundamental changes to their businesses. Once again this reiterates that stock prices trade on more than fundamentals alone. Investor psychology and temperament has just as much to do with company valuations as do their fundamentals.

Specifically, within our portfolios for the quarter, we continued to trim some of our holdings. Our average portfolio now carries between 25 and 30 individual positions. Research has proven that carrying more than 30 to 40 holdings can actually provide less diversification than holding a smaller number of individual companies.

Insider Trading

$6.6 trillion...the amount American workers are short of what they need to retire comfortably (source: Boston College Center for Retirement Research).
$24,671... total average health care costs for a typical four-person family in 2015, up from $13,382 in 2006 (source: Millman Medical Index/Money.com)
$104,000...median savings for households headed by somebody between 55 to 64 (source: Government Accountability Office)

This quarter we closed our positions in Lowes, Fastenal, Proto Labs, and Skyworks Solutions. These are all companies that we will continue to watch but for now the company fundamentals do not align with our investing principles and objectives. From a valuation perspective, these companies have also become too rich for our liking. Still, as we pointed out earlier, these companies will likely trade on the current investment sentiment rather than their fundamentals in the short run.

Rather than sitting on an increased level of cash, we have adjusted our strategy to increase our bond holdings from their current levels depending upon each individual clients' risk profile. Those clients with a 70/30 Equity/Fixed Income split, will now hold ~25% in bonds and only 5% in cash for their fixed income portfolio portion.

We did add two new positions that we have previously never owned, Toyota Motors and Travel Centers of America:

- Toyota Motors – While some Wall Street analysts are projecting peak auto (top of the cycle in auto sales) we see things a bit different. Toyota is actually projecting a positive earnings estimate trend which is a bullish indicator for us. The price of Toyota is currently trading at the low end of our range indicating a good point to initiate a position. Our risk/reward spread is very positive which also provides for some margin of safety. In addition, Toyota also sports a 3% dividend yield which adds another layer of protection.

- Travel Centers of America – We see two byproducts of lower gas prices:
  1. Increased driving
  2. Increase in discretionary income while driving

  Both of these factors we see as having the ability to increase not only revenue but profit at TCA. People may be more apt to drive than fly or simply take a vacation vs. not taking one at all. And while people are driving they may spend more on convenience store items which for TCA carry a much higher profit margin than does gas. Both of these events if they were to occur could be a boon to TCA.

Other changes to our portfolios included the following:

- Reduced our ownership in Apple
- Reinstated our ownership in Diageo (we previously owned)
- Reinstated our ownership in Rayonier (we previously owned)

Recall that although we consider ourselves to be long-term investors, we are not married to any specific position. If our analysis and/or reasoning for why we bought a position changes then we will act accordingly.

Personalized Investing; TAMMA Value Proposition

At its core, wealth management is a process that encompasses building a plan to achieve your financial and lifestyle goals. Selecting an investment professional to help guide and direct you through this process is an essential and critical first step but often the hardest. This is why TAMMA offers the following six key value propositions to our clients:

- **Organization**; we help to bring order to your financial life by taking a holistic process oriented approach;

- **Accountability**; we help you follow through on your financial commitments by assisting you in developing and prioritizing your financial and life goals, guiding you through the key steps that you need to take in order to succeed;

- **Objectivity**; we help you to avoid emotionally driven decisions in critical financial matters by being able to consult with you at key moments with the necessary data to ensure that you have all of the right information to make informed decisions;

- **Proactivity**; we work with you to anticipate your life transitions and to be financially prepared for them by regularly assessing any potential evolutions that might be coming with an action plan to address and manage changes ahead of time;

- **Education**; we provide specific knowledge and the necessary resources to facilitate your decisions while explaining your options and risks associated with each choice;

- **Partnership**; we take the time to clearly understand your own distinctive needs by listening and taking into consideration your background, philosophy, and objectives while working collaboratively with you and on your behalf.

For questions about any wealth and asset management topics, do not hesitate to reach out to us to find out what options may be best for your own personal situation. Remember at TAMMA, we help to personalize investing for your future.

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