Marble Harbor Investment Counsel, LLC
Excerpt from
Second Quarter, 2012 Letter

Dear Client:

"I've got sunshine, on a cloudy day. When it's cold outside, I've got the month of May…"
"My Girl," The Temptations

We are assaulted from every direction by gloom, doom, fear and trepidation. We have articulated to you repeatedly the litany of troubles and tales of woe in the financial system and in the global economy. For those of you who remember what these sound like, we remain a broken record on the topic: There are many negatives out there that suggest to us that the investment environment will provide us with only modest investment returns from both stocks and bonds. Financial markets will continue to be volatile due to choppy economic conditions and the news flow from around the world. Now that we have that out of the way, perhaps we should look at some glimmers of light along this dark horizon.

Europe: Just ask anyone – even the proverbial shoeshine boy will tell you it's a mess. Who isn't aware of the profound fiscal problems affecting Greece, Spain, Portugal and Italy (among others)? We'd assert "No one." "European Fiscal Crisis" brings up more than *20 times* as many citations on a Google search as "Economic Stability." Many assets already do, or are beginning to, reflect this somber view. Where five years ago these risks existed, but were ignored or underestimated, today they are largely recognized and increasingly understood. The Eurozone and the Euro currency are indeed problems. It is likely that we will see some form of devaluation and/or default in one or several countries. If this were a surprise, we could expect meaningful, sustained downside to stocks and bonds. But asset values reflect this danger – at least partially. Equity indices in Europe have fallen heavily, the Euro has lost value against most currencies, and oil has dropped in price due to a global economic slowdown. We may be forming a base in global assets, as investors adjust to the new reality of a slow-growth Europe (and world).

Municipalities and states around the U.S. are strained. California's fiscal troubles make Greece look like a model of fiscal probity. The problems are analogous to those that dropped GM & Chrysler into bankruptcy – unaffordably generous post-retirement benefit promises. The solution is intellectually simple: Renegotiate contracts with retirees to a level that is affordable. In reality, this is brutal. Witness the recall-election soap opera in Wisconsin, N.J. Governor Christie's tussles with the unions and the recent declarations of bankruptcy by both Stockton and San Bernardino, California. But these are all *good*. In each case, there has been progress toward a solution. We are at the virtual starting line in solving the municipal budget problems. There will be much lost – benefits to employees and services to residents – but recognizing the problem is the first step to fixing it.

For years we have seen jobs move away from the United States. Ross Perot was early and geographically off-base when he spoke of a "giant sucking sound" coming from the Mexican border. It has truly come from China, India and the rest of Asia. For the first time in decades, we are starting to see meaningful *on-shoring* of jobs. Intel has recently built a new semiconductor factory in Arizona, IBM is hiring software and hardware engineers, Dell is finding that the landed cost of some servers from China has little cost advantage over manufacturing in Texas, and many companies have moved call centers back to the U.S. As consumers are increasingly interested in buying local, some companies are moving production back home as a marketing gambit. More importantly, companies have figured out that having their supply chain stretched out over tens of thousands of miles is risky. When oil prices head back up, shipping things all over the world may not make the best economic sense. We see a slow, but meaningful shift in U.S. manufacturing. This is one small piece of the employment puzzle.

In the year 2000, stocks were expensive, and consequently have delivered mediocre returns since then – approximately matching inflation. This has led to widespread skepticism about the *future* returns to stocks. Throughout that time, however, profits have grown along with the companies. So, where we had overpriced stocks in a speculative bubble in 2000, today we have wide-spread pessimism and reasonably valued companies. Your companies have done much better for you than the overall market over this long span of time. And today, they yield more than the market, trade at reasonable valuations against both their own history and the market, and have prospects for meaningful growth in profits over the next several years. While we see a plethora of problems, we also see a path for your investments to prosper in the coming years.

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