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

Dear Client:

"Reports of (their) death have been greatly exaggerated" - with apologies to Samuel Clemens

This past year was a good one for the stock market, despite structural concerns about the global economy. In contrast to the environment, your stocks and companies did well, though our more conservative bias kept us from fully capitalizing on the strong market. As we wrote a year ago (and the year before that), we see continued uncertainty and risk in economies around the world. Greece, Italy, Spain, Portugal and Ireland are not really better than they were. Japan, with a huge national debt and an aging population, just elected its 7th Prime Minister in 6 years. China and Germany's economies are slowing. US deficits are growing by $1 trillion per year.

The US Congress (unfortunately) kicked the "Meaningful Fiscal Reform" can down the road to the next session. A package of tax increases was passed, without anything in the way of significant spending cuts. While the tax increases are necessary, they aren't sufficient for getting our fiscal house in order. From here, the really hard decisions about Social Security, healthcare, Medicare & Medicaid and military spending cuts need to be made. We hope for courageous, thoughtful leadership from Washington, but we are not holding our breath.

Over the last several decades, the US has moved away from investing in education, infrastructure, research and the health and well-being of our youth, toward providing insurance-like benefits for adults. One wag has analogized that the US is turning into an "Insurance Company with an army." While perhaps overstating the case, the current trajectory of spending will make this so in a mere 30 years. We are taking resources from the future and through the miracle of borrowing, using them today.

How does this factor into your investments? First, we remain cautious with respect to bonds – preferring shorter-term issues and those that carry some form of protection or hedge against rising interest rates. In fact, the drop in price of 30 year Treasury bonds during the first week of 2013 wiped out the interest that one would expect to receive on those bonds for the rest of the year. This risk has been foremost in our thinking for several years (you are probably tired of hearing our lamentations!), and keeps us away from lending money for long periods of time. "Safe" long-term bonds may lead to some unhappy surprises when interest rates rise.

We can't predict what Washington will do (despite a sadly accurate prophesy last quarter that Congress would defer any real fiscal decisions rather than make headway toward solving the problem). For your stocks, our focus is on the long-term prospects for companies and owning a diversified portfolio of good businesses. Chasing "unpredictables" and making guesses on things like politics makes no sense to us.

We'll close with a *good* thing we're seeing in the US economy: on-shoring. For 25 years, the trend in manufacturing in the US has been down. While much is still produced here, domestic manufacturing represents a smaller *percentage* of the economy than it did 2, 5, 10 or 25 years ago. This is due, in a sense, to Ross Perot's infamous "sucking sound" of jobs heading first to Mexico, and then further abroad. But during the past couple of years, we have seen a marked shift, first in corporate thinking and attitudes, and more recently in behavior. High-paying jobs are coming back to the States: Intel has located its most recent semiconductor fab in Arizona.

GE has reopened appliance factories in Kentucky. Caterpillar built an assembly facility in Texas, its first new one in the US for many years. Apple is considering moving some laptop manufacturing to the US, while several Chinese electronics manufacturers are scoping out sites for factories here. On-shoring does present many challenges (which due to space we will talk about at a later date); however, this trend is likely to endure. It is a silver lining to the many prominent clouds.

2013 will bring many new surprises. We thank you for your constancy, trust and support and we remain committed to caring for your investments in a prudent manner through the inevitable ebbs and flows.

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