Marble Harbor Investment Counsel, LLC
Excerpt from
First Quarter, 2015 Letter

We are pleased to send an excerpt from our first quarter client letter that discusses our current thinking. We welcome your thoughts.

Sincerely,

Paul Davis, Suzanne Coleman, L.J. Harrington, Eric Robb and Daniel Rosenblatt

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Dear Client:

For all of the ups and downs over the past several months, stocks ended the quarter just ahead of where they were at the end of the year. This familiar churn has been a hallmark of the last several years. The issues *du jour* are both new and in many respects perennial to those we've discussed in the past: fears of a Greek default, turmoil and geo-political adventurism on the part of Russia, an economic slowdown in China, and as a result of all these issues and more around the world, a flight to safety here in the US and a strong US Dollar.

Each of these issues presents challenges. However, it's the last that may be most relevant to US-based investors. The US economy is vast, but only about one-eighth of our GDP is generated from trade with foreign entities, and much of that, such as airplanes, is priced in dollars with multi-year lead times – which gives our partners ample time to hedge their currency exposure. Consequently, despite this historic run in the dollar versus other currencies, we don't see a big impact to the economy in general. While the lion's share of the sales that your companies generate come from outside the US, much of their corresponding costs are similarly denominated in that same currency, thus creating something of a natural hedge for these businesses.

Perhaps an illustration would help – If one of your companies earned 100mm Euros in 2014 and then 110mm Euros in 2015, on the surface, we would say, "Good Job!" 10% growth is favorable and reflects a better than average performance versus the growth in the European GDP or inflation. However, consider that since last year the Euro has depreciated against the dollar by more than 20%. When these numbers get translated back into dollars, it will actually be reported in the company's financial statements as if the company's business in Europe *shrank* by about 12%! Of course, not much actually happened in real, economic terms – the company made more money in Euros, the business is expanding and, in fact, the company can probably afford to buy more assets to expand their business – perhaps exporting more to the US with its now-strong currency. In other words, we don't expect fluctuations in the US Dollar to inflict too much long-term pain. Moreover, while we may experience heightened volatility, these imbalances typically self-correct without any detrimental impact to your businesses. In the past, these periods have presented opportunities to acquire good businesses at reasonable prices. We are vigilant to capitalize on that prospect once again.

The NASDAQ recently topped 5,000 for the first time since 2000. Coincidentally, we also had a chance to visit with management of a company that we don't own – JDS Uniphase (***JDSU***). JDSU is a networking company that was amongst the 2000 tech-bubble poster-children. The first time the NASDAQ reached this level, companies like JDSU were driving it, with Price-to-Earnings ratios of 100x, 200x even 300x. In the case of JDSU, the multiple peaked at more than 500x earnings. Today, the company's earnings multiple is a much more modest 21x, and the stock price has come down from a split-adjusted $1,500 to $13 (up from its low of $1). On the other hand, the companies that have been driving appreciation in the NASDAQ this time around are much more modestly valued, some with single-digit P/E ratios. Though people keep trying to fight the last war and mention the tech sector as a re-emerging bubble, we are not convinced. There are certainly numerous smaller companies that seem to us to have huge valuations – many of which are private with very short operating records – in general we see rationality amongst the larger, public technology companies. We have no doubt that somewhere there is a bubble inflating, and perhaps it's amongst private, technology Unicorns (companies with a valuation above $1bb), but it doesn't seem to be amongst the companies we are looking at for your investments.

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