Marble Harbor Investment Counsel, LLC
Excerpt from
First Quarter, 2018 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, L.J. Harrington, Eric Robb and Daniel Rosenblatt

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Dear Client:

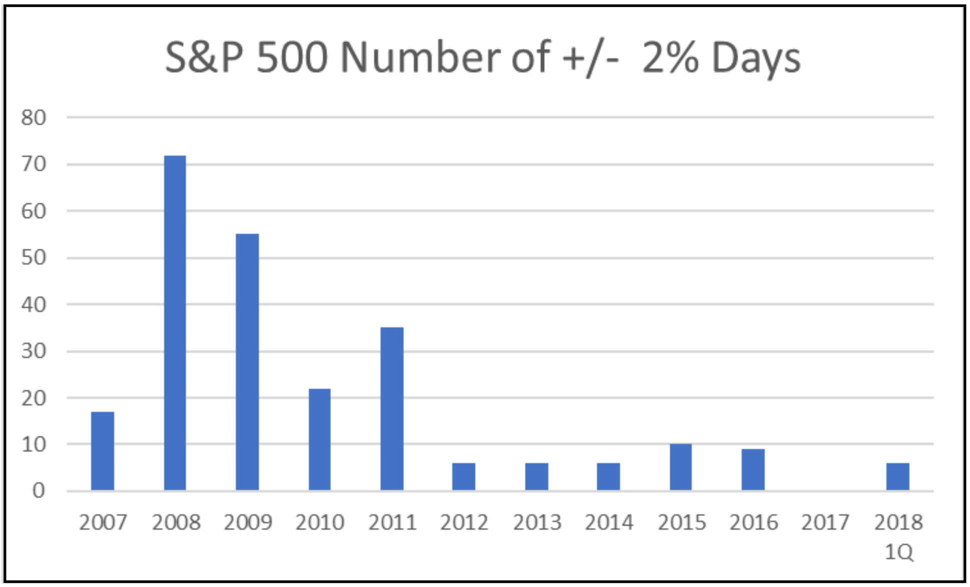
We're moving up in the world! This month we relocated our office from the 25th to the 29th floor of 101 Federal Street. While planning our new space, we were struck by the number of times those involved with the project asked where the television would be installed. The assumption seemed to be that given our field, surely we have our eyes glued to CNBC and its kin, paying rapt attention every time an anchor declares that the Dow has dropped (or surged) by 500. But we've never had a TV, and the move to the new digs won't change this fact. By not tuning in, we avoid the blow-by-blow melodrama. As with all television, the object is to sell advertising, and one way to achieve this is through sensationalism and fear-mongering. Unfortunately, the short-term objective of selling advertising is diametrically opposed to our long-term investment philosophy and your long-term investment goals. We don't get our investment news from cable TV, and we urge you not to do so either.

When we first started our careers in the investment business in the 1990s, the Dow was at 2,500. A 100 point move in the Dow was 4%, and that was a big deal. Given that it's hard to let go of the days of *Seinfeld* and *Friends*, getting past this frame of reference can be challenging. Thus, 100 points still seems like a lot, even though 100 points is now less than 0.5% of today's 24,000 Dow. And if 100 points is tough to swallow, 500 points seems unthinkable, but it's only 2%, one half of the 100 points in our formative days.

A 2% change in a $100,000 portfolio is $2,000, a 2% change in a $1 million portfolio is $20,000, and a 2% change in a $10 million portfolio is $200,000. As your assets grow, the numbers get bigger, and if your frame of reference is a more modest portfolio, thinking about it relative to an entire year's salary and bonus from decades ago can feel scary, but if your portfolio is down $200,000 in a day, it is still only 2%.

As an aside, we don't look to the Dow as a meaningful measure of market performance. Created in 1896, long before the advent of computers, Charles Dow and Edward Jones chose an easy way to manually tabulate change in the market. The results merely represent fluctuations in the *stock prices* of the index's 30 constituents. The S&P 500, on the other hand, reflects the change in the *value* of its 500 companies. As such, it is a far better barometer of the market, and consequently the one we tend to follow.

As much as the talking heads would like to keep everyone in a state of perpetual panic, what we need to do is recalibrate our perspective and remember that volatility is normal. Looking at the chart below, we observe that 2017's extreme tranquility and the relative calm of the prior five years were abnormal. Over the last ten years, the S&P was up or down 2% an average of 22 days. We also see that we've endured far stormier times, particularly in 2008, 2009 and 2011, with 2008 topping the charts at more than 70 days of +/- 2% turbulence. The renewed, more normal volatility also seems that much more striking, coming as it does after several years of placid trading.



Source: IDC

What does the return of volatility mean for your portfolio? The market was down 0.8% since the beginning of the year through March 31 – about flat. It rode the rapids to arrive at essentially the same place it started. Imagine if it had taken the lazy river instead. The shrill voices predicting impending financial Armageddon would be mute. While you may enjoy the lazy river more than the rapids, your net worth is the same, whichever the route. And one potential benefit of those roiling waters is the opportunity to add stocks to your portfolio at reasonable prices.

Something else that has been somnolent for 10 years has recently returned – inflation. Wages for lower income Americans are perking up, and this is causing some increased costs in several sectors, including transportation. We've noticed consumer companies experiencing difficulty fulfilling transportation and logistics jobs and having to pay more to get their goods delivered. We will keep an eye on this as higher wages make their way through the supply chain. A little bit of inflation can be good for companies as they are able to pass through price increases, and it can also be beneficial for stock returns. Of course, excessive inflation would be detrimental to stock and bond returns, but we don't see evidence of this on the horizon.

When we speak to our companies, they continue to describe the economy as robust. They are enjoying the first *global* economic expansion since the mid-2000s. One specter that could derail this train is a trade war. It remains to be seen whether the U.S./China posturing is sabre rattling or something more insidious; either way, it's clear that the placidity of 2017 is a thing of the past, and the markets are back to their usual volatile selves.

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