Marble Harbor Investment Counsel, LLC
Excerpt from
Third Quarter, 2014 Letter

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

Sincerely,

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Dear Client:

"Not everything that counts can be counted, and not everything that can be counted counts."
Sociology researcher, William Bruce Cameron

We are all optimizers. Whether subconsciously or intentionally, our brains constantly evaluate what choices we should make that are best. Defining "best" can be tricky – it's typically an outcome that seems favorable – usually in the short-term, but at a reasonable cost – either in terms of money spent or the time and resources necessary to make the choice. In working through options, we are, like moths to a flame, drawn to what can be (easily) measured and compared. More nettlesome, more difficult and "expensive" for us to consider are those things that may be big and important, but hard to quantify.

The quote above, often attributed to Albert Einstein, is an apt way to think about this all-too-human tendency, and more specifically to explain what we are seeing in the markets today. There are certainly a number of positives in the global economy; however, we also see plenty of troublesome signs that could portend a rough ride. Though the US market has recently given back a bit of its gains this year, the S&P 500 is still up more than 6% in the year to date, and almost 17% over the past 12 months. What is the disconnect between an environment that can appear rather challenging and the continuing good performance of US stocks?

There are millions of aggressive, thoughtful people trying to figure out what stocks to own, based on what a company's prospects are in the future. However, most of these folks look ahead over relatively short time horizons and focus on what is easy to understand. Often that has meant relying only on data that can be measured and quantified, rather than focusing on what is important, but more qualitative in nature. Consequently, while markets tend to reflect much of the widely-known news and information, it is often the easily quantifiable. And what does that mean right now? To many, it is that the US stands astride the world economy, something like the Colossus of Rhodes. Let's look for a moment at some of these factors:

Can Be Counted	Can't Be Counted
Current Interest Rates	When Interest Rates Will Rise
Past Economic Growth	Future Economic Growth
Investors Are Underweight in US Stocks	Dollar as a Safe Haven
High US Profit Margins	Climate Change
US/EU/Japanese "QE" Activity	Russia's Intentions in Ukraine
Inflation	China's Reaction in Hong Kong
Jobs Growth	Ebola
US Oil & Gas Production	Location/Timing of a Terrorist Event

On the left hand side of the table are things that are easy to count. And a brief rundown suggests that they are generally positive for the United States and for stocks. To the right are several big, uncertain, "uncountable" items. While we can understand numerical elements of each, factoring in how their qualitative aspects will alter the investing environment or particular companies requires comfort with the unpredictable. And there's the rub. Our brains are generally wired to analyze what is analyzable, and discount what is not. Faced with the known, quantifiable "good stuff" on the left, most investors will acknowledge, but essentially downplay the risks on the right. However, in our investing experience, we have found that it is not the easily understood items that cause markets to change direction, but rather the unknowns, the surprises, the hard-to-quantify-but-meaningful. Those uncountable items play an important part in how your companies manage their businesses for the long term. They also inform how we think about your portfolio and select your investments.

For the past 5½ years, in an almost uninterrupted run, the stock market has delivered strong returns. The focus on consistently improving economic news and the slow, but steady repair of the financial system has driven equity markets upward. The lower-risk, better businesses that make up your portfolios look to perform not only during those times when the focus is on that which can be easily counted, but also when those uncountable things become more real. Stocks were quite reasonably valued 6 years ago. After this long run and a rush for the safe haven of the US, they are not expensive, but by no means cheap. When those "uncountables that count" emerge, your portfolio of quality companies will continue to serve you well.

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