Reflections on the Past as Prologue

BY JOSEPH PIROPATO ON *JANUARY 3, 2018*

At the beginning of a New Year there is a tendency, particularly among Wall Street prognosticators, to review the recent past and extrapolate its trends into the near future. At this time twelve months ago many were projecting a continuation of slow but steady growth for the economy, perhaps a little better than that due to some hopes for tax reform, and a mid to high single increase in the stock market indexes. What we got instead in 2017 was not tax reform (that came at the very end) but a dramatic reduction in regulations which unleashed better business confidence, a sense that the government was no longer a deterrent to or enemy of business, and a pro-business psychology that encouraged risk-taking, “animal spirits”. In addition, the very large and important Eurozone economy, despite Brexit, showed a marked uptick in growth; Japan did well; China did not implode. After years of slow growth, we finally began to experience the cyclical upturn component of a business cycle. Profit margins remained high, earnings were better than expected, and the stock market indexes reached record highs and performed better than most expected.

So now what? The markets have historically acted as discounting mechanisms of the future; to what extent is the better business environment, and the implications/benefits of the new tax law for corporations, already baked into prices of stocks and other assets? The answer is “it depends”. There are clearly some sectors and stocks where potential future earnings increases are largely priced in. Conversely, the markets may be underpricing companies that already have tax rates at 20% or lower, and where expectations for continued steady growth may be underappreciated.

Now more than ever it is helpful to revisit our core long term, time-tested and historically successful principles of investing. Tocqueville analysts construct dispassionate financial models as part of their research on companies; all portfolio managers have access to the research and use it in a way that best suits their portfolio management style and client objectives. In the Core Equity strategy we aim to combine the best practices of the growth and value investment disciplines. Our preference is to buy and hold good to great companies that can grow regardless of the economic cycle, tax laws, and politics, that on a relative basis have greater control to shape their destinies and are not dependent on outside forces for their success, those that depend on their own innovation and ingenuity. Our stubbornness for value kicks in when we aim not to overpay for growth, or overstay our welcome in periods or sectors or stocks that suggest mania or over-speculation.

After eight consecutive years and twelve consecutive months of gains in the S & P 500, the opportunities to buy at reasonable prices are no doubt scarcer, but they do exist. The rise in the indexes has been far from monolithic, the rising tide has not lifted all boats, and there has been a tremendous amount of rotation in and out of different sectors and stocks over the past eight years. While we have participated in the bull market, most of the time we have made our mark in the past by being more defensive and losing less in those months and periods when the markets are down – and yes they do go down at times! We have often said that investing the way we do in stocks is a good place to save and to grow and preserve wealth after taxes and inflation. In our experience, those who view stocks as a good place to get rich often get into trouble.

While clearly positive for corporations, the final result of the new tax law provided some jolts of the unexpected, especially to very high wage earners and professionals and real property owners in states such as New York, New Jersey, California, Connecticut and Massachusetts. As always, we stand ready to engage with our clients' tax and legal advisors and to execute an investment strategy that is aligned with coordinated long term financial planning, and in many cases, intergenerational wealth planning.

In summary, there are clearly limits to extrapolation and prognostication; the past is not necessarily prologue. While we are conscious of change and impermanence, our core guiding principles and values remain solid and steadfast. We begin the New Year alert and attentive to opportunities in specific stocks and situations backed by a methodical research process performed by our in-house staff of analysts and portfolio managers. The hunt for new learnings and ideas begins again.

Joseph Piropato
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