

Marble Harbor Investment Counsel, LLC
Excerpt from
Third Quarter, 2009 Letter

Dear Client:

October 2009

Are we off to the races?

Over the past seven months we have seen an historic run in stock markets around the world. Since early March, the S&P 500 has rallied over 55% from its lows, while some markets overseas are up over 80%. As discussed last quarter, where there seemed to be nothing but fear and doom on the horizon in March, we are now seeing many signs of optimism and growth. Interest rates are down, some measures of consumer spending are up, corporate profits have exceeded expectations, and companies seem to be restocking some of their inventories in anticipation of an uptick in sales. Green shoots abound.

A retired colleague of ours had a phrase for moments like these: “I’m from Missouri on this one.” The Show-Me state. As we scratch the surface, we are having difficulty believing there is *sustainability* to the good news we are seeing. Interest rates have plummeted to historic lows due to heavy intervention by the US Federal Reserve Bank. Essentially, the Fed is buying most of the US Government debt with maturities greater than three years that others are unwilling or unable to buy. In the long-term, this is unsustainable and problematic. As the Treasury is borrowing money, the Fed is simply printing new money to buy it.

As for consumer spending, we believe that with continuing job losses, along with rising consumer savings, and persistently high levels of debt, the outlook for strong and sustained consumer spending growth is poor. We echo Brad Perry’s excellent discussion of the recent strength in corporate earnings found in the October installment of *Ruminations* – that this has been driven by cost cutting and frugality. As an economy, we can not shrink our way to growth.

This leaves us with a continuing bias toward caution. We did add to your holdings in stocks in early July during a brief swoon in the market. These purchases have proven profitable, as the market rallied strongly from that point through the rest of the quarter. As is often the case, the most speculative stocks have done the best in this snap-back rally. Said another way, the better the quality the company, the worse its stock has performed. Chasing speculative stocks may be a good trade, but it is a poor long-term investment strategy. We are taking care to hold our gains as we feel that the nascent recovery could be one characterized by two steps forward, one step back.

We hope you are well. As always, please don’t hesitate to call with questions or comments.

Marble Harbor Investment Counsel, LLC

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