Resources Management Corp

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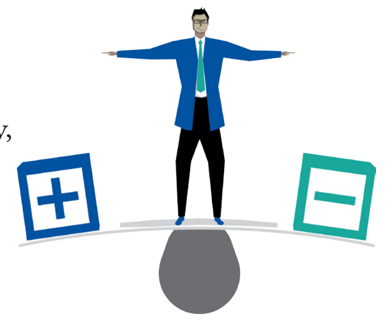
MARKET COMMENTARY

ENOUGH WITH THE VOTES – I'LL USE THE SCALE!!

The Dow Jones Industrial Average (DJIA) was first calculated on May 26, 1896 by Charles Dow to measure the performance of major public companies in the United States. At that time, the DJIA consisted of only 12 stocks, of which General Electric is the only company that remains. Though the composition of the index has evolved substantially since its inception, the nature of the DJIA has not. Investors across the U.S. track the performance of the Dow 30 to get a gauge of how American business is performing. The average was first calculated to be 40.9, and today, the DJIA is approaching 20,000. While milestones like this can provide an interesting perspective of the development of the American economy over time, the crossing of arbitrary thresholds such as this one offers no unique insights into the long-term future of the stock market or the economy. All-time highs and notable "milestones" such as Dow 20,000 are often pointed to as inflection points for the stock market. Television pundits continuously discuss this number and others like it as though it actually holds some bearing on the prospects of the stock market or economy. Despite the media's insistent focus on the implications of the Dow crossing above 20,000, it is critical to not lose sight of what really drives equity values over time. Stocks represent real ownership claims on the assets of their underlying businesses and, as such, should derive their value from the cash flows they are expected to generate in the future. Historically, stock exchanges have proven reasonably effective at allocating funds to the companies that are able to produce the highest return on capital for shareholders. In the short term, however, there can be a disconnect between the intrinsic value of a business and the price it is trading at in the market. Benjamin Graham, the father of value investing and Warren Buffett's mentor, once stated, "In the short run, the market is a voting machine, but in the long run, it is a weighing machine." In our investment process, we aim to make decisions using the "weighing machine" that evaluates the fundamental characteristics of a business such as earnings power, quality of management, competitive dynamics and valuation, while maintaining a keen focus on the effect the "voting machine" is having on stock prices. In considering the outlook for 2017, it is far more effective to use the "weighing machine" rather than trying to predict what the short run "voting machine" will have to say (voters have proven themselves to be quite unpredictable recently). From Dow 20,000 to the potential for interest rate hikes by the Fed, there will be plenty more for the market to "vote" on over the next twelve months. Instead of trying to predict what the initial market movements will be in reaction to these events, we are focused on identifying high quality businesses that will offer strong returns on capital for years to come.



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