J.W. Burns & Company
Investment Counsel
Quarterly Update - April 2017

Lessons Learned From Thirty Years in the Trenches!

"Never let the future disturb you. You will meet it, if you have to, with the same weapons of reason which today arm you against the present"
- Marcus Aurelius

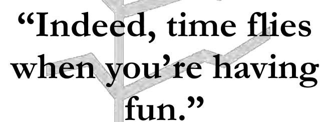
Dear Clients and Friends,

On March 16, I celebrated my 30th year working in the investment counseling profession. I am incredibly grateful and honored to have worked with such wonderful clients and colleagues over the past three decades. I truly remain passionate about helping the clients of J.W. Burns & Company reach their financial goals; and this business – and the world – seems to become more interesting by the day! Indeed, time flies when you're having fun.

When I reflect on the last 30 years in the investment industry, it is amazing to think of the long-term wealth creation we have been able to achieve, especially considering the upheaval created by the major world and stock market events over this timeframe. When I started working with my father at J.W. Burns & Company Investment Counsel on Monday, March 16, 1987, the Dow Jones Industrial Average stood at 2,248. Over the next five months, the Dow would rise powerfully, reaching a high of 2,727.42 on August 25. Then came "Black Monday" – the biggest one day crash for stocks ever, a 22% loss for the Dow Jones Industrial Average on October 19, 1987, to close that day at 1,738.74.

Talk about a "Baptism by Fire!"

"Indeed, time flies when you're having fun."



Over the next few months, the stock market experienced a few harrowing aftershocks, and the fear was pervasive. I remember the financial media was relentlessly drawing parallels between the 1929 crash and 1987, as well as the Reagan presidency and Herbert Hoover's, predicting a similar dire outcome. Many well-known "experts" predicted massive further stock market declines and a repeat of the Great Depression. It was a scary time.

However, the end of the world did not come. Stocks recorded big gains in both 1988 and 1989. Other significant events over these last three decades have included two wars with Iraq, the second one featuring a 10+ year deployment of American troops; the shocking September 11 attacks coupled with a now 16-year war on terrorism, including significant wars against ISIS in the Middle East

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and the Taliban in Afghanistan; two stock market declines of more than 50%, including the 2008-2009 financial crisis and "Great Recession" that resulted in numerous global economic aftershocks; the election of the first African-American president, many of whom deemed a closet socialist, but who just happened to preside over one of the strongest bull markets in history; and the surreal election of celebrity businessman Donald Trump, which almost no one believed would actually happen and has driven the Dow Jones higher by about 11% in only five months!

30 Years Later – Lessons Learned:

Through it all, stocks proved to be the asset class of choice. On March 16, 2017, thirty years to the day from my first day at J.W. Burns & Company, the Dow Jones Industrial Average closed at 20,934.55, almost a 10-fold return from when I started thirty years ago! And that does not even include the dividends that blue chips paid to investors each year. Remarkable indeed.

"Stock prices move in highly unpredictable short-term spurts and frequently generate their biggest gain - or loss - when you least expect it."

The lessons I have learned over my three-decade career about markets, investing, business, and life could probably fill a 500-page book, but below are six vital investment lessons that are worth being reminded of:

1. There is no "Free Lunch" to be had when investing in stocks.

You must accept that frightening and swift market declines are inevitable; investors in stocks must take the good with the bad and stay the course through it all. Put another way, "To make money in the stock market, you've got to be in all markets." From the super wealthy to the young investor just beginning to save and invest, accepting that market volatility is the price one must pay to achieve satisfactory returns in the stock market.

2. The stock market moves in completely unpredictable and, in most cases, utterly irrational ways.

Just accept this one fact: you, and I, and everyone else have no idea of the short-term direction of the stock market.

Stock prices move in highly unpredictable short-term spurts and frequently generate their biggest gain – or loss – when you least expect it. I have seen this over and over in my 30-year investment career, but here are two recent examples: In the first six weeks of 2016, U.S. stocks dropped a frightening 13%, with what seemed like daily losses. At one point in early February, famed investor Ray Dailo basically predicted the market was headed for an even greater drop because interest rates were already so low. Therefore, he reasoned, the Federal Reserve could not step in and lower interest rates that historically have stemmed other market declines. This all sounded very well thought out, and Dailo's comments were big news at the time in the financial media. Problem was that, almost on que, the market stopped falling and instead rose from February 11, 2016, to February 11, 2017, by 26%! Glad we didn't follow that prediction.

As a second example, during the 2016 presidential election, it was repeatedly stated by almost every market strategist that if Donald Trump pulled off a surprising win, the markets would fall "at least" 10-15%. He did win; and markets have risen over 11% since then!

Bottom line: Forget moving in and out of the market. You have to be in the market and positioned for growth in order to generate satisfactory returns.

3. Put the probabilities of success overwhelmingly in your favor.

The shorter your time horizon, the more you're speculating, or betting, against the house, and the

lower your probabilities for success. The longer your time horizon, the more you become the house! Weaker hands sell when markets go down, generating higher return for investors who have the stomach to stay in. That's why selling in declining markets has not worked because, historically, the stock market has always come back and you are, in effect, selling away the winning trade.

4. Earnings and dividends are the ultimate measure of a company's value.

In my first few years in this industry, especially after the 1987 market crash, when I told people my profession, they would blurt out, "The stock market is simply gambling!" Today, however, with the internet and the democratization of financial information, successful investors know that the economic performance of underlying companies determines stock values – no different than if you owned a corner bakery store whose earnings and cash flows increased nicely every year. You would have no trouble finding a buyer to bid a much higher price than what you bought it for. ***Long-term earnings drive stock prices!***

"Buy great companies, with great managements, selling at attractive prices...this is our mantra."

5. Buy great companies, with great managements, selling at attractive prices!

That is our mantra at J.W. Burns & Company. Buying the great, durable brand-name franchises at attractive prices is a proven money-making formula. We augment this with index funds (or ETFs). Additionally, our fees are very competitive, we treat our clients' money as our own and truly view our clients as our family. This reflects J.W. Burns & Company's values and how we strive to operate our business day in and day out.

6. Remember Warren Buffet's own words on his investment criteria:

"We select our marketable equity securities in much the same way we would evaluate a business for acquisition in its entirety. We want the business to be:

1. One that we can understand,
2. With favorable long-term prospects,
3. Operated by honest and competent people, and
4. Available at a very attractive price.

We ordinarily make no attempt to buy equities for anticipated favorable stock price behavior in the short term. In fact, if their business experience continues to satisfy us, we welcome lower market prices of stocks we own as an opportunity to acquire even more of a good thing at a better price."

So, how about the next 30 years?

Who knows!?!

But, I think it was self-improvement legend Jim Rohn, who once said, ***"What will the future look like? Probably a lot like the past."*** This is likely true of stock values. I believe they will be higher 5, 10, 20, and, yes, 30 years from now – by a lot. And me? I will be 83 years old in three decades and I will probably still be reading, studying, absorbing information and managing your portfolio.

<u>**First Quarter Summary:**</u>

Stocks performed very nicely in the first quarter of 2017, with most of the gains being generated in January and February. After watching the more cyclical sectors leading the market higher in 2016, our stocks performed quite well in the first three months of the year. We believe your investment account(s) are well positioned; and at J.W. Burns & Company, we are always working to improve the economic profile of your portfolio. Needless to say, we are not expecting any major changes. So far, we are pleased with almost all of your portfolio companies' earnings and forward guidance here in April's first quarter earnings season,

with a few exceptions. As mentioned previously, earnings drive stock prices, and I think it is fair to say that your portfolio companies are reporting, on average, high single-digit to low double-digit earnings gains. We still have more earnings reports coming up, but we are pleased with what your companies are telling us about their growth prospects.

Tell me something I don't know:

After lagging U.S. equities substantially over the last six years, international stocks actually outperformed strong U.S. equities in the first quarter. In fact, major international markets such as Germany, India, Hong Kong and South Korea had stronger returns than the S&P 500. As you know, we have included international stocks as well as ETFs within your portfolio, but we may add to these positions as most international markets are selling at much cheaper relative valuation compared to the U.S. Stay tuned.

Now on to your questions:

Q. The stock market has had a very strong rally based on Donald Trump's election/pro-business agenda. Do you think the market has overpriced Trump's promises?

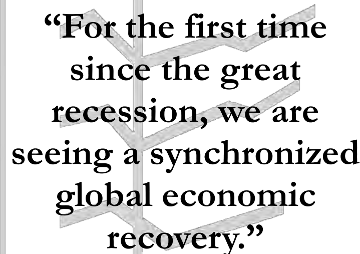
A. Both the S&P 500 Index and the Dow Jones Industrial Average popped following the election and then hit their all-time highs on March 1. Since that time, the market has paused, due to the Trump's administration's failure to "repeal and replace" Obamacare along with extending the time horizon for when Trump's anticipated tax reform policies will finally be enacted.

I think it is fair to say that U.S. stocks are pretty fully valued right now. And investors expect Trump to come through sometime in 2017 with tax cuts, in particular corporate tax cuts. Lowering corporate taxes are important for stock investors because they immediately accrue to a company's earnings. Currently, the United States has the third highest corporate tax rate in the world.

So, if Trump cannot deliver on tax reform, including lowering corporate tax rate to 20% or so (from 35% currently) this year, you can expect a decent stock pullback.

Recently, I gave a speech to the Manufacturers Association of Central New York (MACNY) for which I did a lot of research on Trump's various tax proposals. Ultimately, I think it will get done late this year, as Trump's presidency will be on the line. He almost has to get it done!

However, I think the "Trump trade" is not the only reason stocks are strong. ***For the first time since the great recession, we are seeing a synchronized global economic recovery.*** Europe, Asia, and the United States are all reporting stronger economic growth, and this is fueling higher equity values. Trump's tax reform could help drive global economic growth to the next level, and my best guess is U.S. stocks could climb moderately, 2-5% from current levels through the end of 2017.



"For the first time since the great recession, we are seeing a synchronized global economic recovery."

Q. Why do you hold on to stocks that have gone down from our original purchase price or seem to just languish behind the market?

A. First, as is true with all investors, Warren Buffet on down, we will never bat 1,000. Mistakes will be made even if our due diligence was thorough. Every company's future is uncertain.

We manage your stock positions as Warren Buffet prescribes, looking at stock prices only as a snapshot in time and not selling "simply because it is down." We certainly don't find it prudent or wise to focus obsessively on what the original cost basis is; surely, and obviously, we want our clients to make money off of each original investment, but, again, it just

doesn't always happen that way. Hockey great Wayne Gretzky used to say, "I skate to where the puck is going to be, not where it has been." Put another way, your money does not know what stock it is in, or what price it was bought at. So, if I sell stock A at $20, at a loss, ***and it proceeds to go to $25 over the next twelve months,*** and proceed to buy stock B, ***that is flat over the next twelve months***, I've badly hurt my performance. The fact is, I've had huge winners over many years that have gone down substantially off the original investment; and, theoretically as an asset becomes cheaper, you want to own more of it, not less.

Stocks go up and down in the short term for all kinds of reasons, some valid, many due to unpredictable forces such as large institutional money flows, sector rotations, earnings reports, upgrades or downgrades by brokerage research firms, etc. A sure way to the poorhouse is to think you can just quickly sell your losers or laggards and move that money into a stock that's "working." Because nine out of 10 times, eventually that stock will also face earnings disappointments, sector outflows, downgrades, etc. In essence, you are basically buying high and selling low, over and over again.

"In the short run, the market is a voting machine...in the long run it is a weighing machine."
- Ben Graham.

The important message I would like to convey is that we are watching the equities in your portfolio ***every trading day***, and we are researching, discussing and evaluating all of our positions, including the current laggards. ***In almost all cases, we own the same stocks personally as well.*** We hand pick the companies we position in your portfolio after extensive research, and we believe your portfolio companies have excellent long-term prospects. I can tell you from experience, I could name the stocks that we have sold early that turned out to be nice winners. Don't get me started!

That, I believe, is why almost all successful investors buy and hold a majority of their stocks. As legendary investor Ben Graham has said, "In the short run, the market is a voting machine" (based on popularity), "but in the long run, it is a weighing machine" (based on earnings). We focus on the weighing machine. We suggest you do as well.

To sum up, the market has put in a nice first quarter of 2017 and our stocks are performing well. Trump's tax reform is important for the equity rally to continue, but the global economy is also currently enjoying its first synchronized recovery since the financial crisis, providing ballast for global stock prices; as always, we caution our clients to expect increased volatility over the next few months, and from current prices, we think another 2-5% up is the likely scenario for 2017. Most importantly, we believe your portfolio is well positioned in great companies with strong long-term earnings prospects.

Here's to the next 30 years!

Thank you again, sincerely, for the opportunity and your confidence in J.W. Burns & Company Investment Counsel.

Warmest regards,

Jim

James C. Burns, CFA
President

J.W. BURNS & COMPANY, INC.

INVESTMENT COUNSEL

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