COLBERT
INVESTMENT
MANAGEMENT

Third Quarter Letter to Clients
September 30, 2015

Summary

Confidence has been shaken by slower growth in China and concerns over its impact on emerging market economies. Stock and bond markets have also been affected by uncertainty with the U.S. central bank regarding future increases in interest rates. A review of current conditions and likely outcomes follows.

Four cylinders of growth

The global economy is being driven by four main motors: the U.S., China, Europe, and a grouping loosely labeled as developing market economies. Since 2008 three of them have been powering the world, while Europe has gone from being a drag to global growth, to now being roughly neutral. The U.S. is still motoring along, not fast enough for some, but at a fairly good pace nonetheless. China has been slowing down recently. If China slows down too much, while developing countries are in recession and Europe remains in neutral, the U.S. economy can't carry the whole world. The Chinese government has to continue creating millions of jobs to keep the party going, therefore, they are likely to increase mechanisms to stimulate economic growth.

Get on with it already!

One of the main reasons why the world rebounded so well from the Great Recession of 2008-2009 is that central banks around the world primed the pumps repeatedly. Artificially injecting combustible provokes combustion (the economy starts going again), but too much combustible can provoke a fire that is hard to control (high inflation). The U.S. Federal Reserve stated for several months that the U.S. Economy no longer needs much unorthodox support, and that they planned to start raising interest rates ever so slowly in September 2015. My own view was that the zero-interest-rate-policy was no longer doing much to stimulate the economy, and that the markets could live with a multi-year, gradual, rise to 3% for short-term rates. I thought the whole debate of "Will they?" or "Will they not?" was without much importance because it was about a 0.25% interest rate increase which would have no impact on the economy. It was an irrelevant debate. They should just do it.

What were they thinking?
When September rolled out of bed, the Fed announced they would not raise rates, for now. That was not really surprising because half of the people thought they would raise rates, while the other half thought they would not. The Fed explained that while the strengthening U.S. economy warranted an increase in rates, the slight wobble in the rest of the world meant they should wait a little longer. That statement really spooked the markets: what did the Fed know to make them hesitate? It reminds me of this joke: *The traveler was lost. He asked a local resident for directions. The local man responded: "You can't get there from here".* Investors must have felt like the traveler in the joke. There is almost nothing markets hate more than uncertainty. When in doubt, even if there is no real reason to sell, traders sell. Shoot first, ask questions later.

How's business?
Over short periods of time market prices often disconnect from the business world. By focusing on the business itself, on intrinsic value, there is a certain comfort level that over time stock prices should converge with intrinsic value.

Example 1
Starz Network has been one of our best performers so far this year. When we were buying Starz, investors were concerned that competition from over-the-top providers like Netflix would undermine Starz's television programming business. The threat to Starz was valid, however, bearish investors pushed down its stock price down to levels way below their intrinsic value. Starz's excellent management kept their heads down, continued generating solid cash flows, and these cash flows permitted them to buy back lots of their own shares at low prices. Over time the stock bumped up and down with the overall market until reaching what I considered my selling price (or my estimate of intrinsic value).

Not all our companies have done as well as Starz. Some of the stocks and bonds we selected for client portfolios went down in price this year, like GM & TripAdvisor:

Example 2
One year ago General Motors held an analyst day at which it reviewed its business in great detail for the investment research community. At the time they were in the midst of massive automobile recalls for various defective parts. They were forthcoming, transparent, honest about their past mistakes and decisive with corrective actions being taken. They clearly presented their goals for 2015 and for years ahead. Every quarter since then they updated the analyst community on their progress and any changes made. A few weeks ago they held another annual "Investor Day". They spoke about their automobile models, their markets (including China) and updated their operating and financial targets.

In the last 12 months GM mostly delivered on the the numbers in the business plan they presented in 2014, and they have continually confirmed or increased projections for the next few years. But their stock and bonds are down. Anybody who owned GM stocks or bonds in the last 12 months are seeing red (losses) in their investment account. But the intrinsic value has remained firm, and even increased some during the same period. In my opinion GM shares sell at an unreasonably low price relative to their intrinsic value. In the meantime they pay a solid dividend of over 4% per year. We get paid to wait for the market to recognize and improve the price-to-value relationship.

Example 3
TripAdvisor is another example of a stock that was down since our purchase price. When travelers go to TripAdvisor.com to find out about things to do in a city, places to visit, tours to take, they see reviews from hundreds or thousands of tourists. Those reviews are an invaluable source of information from ordinary travelers who have stayed at that hotel, ate at that restaurant, visited that museum or nightclub. TripAdvisor makes money through advertising and other means. TripAdvisor has a wide "moat" to protect its business from competition. As of the end of the quarter (September 30th), when the overall stock market was dropping, TripAdvisor's stock was down about 16% from our average purchase price.

On October 14th, online booking agent Priceline.com announced a new business deal with TripAdvisor. On that day, TripAdvisor went up 25%, putting us in the positive (above our cost) by 12%.

Conclusion
Eventually, stock and bond prices tend to converge with their respective intrinsic value. The examples above show this, and, I think, so will the rest of our carefully selected portfolio. Here's hoping to bring you good news next quarter!

Best wishes,

Karim Armand
President

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