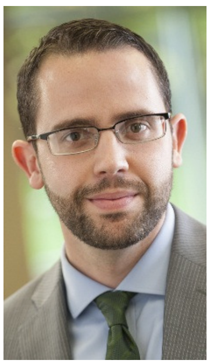
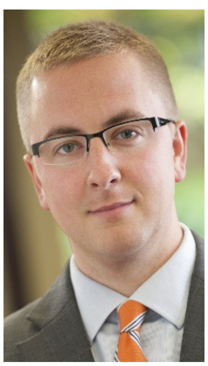
AMI INVESTMENT MANAGEMENT
Registered Investment Advisor

Quarterly Investment Commentary

Second Quarter **July 2015**


Michael D. Axel, CFA


Jacob D. Benedict, CFA


Ryan A. Kay

U.S. stocks and bonds roughly treaded water year-to-date, while international stocks recovered some ground after a weak 2014:

Asset Class	As Measured By...	Second Quarter	Year-to -Date
U.S. Bonds	Citigroup 1-10 Year Index	-0.5%	0.8%
U.S. Stocks	S&P 500 Index	0.3%	1.2%
International Developed Stocks	MSCI EAFE Index	0.8%	5.9%
Emerging Market Stocks	MSCI Emerging Mkts Indes	0.8%	3.1%

The front page of the July 6th edition of the *Wall Street Journal* featured three stories that highlight some of the tensions in today's global economy:

- Greek voters "overwhelmingly voted against their international creditors' conditions for further bailout aid." Greece's Prime Minister promised to use the mandate to get a sweetened deal from his European counterparts, but the prospect of a Greek exit from the Euro grew. Greece's economy is quite small from a global perspective, roughly the size of Miami's, but the worry is that a "Grexit" might cause broader issues.
- China readied "a massive injection of funds to try to reverse the country's worst share selloff in years." The Chinese stock market has fallen around 25% from recent highs (though it was still up from the lows of 2014). The central bank plans to "help investors borrow to buy shares." The Chinese government has opened up its markets over the past year, which has likely driven the volatility (the market is dominated by retail, as opposed to institutional, investors).
- The SEC "launched a broad investigation into whether hedge funds and other investors are improperly selling hot private technology stocks amid a boom in the trading of such shares." The valuations of privately-valued venture companies have taken off in recent years and some worry a bubble has formed.

We don't have much insight into Greece, Chinese equities, private tech companies or the market at large. It's not that these things don't matter, only that we don't have much of an "edge" predicting the outcome (nor do we think others do). And remember that whether you foresee them or not, there are always storm clouds on the horizon. We've grown increasingly fond of the following reflection from Warren Buffett:

> A further related lesson: easy does it. After 25 years of buying and supervising a great variety of businesses, Charlie and I have not learned how to solve difficult business problems. What we have learned is to avoid them. To the extent we have been successful, it is because we concentrated on identifying one-foot hurdles that we could step over rather than because we acquired any ability to clear seven-footers. The finding may seem unfair, but in both business and investments it is usually far more profitable to simply stick with the easy and obvious than it is to resolve the difficult.[1]

[1] Berkshire Hathaway 1989 annual letter to shareholders.

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(260) 347-1281

Investment mistakes most often come from trying to clear seven-foot hurdles. As you might imagine, though, one-foot hurdles are hard to find – if they were easy to spot, everyone would be doing it, and crowded investments by definition can't be great investments. So extreme patience and discipline is required. This is hard. As Buffett notes:

> Success in investing doesn't correlate with I.Q. once you're above the level of 125. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing.[2]

If you think about it, the key part of our job revolves around partnering with the right people, either in the form of a fund manager or chief executive officer. We are naturally looking for intelligent, passionate and most importantly ethical people. But perhaps equally significant, we are looking for such individuals working in fields where the odds of success are high; Buffett:

> Good jockeys will do well on good horses, but not on broken-down nags…I've said many times that when a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact.[3]

You often hear people say things like "he's a genius" or "she's brilliant." But we often don't realize how dependent such judgments are on the respective field of endeavor. An individual could be the most intelligent, ethical and hard-working person on the planet, but if he devotes his life to conquering time travel, society will harshly judge both his aptitude and his accomplishments. But doesn't intelligence presume the selection of tasks that the astute individual knows he can accomplish? Maybe, but in reality, many able people fall victim to a version of the Peter Principle[4] – early success makes us think we can do anything, which is bound to result in eventual failure. We are looking for two things: (a) good people (b) tackling one-foot hurdles. Such individuals embody a rare blend of confidence and intellectual honesty and humility. One more Buffett quote:

> Your win-loss percentage in tennis will not be determined by the absolute level of ability that you possess. Rather, it will be determined by your ability to select inferior opponents. If you select with care it will be quite easy to attain a winning percentage higher than, say, Cliff Richey while he is playing on the tour. Application of this principle is the key element in bridge, poker, or investments. (Harder to apply in the latter, however – it is easier to identify a couple of palookas at the bridge table.)[5]

This is not to say that society doesn't benefit from intelligent people tackling difficult problems – it most certainly does! Indeed, this is how society advances. But as investors, our goal is to have the odds on our side, and the field of major breakthroughs in difficult endeavors is a graveyard.

As we've said for some time, we don't have much of a view on the stock market as a whole. If interest rates remain low, the current level of stock prices seems reasonable. If interest rates were to rise *materially*, it wouldn't surprise us to see stock prices fall. We don't know what interest rates will do, but it doesn't seem that materially higher rates are imminent. But recent volatility seems to have yielded some interesting opportunities to partner with good people at good prices.

As always, we keep our nose to the grindstone! Thank you for your continued confidence.

Sincerely,

Michael D. Axel, CFA
Jacob D. Benedict, CFA
Ryan A. Kay

[2] "Homespun Wisdom from the 'Oracle of Omaha'" *Businessweek*, undated, edited by Amey Stone.
[3] Berkshire Hathaway 1989 annual letter to shareholders.
[4] Based on the storyline that St. Peter, the first Pope of the Catholic Church, was promoted to a position too demanding given his abilities simply as a result of his earlier success. [This is a parable, not a thesis!]
[5] Warren Buffett memo to the board of the Washington Post, October 14, 1975.