AMI INVESTMENT MANAGEMENT
Registered Investment Advisor

Quarterly Investment Commentary

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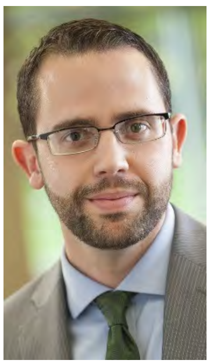
Michael D. Axel, CFA



Jacob D. Benedict, CFA

Ryan A. Kay

U.S. stocks finished the year on a strong note, returning 4.9% in the quarter to bring total 2014 gains to 13.7%.[1] Over the past six years, the S&P 500 is up over 150%, or 17% per year. Not too shabby! Bonds, despite beginning the year in an environment of depressed interest rates, returned 2.5% as interest rates drifted even lower.[2] Unfortunately, international markets have had a much tougher go of it. Developed international markets fell 4.2% on the year and emerging international markets fell 2.1%.[3]

We've long been on record warning that forecasting is a very dangerous business. In the words of John Kenneth Galbraith:

> There are two kinds of forecasters: those who don't know, and those who don't know they don't know.

As bad as nearly all forecasts turn out to be, short-term forecasts are the most baseless. Let's revisit the general consensus among financial experts heading into 2014:

- "Interest rates will rise." Almost no "expert" thought the yield on the 10-year Treasury had anywhere to go but up. The 10-Year Treasury started the year at 3.0% and ended the year below 2.2%.
- Essentially no one predicted the price of oil would be cut in half by year-end.

While not unanimous, a lot of so-called experts have also predicted runaway inflation, a stock market crash, and gold prices above $2,000 (ended the year under $1,200) over the past five years. How could these experts be so wrong? For all we know, they could be the Michael Jordan's of economics, but even Jordan would look inept if he tried to dunk on a 20-foot rim. Getting these calls right is just too hard, and any investment program built on such "insights" is a high-risk, poorly structured approach.

Investor Howard Marks offers a notable distinction:

> It's one thing to have an opinion; it's something very different to assume it's right and act on that assumption.[4]

So what does 2015 hold? In a few short words: we don't know. What follows are some of our opinions on various topics, but digest them at your own risk!

- We couldn't say where the price of oil is going. However, economics does suggest that low prices have a tendency to cure low prices: as prices fall, (1) high-cost producers retreat from the market, thereby reducing supply, which increases prices, and (2) lower prices also encourage increased demand, which also increases prices. That being said, it is important to realize that major changes have hit the market in recent years, including new drilling technology that has rapidly expanded US supply ("fracking") and decreased reliance on OPEC. We've learned to be highly cautious when considering investments in companies or strategies whose future is singularly tied to the price of a commodity.

[1] As measured by the S&P 500.
[2] As measured by the Citigroup 1-10 year Treasury index.
[3] As measured by the relevant MSCI international indexes.
[4] "What Can We Do For You?" January 10, 2012.

- The conventional view for several years has been that interest rates could only go up; the conventional view has been wrong. We penned an editorial in the *Greater Fort Wayne Business Weekly*[5] last year that argued the case was more balanced, with the prospect for an extended low-rate environment a legitimate one. While domestic economic growth has improved and the stated unemployment rate has returned to normal levels, core inflation remains subdued and the labor force participation rate remains anemic. We don't know if rates will end 2015 higher or lower, but that view seems to put us in the minority amid experts who will once again pound the table on higher rates.
- We've viewed stock prices as "approximately fair" for some time now. That view hasn't changed. Based upon the current level of interest rates and the current earnings power of U.S. companies, stock prices appear reasonable. If interest rates were to increase materially (say the 10-Year U.S. Treasury rate rises above 5%) or earnings were to decrease (possibly from deterioration in record high profit margins), stocks would likely react adversely. But we don't have the necessary confidence to forecast either of those events, so we remain neutral on the issue. We continue, as always, to assemble a portfolio of stocks comprised of high-quality companies undervalued by the market, and we've been able to find several new entrants the past few months. Hopefully that success will continue in 2015.
- Perhaps the biggest issue for the New Year will be how the performance of foreign economies will affect the U.S. The domestic economy has quickly become the envy of the world, as both developed and emerging international economies limped into 2015. The Eurozone can't escape concerns of prolonged stagnation and Greece fears hit the headlines again as the year came to a close. Russia may have entered a major recession as the price of oil fell and the ruble collapsed, and China's credit problems may be catching up to it. A stronger U.S. dollar may begin pressuring U.S. exports.

  Our investment portfolios do have a strategic allocation to international investments, though we have always remained U.S.-biased. While international stocks look cheaper, they clearly face more headwinds. In any event, as fortunate as the U.S. is to be the economic leader, we'd all benefit from stronger global growth.

In the same memo that Howard Marks offered the aforementioned quote, he acknowledged the following limitations of his firm:

> We can't know what the economies of the world will do; we can't know whether markets will go up or down, and by how much and when; we can't know which market or sub-market will do best; and we can't know which securities in a given market will be the top performers.

We concur. So what can we do? To paraphrase Marks, first, don't act like we can do those things. Second, formulate investment policies based on achieving *long-term* success: diversify across asset classes and investments, avoid attempts to "time the market" by jumping into and out of different asset classes (i.e. stocks, bonds, etc.), keep costs low, and invest the portfolio in a manner appropriate given the client's ability and willingness to take on investment risk. Third, we try to look for undervalued individual investments – a high-quality stock beaten up by investors because of some short-term concern, an asset class forsaken by the market because of a temporary rough patch, etc. Employing this approach isn't rocket science, but it requires discipline and patience. In the words of Buffett, we try to be fearful when others are greedy and greedy only when others are fearful. Over the past several years we think the pendulum has swung from fear towards greed, but not far enough for us to undertake any drastic actions.

We wish you a wonderful 2015 and as always, we thank you for your confidence.

Sincerely,

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

[5] Available at http://www.fwbusiness.com/opinions/columnist/businessweekly/article_33090435-d9fa-5b57-a6ec-0541ca457782.html.