RUTHERFORD INVESTMENT MANAGEMENT
A Registered Investment Adviser

10300 SW Greenburg Rd.
Suite 115
Portland, OR 97223

July 21, 2015

Client Newsletter – Quarter Ending June 30, 2015

June Swoon

S&P Quarterly results were plus 0.3% through June 30, 2015. Year to date results were positive 1.2% through June 30, 2015. Year to date the market has been volatile, barely holding on to gains for the year. Volatility will continue. Upward moves during the first half were later given up over geopolitical concerns.

At home, GDP growth has been slow, profits so-so and the markets have just not had the catalyst for gains. Headlines have complicated matters. The long dance regarding interest rates has teased investors. Overseas, Greece and China have loomed large. Each time Greece has appeared about to default or leave the Eurozone, or both, the markets have reacted negatively. Each time it appeared a deal between Greece and its creditors might be imminent, the market reacted positively.

Greece:

Greece had been in the news for years. Greece owes a lot of money to creditors which Greece cannot pay. Much of the borrowed money was paid to workers in the public sector in exchange for political support, and the money has now run out. Greek banks are closed, businesses are shutting down, and ordinary people cannot get money.

The issues are both economic and political. Because of the long run up to this problem, the issues have been long discussed and ample opportunity has been provided for creditors to prepare. Most of the money that Greece now owes is owed to foreign governments and to their own government and to local businesses and individuals. The creditors want Greece to pay its debts, and to adopt austerity measures.

Greece has elected a radical government that does not want to pay its debts nor adopt austerity measures. There is ample precedent for the positions of both the Greeks and the creditors. German debt, for instance, has been forgiven twice after two world wars. On the other hand Spain, Portugal, Italy, Ireland and Iceland have adopted austerity measures after which their economies improved and they met their debt obligations. These latter countries, as well the Northern European countries, such as Germany, The Netherlands, Finland and France, think Greece should reform too. Interestingly, small countries from the former Soviet Bloc had to undergo austerity measures when they joined the Euro. These counties feel that Greece needs to stop living beyond its means and comply as well.

Politically it is considered important to keep Greece in the European Union and in the Euro, because to exit could signify failure of the concept of the Union. Europe has long been a place where wars are fought, and the Union was supposed to bind the counties together so there would not be wars. What would it mean if the concept failed? What would it mean to the balance of power in Europe? Would Greece cozy up to Russia? European leaders would rather not face these questions.

At this time, it appears that a deal has been struck to keep Greece in the Eurozone. A GRIN (Greece in) rather than a GREXIT (Greek exit). What does all this mean for U.S. investors? Not much. Greece is a very small country with a GDP about the size of Oregon. Imagine if Oregon defaulted on its debt. Who would care? A few people who bought Oregon bonds would care. So we don't see much impact on U.S. investors even if Greece defaults and or leaves European Union and the Euro. Market disruptions should be temporary, because ample warning time has been available to the financial markets. The Greek people, however, will suffer terribly.

The deal that apparently has been reached may not suffice, and we may see Greece back in the news. The IMF has said the deal is not adequate, and the Greek government is not committed to it. Several times before Greece has pledged action which has not been forthcoming and this may well be another such scenario.

China:

China has been liberalizing its economy for some time. It holds out the promise of more liberalization to its citizens. For many reasons China has prospered. Lately their stock market is crashing largely because it was overheated and gripped by speculative fever. China had the largest margin balances ever recorded. The Chinese government has tried to stem the losses with various bailout programs, with limited success. If the government cannot stem the losses, then doubt is cast on the government's infallibility; that is the principal reason the markets are doing so poorly. People have lost confidence. Their dreams are being shattered. There could very well be political upheaval as a result. Their Premier, who has been on a campaign of purging people in power, has made many enemies. Many people with long knives are waiting for him to fail.

What does this mean for U.S. investors? It means that the price of commodities, such as copper and oil will fall. This is a good news/bad news story for the U.S. If you produce metal, as in mining, you lose. If you use metals or oil, you win. Oil companies will make less money, but gas at the pump will be cheaper. Since at RIM we own no commodities or oil stocks and have not for some time, their lower prices will not directly affect us. Our portfolio companies across the board (except Apple and Nike) are not dependent on sales to China. The Chinese economy is not closely connected to their markets; the stock market plays a small role in China's economy. So slowing of the Chinese financial markets should not have a great effect on the U.S.

Christine Lagarde, head of the International Monetary Fund has been warning for some time that the global economy is slowing, and we believe she is correct. But we also believe that the U.S. is still the place to invest. We have said repeatedly that the U.S. is the best house on a bad block. Last year we pulled our money back to the U.S., even shunning some multinationals such as IBM. We did not take these actions overnight. We adopt a long term view and these actions have been on going, in some cases, for years.

We also try to be in the best sectors. For years we have been in a defensive posture. We have underweighted financials, mining, commodities and oil, all of which are the sectors most likely to suffer the most. We have over weighted healthcare, hardly dependent on Greece or China. We have also over weighted technology where the U.S. owns a decided competitive advantage. Our consumer discretionary companies, with few exceptions (think Nike and Apple) sell nothing in China or Greece. Companies like Costco, Nordstrom, and Tractor Supply sell nothing to China, but they do buy from China.

Other hot spots are Puerto Rico, where that Commonwealth appears close to default on its bonds. Putin keeps up his pressure in Ukraine and elsewhere.

The Fed is still determining when they will raise interest rates. They want and need to raise rates to normalize interest rates and retain some dry powder to use in emergencies. They have not been able to do so because of data. With the global economy slowing and the IMF leaning into rate increases, it is not an easy decision. If they raise rates too soon, they could plunge the U.S. back into recession. We are not strong enough to handle another recession just now

We maintain a diversified portfolio to reduce risk. We know our process works because our client results tell us, and Morningstar rates us among the top investment managers in the nation.

We will keep on with our philosophy and process because it is proven. In our investment strategy, headlines become just noise and sometime a buying opportunity. We have been through turmoil before and come out fine. Expect volatility, but don't panic. We will stay the course.

If you have any questions, do not hesitate to contact us.

In the meantime, consider the following statement by Janet Yellen in a recent speech in Cleveland: "As a general principle, the American people would be well served by the active pursuit of effective policies to support longer-run growth in productivity. Policies to strengthen education and training, to encourage entrepreneurship and innovation, and to promote capital investment, both public and private, could all potentially be of great benefit in improving future living standards in our nation." Anybody listening?

Best,

William D. Rutherford

Rutherford Investment Management