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OBERMEYER WOOD **NEWS**

SUMMER 2015

MARKETPOINT

As the U.S. economy resumes its growth after a sluggish winter, the topic of interest rates and the seeming inevitability of a Fed rate hike is at the forefront of many investors' minds.

The last time the Fed hiked rates was in June 2006, which was when Martin Scorsese's *The Departed* was playing in theaters, when Bill Gates stepped down as Microsoft's chairman, and when the Carolina Hurricanes won the Stanley Cup. The timing of when the Fed raises rates is unpredictable, but unquestionably sharp improvements have occurred in many of the economic indicators that the Fed relies on to make such decisions.

The job market has strengthened on several fronts, indicating that the economy may have turned a corner. Businesses added 280,000 jobs in May and jobless claims have stayed below 300,000 for the fourteenth month in a row. Perhaps more importantly, hourly wages rose 0.3% in May, bringing the year-to-date increase to 2.3%, and there has been a strengthening of the employment numbers in the key demographic of 25-34 year olds (from 30 to 33 million employed).

An improved employment situation brings benefits to individuals and businesses alike. Job creation and increased wages bolster consumer confidence, driving the appetite for goods and services. In May, NFIB's survey of Small Business Optimism rose to 98.3 and the University of Michigan Consumer Sentiment index jumped from 90.7 to 94.6. Consumer spending is also up, with retail sales climbing 1.2% in May alone and car and light truck sales up by 7% for the year. Increased business confidence is also evident. Boeing, for example, is planning for $5.6 trillion of new aircraft orders to be placed over the next 20 years, effectively doubling the current commercial jet fleet.

Despite the positive U.S. news, domestic stocks have been mildly positive so far in 2015, following several years of outpaced returns. This is likely due to the fact that many sectors are already trading at above-average valuations, and that positive economic momentum increases the probability of higher interest rates, which can weigh on stock prices in several ways.

First, interest rates are part of the discounting mechanism for stocks, meaning that all future cash flows should be worth less today and share prices should therefore be lower. Put differently, investors may raise their hurdle rates, or the return that is required to justify a stock purchase. Higher interest rates could also pressure share prices as borrowing costs rise; this is especially true for those who buy shares on margin (see chart on page 2). In addition, rising interest rates could slow share repurchase programs, which have been a major driver of stock prices. Further, while the rest of the world competes to devalue their respective currencies, rising interest rates in the ›

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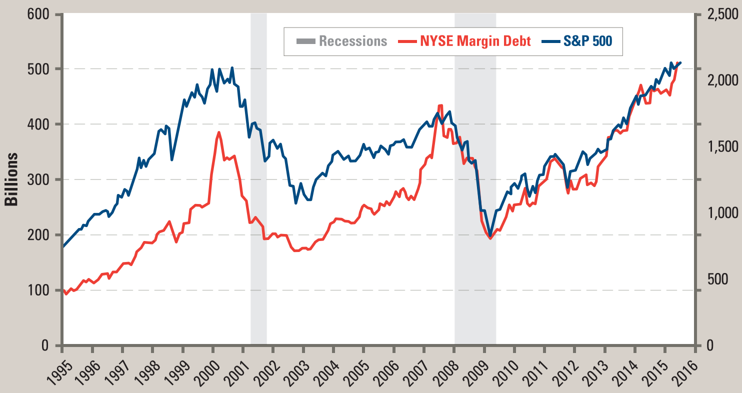
INVESTMENT COUNSEL, LLLP

U.S. will likely keep the dollar strong, which makes it more difficult for domestic companies to generate revenue growth from abroad.

NYSE Margin Debt and the S&P 500 Real values (Adjusted to Present-Day Dollars)



Source: Bloomberg

The fixed income sector has been challenged in recent months as bond investors anticipate rising rates. Traditionally, the most conservative investors tend to look to bonds as a place to preserve principal and find safety. However, as interest rates rise (or in anticipation of rate increases) bonds can lose value. We have seen significant outflows from bond funds as investors move to cash to avoid this. Prices of long-dated government bonds have declined as yields have recently marked multi-month highs with the 10-year Treasury yielding around 2.39% (up from 1.65% in early February).

In addition to concerns about rising rates, political developments and weak economic conditions persist in certain parts of the world, further weighing on markets. Once again, investors are concerned about the potential market fallout should Greece default and exit the European Union. The size of Greece's debt is relatively small compared to the economic cost of low confidence among investors and consumers. As a result it seems likely the EU will remain intact and that the long-term economic impact will be tolerable. However, it's likely that the negotiations will be volatile.

What is an investor to do with these potential headwinds? It is ironic that as things get better in the economy, challenges for investors (such as rising rates) begin to appear. Because the U.S. economy will struggle to realize robust growth without the support of ultra-low interest rates and because the world is facing uncertainty overseas, we believe the Fed will take its time and err on the side of raising rates very slowly. While interest rates will rise, the slow pace should not disrupt the economy and will likely be supportive of asset prices for the foreseeable future.

Our focus remains on making investments whose success depends primarily upon internal company developments. We believe that during periods of uncertainty, especially as we potentially transition from super-low interest rates, diligent analysis and a rigorous approach to security selection will be more important than ever.

With respect to equities, this means owning shares of businesses that have a unique and valuable product or service, and where the shares are valued attractively relative to the company's anticipated profitability. It also means that it will be important to own investments where time is in your favor, where the prospects of share price appreciation isn't dependent on how the overall market performs, and where the potential for high returns on equity can be earned by the operating business. With respect to fixed income, this means focusing on shorter-dated bond securities to help protect against higher rates, and to invest in floating-rate securities and other less traditional fixed income instruments to remain nimble in the evolving rate environment.

We recognize that interest rates will eventually rise, markets will continuously shift, and new uncertainties will emerge. Through these environments we believe that our conservative approach and strict focus on valuations will help protect and grow client portfolios.

TOP OF MIND
REPORTING FROM OMAHA

"I'm Warren; this is Charlie. He can hear; I can see. We work together." And so began the celebration of Warren Buffet's being at Berkshire Hathaway's helm for 50 years.

John Goltermann, Ali Phillips, and Wally Obermeyer

Over 40,000 people traveled to Omaha for the company's May 2nd annual shareholder meeting, filling the CenturyLink arena and its overflow rooms to capacity. For most, the event's main draw was the unscripted 6+ hour Q&A session with Warren Buffett and Charlie Munger. Both men were full of humor this year as they opined on a range of topics, including their business holdings, the global economy, their investment philosophy, and family relationships. Below we highlight some of the key takeaways:

Berkshire Hathaway's businesses and holdings:

- Berkshire continues to operate very leanly, with just 25 people in the home office and 340,000 employees across the broader business segments. Insurance and railroad operations are the biggest contributors to their bottom line
- Utility operations and increasing renewable energy production are a strategic focus as they don't believe fossil fuels will last forever
- Being nimble is one of Berkshire's core advantages (as demonstrated by the deals they secured and the liquidity they provided during the financial crisis); they emphasized that the company is positioned to act when future economic dislocations occur
- There were a few contentious topics (concerns about mortgage practices at Clayton Homes, deals with 3G Capital, underperformance of their IBM holding). Buffett and Munger took each question in stride, offering honest assessments of their successes and past mistakes

Market conditions:

- Buffett acknowledged that certain U.S. market metrics are above historical averages. However, in the context of today's interest rate environment, he believes that some businesses and equity-like investments are still cheap. There is also an opportunity cost of investing in bonds at 1%
- In speaking about global prospects, they are constructive on China but were less positive on the eurozone; As Munger archly put it, "You can't form a business partnership with your frivolous, drunken brother-in-law and expect it to work out"
- In their opinion, activist shareholders are too focused on share buybacks and are not focused enough on the price of the shares that are being repurchased

Investment philosophy and approach:

- In running their business, they remember that they are managing their net worth, their families' net worth, and their friends' net worth, so they are always cautious
- In answering a question on the applicability of value investing overseas, they believe it applies everywhere as "investment principles do not stop at borders"
- There is no one approach that will fit all investments; the key is being open to new ideas and focusing on businesses that you can understand
- Finally, investing is an easy game…if you can control your emotions. Munger quipped, "If people weren't wrong so often, we wouldn't be so rich." It is the periods of wild optimism and wild depression that offer the greatest market opportunity

Each year the questions vary but the core messages remain the same: be rational, buy high-quality companies, know your circle of competence, focus on the long term, and don't get caught up in the crowd.

Our Team

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Co-Chairman and President

Ali Flynn Phillips
Senior Vice President

Roger Hennefeld, CFA
Vice President, Trading and Investments

Christine Goodendorf
Associate, Finance

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FIRM UPDATE

DENVER OFFICE IS MOVING THIS SUMMER

As we mentioned in our merger-related communications last fall, our firm has been working on a new office to accommodate our larger team and increased number of clients in the Denver area. We are excited to report that we will be relocating to our new home later this summer. We are staying in the Cherry Creek area, but are moving over several blocks to 200 Columbine Street. In selecting and designing this new location, we chose an office that will accommodate our business over the next 10-15 years.

We will be sending out more details closer to the move-in date and look forward to showing our clients the new space in the coming months.

NEW TEAM MEMBER: MAIA BABBS, CFA

We are delighted to announce the addition of Maia Babbs, CFA to the Obermeyer Wood team. In her role of *Vice President, Investments and Client Advisory*, Maia performs security analysis and manages client relationships. Maia joined our firm in May, bringing 16 years of broad financial industry experience and a deep knowledge of securities markets. Most recently, she served as an equity research analyst at Janus Capital, focusing on the global financial sector. Maia received her BA in foreign affairs from the University of Virginia and her Master of Arts of Law and Diplomacy (International Affairs) with a concentration in international economics and finance from The Fletcher School, Tufts University.

INVESTMENT NEWS RANKING

Investment News published its annual review of the RIA (Registered Investment Advisor) industry this past spring. They listed Obermeyer Wood Investment Counsel as the #1 independent firm in Colorado and as one of the top 130 firms nationwide. Since our merger, the integration of the firms has progressed extremely well, reinforcing our belief that the strengths created by the combination will serve our clients well for years to come. We remain deeply grateful for our clients and thank you for your ongoing partnership.

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