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OBERMEYER WOOD NEWS

SPRING 2016

MARKETPOINT

Financial markets experienced unusually high levels of volatility as the year began, with sharp market declines in January and February followed by a strong rebound in March. Contributing to the declines was the perception that the U.S. economy was slowing, a view based on limited data. A broader view suggested economic growth was continuing, and indeed the U.S. economy is the strongest of the major global economies by several measures. For example, the Fed moved more rapidly than other countries after the financial crisis in 2008-2009 to require higher capital levels and lower risk in the banking system. Currently, the U.S. banks, especially compared to their European counterparts, are in a strong position and their ability to lend has improved substantially. While energy loan concerns have increased, exposure at the banks is not the systemic issue that housing and mortgages were in 2007-2008, as they represent a much lower percentage of overall loans. Also, the labor markets have shown major improvement. The unemployment rate has nearly halved since 2009 (see chart at right). Inflation remains subdued.

Throughout 2015, the U.S. grew slowly and steadily, with quarterly GDP growth rates of 1-3%. While some corporations and individuals are postponing new investments, the longer-term prospects for the U.S. economy remain positive. Lower

Civilian unemployment rate and year-over-year growth in wages of production and non-supervisory workers
Seasonally adjusted, percent



Source: U.S. Bureau of Labor Statistics

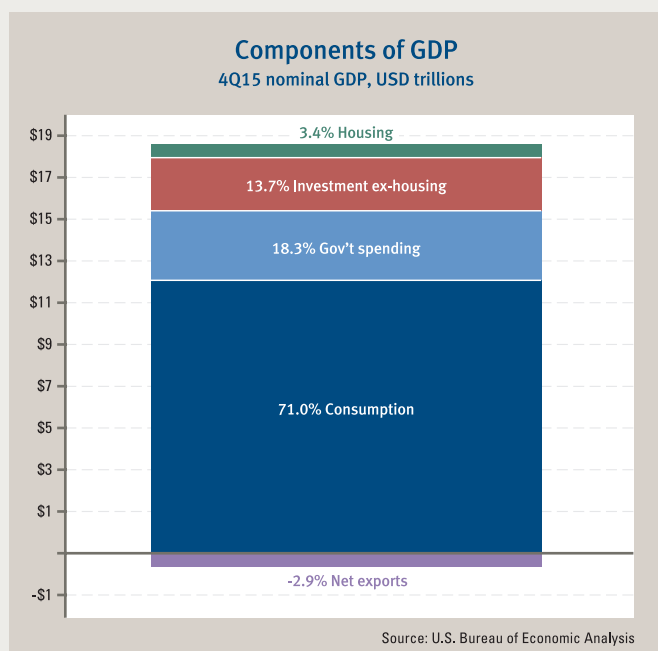
oil prices will benefit the consumer, and the extra savings will likely be spent, boosting consumption and economic growth (see chart on following page). For example, the Dallas Fed, in an April 2015 report, estimated that the 50% decline in the price of oil could raise GDP growth by up to 1%.

In addition to uncertainty about U.S. growth, concerns about China's economy drove an increase in market volatility worldwide. China has begun to transition from an investment, manufacturing-led economy to a consumer-led economy, creating some uncertainty about its growth trajectory. Slowing Chinese demand for commodities and the devaluation of the Chinese yuan created numerous >



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MARKETPOINT (CONTINUED)



ripple effects, including lower oil prices and global currency fluctuations. Although China has become the world's second largest economy, most investors had yet to experience a sharp decline in its economy. China's central bank devalued the yuan during the fourth quarter of 2015, and financial markets remain concerned about further devaluations. Chinese policy makers added further to uncertainty in January with unsuccessful attempts to manage fluctuations in their stock market. Financial markets outside of China appear to have overreacted to these developments.

The current situation in China has several similarities with Japan's "Lost Decade" (1991-2000). Rapid economic expansion in the 1970s and 1980s in Japan transformed it from a war-torn, rural economy to one of the strongest economies globally. However, the growth also created property and stock market bubbles. After the asset bubbles popped, Japan experienced a long period of secular economic decline. At the time, many investors worried about contagion, but in fact the rest of the world was relatively unaffected, and the U.S. experienced a


prolonged bull market. China has also had a prolonged period of GDP growth fueled by investment in infrastructure and credit expansion. This combination has resulted in a property bubble, and China's real estate valuations are now declining. Ultimately, China will likely experience some difficult economic adjustments. While China's economic challenges will continue to produce volatility in world financial markets, we don't believe, based in part on the Japanese experience, that China will create systemic financial problems for the rest of the world.

Overall, financial market volatility will likely continue, driven in part by the fact that the major economies of the world are at different states of recovery. The U.S. appears to be recovering and is beginning to raise interest rates. However, other economies (e.g., Europe, Japan) faced with sluggish environments will continue their efforts to spur growth using monetary policy tools, including low interest rates and money supply growth. Developments in China may also cause further market volatility, as could the U.S. elections.

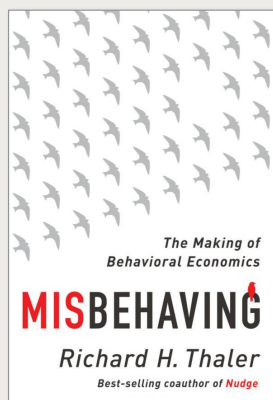
Longer-term, there are a variety of positive secular trends at work in the U.S. economy. These include a strong financial system, abundant low-cost energy, and continued innovation in the pharmaceutical and technology industries, including gene therapies, Big Data, and the Internet of Things. Despite short-term market turbulence in the U.S. and globally, innovation and cutting-edge research continues, and companies continue to create shareholder value.

While volatility is unsettling, it does occur occasionally and at unpredictable intervals. During such times, it is helpful to pause and reflect on what we do as investors. We seek strong, high-quality companies with competitive positions that we believe are able to grow and create long-term shareholder value. Our in-depth research process involves assessing a company's fundamentals, including the firm's potential revenue growth, profitability, and future cash generation in order to estimate what a

company is worth, or its “intrinsic value.” We invest in shares of those companies when we believe the current price represents a significant discount to the intrinsic value. The market’s recent volatility has created a variety of examples of companies whose stock prices are likely

trading below their long-term intrinsic values and, in some cases, by significant amounts. We cannot know when these valuation disparities will correct, but we believe their existence bodes well for future returns. 

RECOMMENDED READING



Misbehaving: The Making of Behavioral Economics

Fans of behavioral economics will no doubt be familiar with Richard H. Thaler, author of numerous books on the topic (including *Nudge*, previously reviewed in these pages) and part of the discipline’s advance

guard. In his latest work, Thaler walks readers through the origins and evolution of behavioral economics, pausing along the way to share anecdotes, highlight key concepts, and playfully tweak the noses of the field’s adversaries.

One way to understand behavioral economics is to contrast it with a traditional economic viewpoint, which presupposes the ultimate rationality of economic behavior. This view assumes that people (what Thaler calls “Econs”) will predictably optimize a given situation. For example, this theory holds that in aggregate, consumers will purchase the best good or service that they can afford.


As Thaler and others discovered, it is easy to poke holes in this theory because it does not account for human bias and irrationality. Below is an example Thaler provides:

Lee’s wife gives him an expensive cashmere sweater for Christmas. He had seen the sweater in the store and decided that it was too big of an indulgence to feel good about buying it. He is nevertheless delighted with the gift...Lee feels better about spending family

resources on an expensive sweater if his wife made the decision, though the sweater was no cheaper.

Early in his career, Thaler made a list of instances where traditional economic theory did not seem to hold. Bolstered by the contributions of esteemed cognitive psychologists Daniel Kahneman and Amos Tversky, Thaler began to formulate theories that could account for the many ways that humans “misbehave,” or make predictable errors. Of course, instances of observable irrational behavior (such as the gift example above) were bound to draw criticism from academics whose economic models depend on the opposite. Thaler dedicates a good many pages to candidly outlining the (sometimes amusing) objections from traditional economists. As one economist queried Thaler “If I take what you are doing seriously, what am I supposed to do? My skill is knowing how to solve optimization problems.”

While the academic battle over behavioral economics’ merits is far from over, its value in daily life is undeniable. Thaler has harnessed his theories to suggest ways policymakers can nudge their constituents towards beneficial behavior. For example, businesses can help their workers save for retirement by automatically enrolling employees in company-sponsored retirement plans unless they opt out.

While *Misbehaving* is required reading for behavioral economics buffs, it is also a great point of entry for those new to the field’s ideas. If you would like to read more about this fascinating topic, please reach out and we are happy to send you a copy of Thaler’s book. 

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TOP OF MIND

OBERMEYER WOOD AMONG NATION'S TOP ADVISORS

We are delighted to share that Obermeyer Wood was named to *Barron's* 2016 list of America's top financial advisors, published in the magazine's March 5, 2016, edition. Representing our firm, Wally was ranked #2 in Colorado and is the top-placed *independent* advisor in the state.


This state-by-state ranking annually evaluates advisors on a range of metrics including assets under management, overall quality of the practice, philanthropic work, and regulatory record. We are honored to have been included on this list every year since 2013, when *Barron's* opened the ranking to RIAs.

We believe this acknowledgment pays tribute to our firm's investment philosophy, relationship approach, and the strength of our team. Of course, we couldn't have achieved this recognition without the support of our loyal group of clients. We are incredibly grateful for your ongoing support and partnership. Thank you.

REVIEW MEETINGS

Ongoing communication helps ensure that we are able to do the best job we possibly can for you. While we work towards keeping our clients informed on broad developments and market conditions through our quarterly newsletters, there is no substitute for one-on-one discussions. As a rule of thumb, we recommend having an annual conversation about your accounts to discuss your particular situation in detail. We welcome you to contact us in Aspen or Denver to schedule an appointment or call. Our team is always here to answer any question or address any concern – big or small.

BERKSHIRE HATHAWAY ANNUAL MEETING BROADCAST

Berkshire Hathaway has announced that it will be partnering with Yahoo to live-stream its annual meeting for the first time this year. As one of America's largest shareholder gatherings (it regularly draws 30,000-40,000 attendees), this development will enable a wider audience to hear Warren Buffett and Charlie Munger share their views on the business, global economy, and investment themes. The live-stream will begin on April 30th at 8 a.m. MT on www.finance.yahoo.com, with a replay available for 30 days following the event. 



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