F|I|M group

SEPTEMBER 2015

Current Observations

October 19, 1987 – Black Monday

By Paul Sutherland, CFP®

On October 19, 1987 – Black Monday – the U.S. stock market crashed 22% in one day. Linda Brezezinski (my only staff member at the time) and I were very busy that day … *buying!* That night, I served as an adjunct faculty member for the CFB Board and taught a course at Northwestern Michigan College to those achieving Certified Financial Planner (CFP) designation. An hour or so in to the class one of my students, noticeably annoyed, blurted out, "Aren't you going to mention the stock crash today?" Unphased neither by his comment nor by the day's financial news, I looked at him and said simply, "This [crash] is normal stuff," and then *briefly* discussed the market's swoon that day. The following week we talked about a conversation I had with a client who was also pursuing her CFP so she could manage her husband's medical practice more efficiently. She had called me the day after the "crash" to sell 100% of the stocks in her family retirement accounts. When I asked why, she said her risk tolerance had changed and wanted "to sell everything and go to money markets until everything settled down." I told her that about 50% of her portfolio was already in money markets the day before the crash, but now we were getting 100% invested because there were so many bargains around. We did not own a lot of bonds at that time, because we felt they were not good values for "growth"-oriented investments (on behalf of her young family). I explained (as adjunct faculty) that she had learned in her CFP training that "*Risk tolerance does not change with market fluctuations, the economy or business cycles – it is a constant, and measures the amount of volatility that one can stand in pursuit of [good, sustainable, solid] investment performance.*" She said, "I think the world has changed [by the events of black Friday] and we are going into a great depression, and I don't want to be invested, so move me to cash." Logic did not matter, fear was the driver for her, so cash she got.

> *Templeton was steady and saw market volatility as a friend to investors, allowing the most savvy to benefit from lower prices. Buying a dollar's worth of goods for 50 cents is better than paying a dollar, and thus buying investments at better prices results in less risk and better future performance.*

Black Friday was a great example of one of those "teaching moments" that educators lust for, and my intent was to milk it to the extreme. My students understood the market and how mass hysteria affected it. In explaining *Black Monday*, Bloomberg quotes Investopedia: *"Interesting enough, the cause of the massive*

continued from page 1

drop [on Black Monday] cannot be attributed to any single news event, because no major news event was released on the weekend preceding the crash. While there are many theories that attempt to explain why the crash happened, most agree that mass panic caused the crash to escalate."

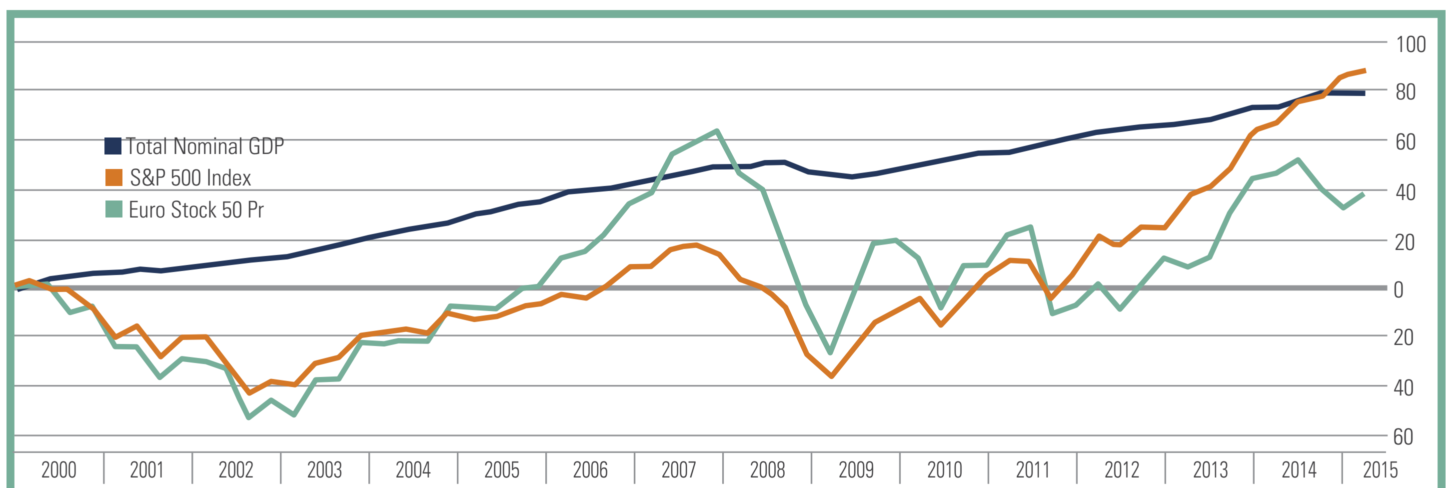
Though I was young in 1987, I was not unschooled in the market's volatility. As a student of the markets, I had watched as the Dow drop from a high of 1051 in January of 1973 to a 578 low the following January (1974), only to rise again to near its January 1973 high a couple of years later (1015 on 9/21/76). My reading was mostly Sir John Templeton who was a values and value-driven global investor who searched the world for opportunities. Templeton was steady and saw market volatility as a friend to investors, allowing the most savvy to benefit from lower prices. Buying a dollar's worth of goods for 50 cents is better than paying a dollar, and thus buying investments at better prices results in less risk and better future performance. Early in my career I learned that *markets fluctuate – that's a good thing. Don't sweat the day-to-day volatility*. If Templeton were alive today, he would most likely be handing out organic tee shirts printed with "Keep calm and stay the course" or "Keep Calm … *Markets fluctuate – that's a good thing*" emblazoned on them.

As I am writing this, most world and U.S. markets are down less than 10% on the year and around 10% from the [Dow] high on May 19. Most of the economic world is pointing to China for this market swoon. Some attribute it to quantitative easing. Others may point to Greece or falling oil prices. China's markets have had quite a run lately. The Shenzhen Stock Exchange Composite Index is a market cap-weighted index that tracks the A-share and B-share lists on the Shenzhen stock exchange. Unlike the U.S. and most European and Asian markets, the Shenzhen is up this year, rising from 1394 at the beginning of the year, peaking at 3156 on 6/12/15, and now sitting at around 2000 points today. Markets fluctuate, obviously, even in China.

Still, we have been very active during the past several weeks, selling investments that we felt were "not as good" as other investments due to price, value and the current landscape we see developing. I have spent my career scratching my head during times like this, watching smart, thoughtful people panic and turn their investments to cash. ***Things are never stable. Everything fluctuates. Everything changes.*** Still, there is a near constant move forward for most boring old steady-eddy economies. If the economy is doing **well,** it's up a few percentage points. If it's doing **poorly,** it's either up a little, flat or down a bit. And the investment markets go crazy around the boring, old economy and its few percent swings over time. The chart below illustrates this fact quite well. The blue line **Total Nominal GDP** rises steadily over this 25-year period. The stock markets as illustrated by the orange line (S&P 500 stocks) and the green (Euro Stock 50) fluctuate a lot.

The worry about China is not irrational and is based in fact. China's economy will grow slower than it was expected to, and that will spill over into slower global economic activity and slower world demand. But this is nothing new. Everything is cyclical, and economies naturally have recessions, slow periods, periods of modest growth and boom times. Economies chug along, life goes on and most companies keep paying their dividends, making products people will buy and doing that profitably. My point in this missive is that all this fluctuation is normal and good. Recessions let poor-producing industries and companies reorganize, retool or sell out to a stronger competitor. Some companies need to fail, not because they are "bad" but because they are producing stuff that is no longer relevant. Henry Ford put buggy manufacturers out of business.

People often are unable to see that the future is a bright and wonderful place. Rather, they see the problems and some see the "good ol' days" as good. But my school teacher, a Depression-era mother, gets mad when people will talk about the "good ol' days." She says, "good ol' days,



Data Source: Bloomberg

huh? Women could not vote, blacks could not sit next to me on a bus, my school friends were killed in WW2, kids I taught were killed in Vietnam, presidents were getting shot and killed, race riots were happening. I will take today's problems any day." Yes what we have are gridlocked political systems, governments printing money, China, Greece, the Euro, Donald Trump and immigration issues, but the economy will go on. This all creates opportunities for the thoughtful to profit and increase their security. In times of stress (perceived or real) it seems that money is transferred to the wise who think long-term from those who panic and say "My risk tolerance has changed, sell everything, until things look brighter." The perception is that fluctuating currencies, Greece and China will have a big effect on "all" investments – the truth is they won't.

There are only a few times where I have been more optimistic about our clients' future investment returns. The recent selloff and years of economic growth since the financial crisis in 2008 have created real value and many bargains in both the stock and bond markets. Yes, we believe that the economies of the world will be slow, the forces of currency will be in unrest, and government interventions will cause significant short-term volatility. Today, based on most any measure, dividend yields, price to cash flow, price to net asset or private market value, the stocks in client's portfolios are priced right to perform into the future. Bottom line: We at FIM Group see the recent selloff as a opportunity, just like we did during the Black Monday crash in 1987, the GFC of 2008 and other selloffs. This is not a time to be ruled by fear. Rather, it is a time to be ruled by pragmatic, thoughtful forward-looking optimism. There are many great companies and great investments selling at great prices.

Linda Brezezinski celebrated 35 years with FIM Group in 2015.

China's Financial Chop Suey

By Zach Liggett, CFA®

China has grabbed much of the financial media spotlight this summer. Weaker economic data, wild swings in its stock market and currency policy changes came together quickly these last few months, like a big plate of financial chop suey for business leaders and investors to digest. As a number of questions about China have come up in recent client meetings, I thought I would tackle a few here this month.

Q: What's the deal with China's stock market this summer and the government's heavy-handed response?

A: China's stock market (as represented by the Shanghai Composite in Figure 1) doubled in less than seven months. The rapid ascent began last November after Chinese policy-makers responded to an economic slowdown with a mix of interest rate cuts and fiscal stimulus. More than 80% of China stock market trading is done by individual Chinese investors, many of whom had their first taste of margin trading (i.e., making leveraged bets), so we probably should not be too surprised that once the market train got rolling, it REALLY got rolling. What did come as somewhat of a

Data Source: Bloomberg

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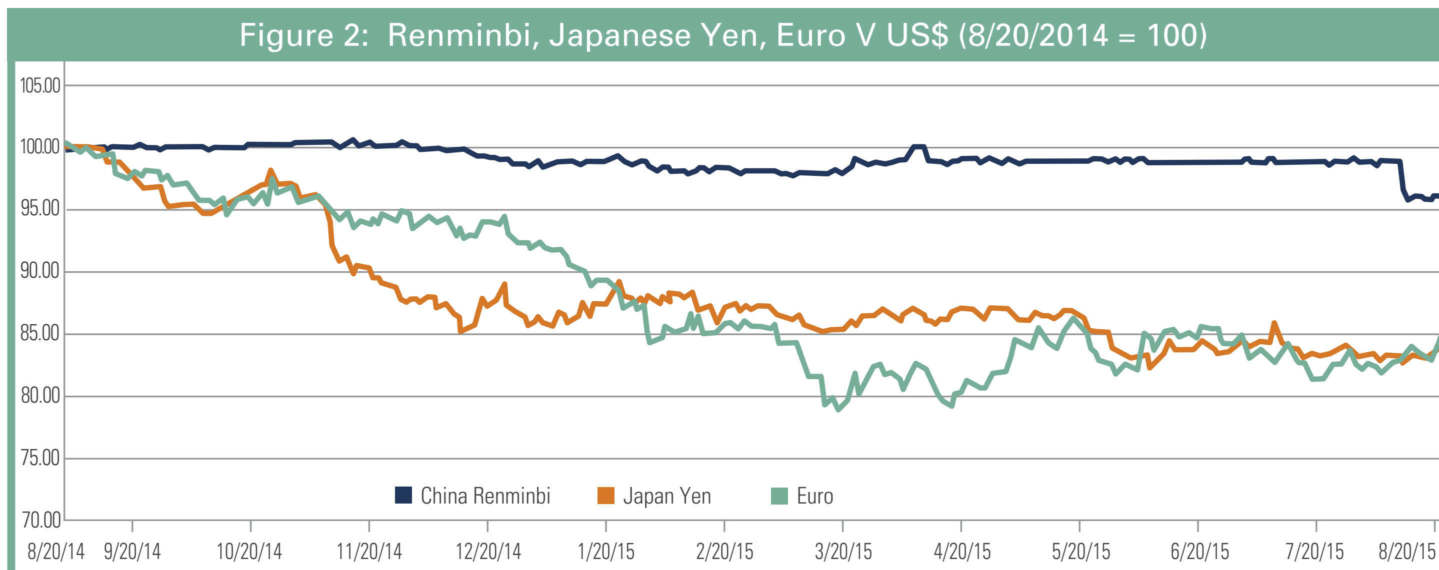
continued from page 3

Figure 2: Renminbi, Japanese Yen, Euro V US$ (8/20/2014 = 100)



Data Source: Bloomberg

surprise was how the Chinese authorities responded to the correction that ensued once the upward momentum faltered. In a nutshell, they pulled out a barrage of market-propping tricks, from halting trading in hundreds of stocks, to banning short sales, and even feeding cash to Chinese brokers so they could buy shares. While these measures provided short-term support to stock prices, they raise the question of how serious the Chinese government really is when it comes to liberalizing its control over Chinese capital markets.

Q: Should we expect China's stock market slump to have a negative impact on the Chinese economy?

A: That's the 10-trillion-dollar (China's 2014 GDP in US$) question. We have a precedent of sorts in that China's stock market went through a similar boom/bust in 2007-2008 with little impact on economic measures like retail sales and industrial output. According to data from Matthews International Capital Management (a leading institutional investor in China), China has "only" around 50 million active investors, which equals roughly 4% of the population. As the majority of these investors have less than US$15,000 in their accounts, it would seem that leakage into the real economy (via a negative "wealth effect") should be fairly minimal.

Q: And what happened more recently in the currency markets?

A: Listen to the likes of Senators Chuck Schumer and Lindsey Graham and you would think China's policy actions taken in August were another round of no-holds-barred financial warfare. What actually happened is that China took a step toward letting its currency be set by the market, which is exactly what the West has been asking it to do for decades. Since 2005, China's central bank has "fixed" the exchange rate of its currency, the renminbi, with a formula largely tied to the US$. On August 11, it announced that this fixing would be allowed to be more of a market-driven rate, although still managed by the central bank.

The result of this change was a devaluation of around 3%. Bear in mind that the renminbi has appreciated to the tune of nearly 25% against the dollar over the last decade, so we probably shouldn't buy into The Donald's view just yet that China's move will "suck the blood out of the United States." In fact, if you look at the devaluations over the last year in the euro and the Japanese yen against the dollar (both more than 15% as shown in Figure 2), you might wonder why China gets picked on while other governments get a pass. Now don't get me wrong, there are plenty of economic gripes to be had with China, including insufficient respect for intellectual property rights, arbitrary "antitrust" rulings against U.S. companies and the like. But at least in this situation, it seems to me that the China-as-Big-Bad-Currency-Manipulator meme seems a bit disingenuous.

Q: How does FIM Group view investment risks and opportunities given the latest developments in China?

A: As we've stated for many quarters now, our "base case" economic scenario is one of slow-at-best global economic growth. This view is partially a function of trends we are seeing in China. Currently ranked as the world's second largest economy (on some measures #1), China's economic health is increasingly interlinked with the rest of the world. For example, China's massive stimulus and its willingness to let its currency appreciate coming out of the 2007-2008 global financial crisis was one reason much of the world did not get swept into a deflationary depression. Now, though, with Chinese policy-makers purposely down-shifting the economy to a more sustainable (and slower) growth trend, that tailwind is becoming a headwind for many parts of the global economy. We've already seen the impact of this slowdown in the form of slumping global commodity prices and weaker trade with China. If the current China slowdown trend continues, we would expect downward pressure on global interest rates and inflation to also continue. In such an environment, our broad mix of fundamentally solid income-paying holdings on both the equity and the fixed-income sides should do well.

Our direct China investment exposure (Chinese-headquartered companies listed in Hong Kong, Singapore or elsewhere) is very modest at the moment (and mostly in the Growth and Balanced strategies), although we continue to hunt for high-quality investment candidates there. We expect that China's economy, despite the current slowdown, will likely top most other economy growth rates for years to come. And within a Chinese economy growing in the mid-single digits, we expect certain sub-sectors like e-commerce, healthcare, transportation infrastructure and environmental services to grow much more robustly.

One wild card is the extent to which a China economic slowdown will have on companies (and national economies) that have benefited from its rapid ascent over the last decade. To date, the slowdown has been brutal for commodities (like copper and iron ore), the stock prices of their producers, and the currencies of the countries where these producers are based (e.g., Australia, Brazil and Canada to name just three). As the global economy muddles through and as China makes further adjustments away from an export-driven economic model to one more geared toward domestic consumption, it seems reasonable to expect that downward pressure on commodity prices may be with us for awhile.

Another possibility that we are carefully reviewing is that of further renminbi depreciation against the dollar and the daisy-chain impact that may have on other Asian currencies like the Japanese yen, Singapore dollar, Thailand baht, South Korean won and Vietnamese dong. We currently have some investment exposures to these currencies and have been reassessing these holdings against the scenario of a potentially prolonged period of dollar strength.

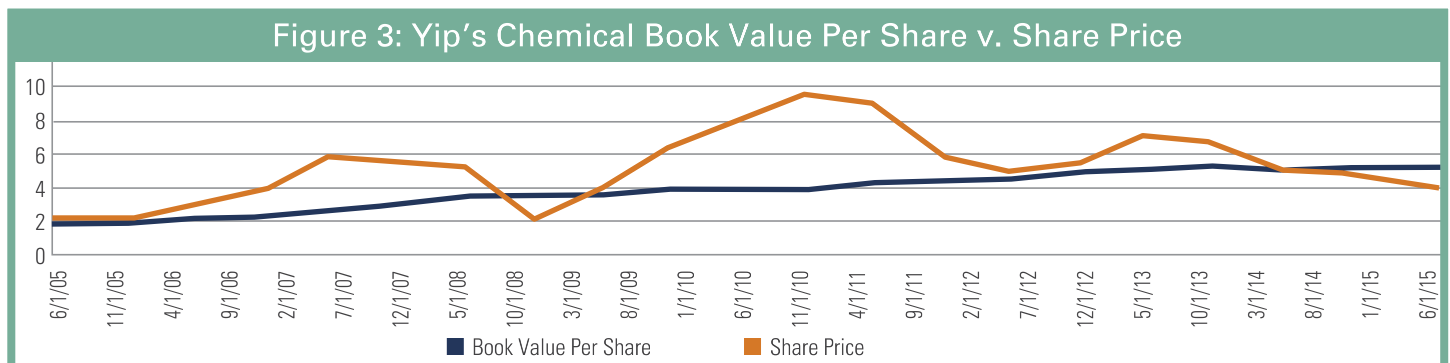
Q: Can you give an example of a current (as of August 19) China-related holding in FIM Group-managed portfolios, and what, if anything, has changed with your investment thesis?

A: Yip's Chemical (ticker YIPCF) is a stock we hold for select accounts primarily in the Growth and Balanced strategies. Yip's is listed in Hong Kong but does all of its business in China as the world's largest producer of acetate solvents. The company produces mostly eco-friendly industrial organic solvents used in areas like paints, inks, medicine and adhesives along with other related products. Although revenues were down about 9% for the first half of the year on continued pricing pressure, profit margins are moving higher thanks to management's restructuring initiatives put into place last year. As a major new solvent plant comes online in the second half of this year, we expect revenues, profits and cash flow to improve further. Such improved financial fundamentals should support dividend growth in the medium-term from an already attractive 6% yield today. As Figure 3 shows, Yip's has been a steady grower of book value and has rarely traded below book like it has in recent months. We will be closely watching profit margin trends in the quarters ahead and will look to add to our position on China-economy-related weakness given the strong management team and strategy now in place.

Q: Any final thoughts on the China investing theme?

A: Clearly I've just scratched the surface when it comes to the issues surrounding China-related investing. It seems likely that even with the slowdown in its economic growth trend, this massive country will provide investors with ample opportunities for years to come. Sifting through the financial chop suey to identify these opportunities takes patience and discipline, but the rewards can be well worth the effort. Our team's approach remains one of being highly selective and focused on the same things we look for in our investments around the world: Shareholder-aligned and ethical management teams, strong competitive positions, solid balance sheets, significant cash flow generation, and prices that provide us with a sufficient margin of safety.

Figure 3: Yip's Chemical Book Value Per Share v. Share Price



Data Source: Bloomberg

Happiness Is a Down Stock Market

By Jeff Lokken, CFP®

Thirty-two years is a long time. Amazingly, I have been blessed to have served that long in the financial industry. However, all days in the stock markets are not "good days." As we are currently witnessing, stocks and the indexes that are comprised of stocks can be volatile. It was only seven short years (2008) ago that most world stock markets dropped about 50%. Bear markets and corrections can be hard on investors, especially when they "expect" to avoid downside volatility. Frankly, if you are a stock market investor, you cannot avoid periods of losses unless you are just lucky. As a stock investor you must be able to withstand the emotional response to short-term or temporary losses by selling at the wrong time and thus making your losses permanent.

The behavioral response that stock "investors" have to down stocks markets has always fascinated me. In particular, selling when everyone else is selling. It is not rocket science to know that it is best to buy when prices are low. Usually prices are low when "everyone" is selling. Thankfully, the marketing "experts" of the financial news and Wall Street let us know when markets are down with report after report of how "bad" stock prices are dropping. Buying when prices are low requires a disciplined investment behavior and not an emotional one.

In light of recent events, I wanted to share with our clients a few characteristics of a disciplined investment approach that I have learned over the last 30+ years. Each one is taken into consideration on a daily basis by the FIM Group investment management team.

1. Be happy when prices fall, because you can buy great companies at low prices. View this as an opportunity, not as punishment. One true characteristic of a successful investor is happiness in down markets.

2. Always keep some cash around for emergencies so you aren't forced to sell stocks at the wrong time (i.e., when prices are low).

3. If you aren't living off the income of your portfolio or have cash on the sidelines, keep buying on stock market weakness. The principal of "dollar cost averaging" is simple and has proven successful. If you invest regularly, you'll buy more shares when prices are down and less shares when prices are high. This is a natural risk reducer.

4. Don't pay attention to the daily financial news. The financial news is driven by readership/viewership and overly hypes the negatives. Why? Frankly, it's good for them. The financial press doesn't know you or your goals, but they do know that bad news drives clicks and moves papers.

5. Always have a globally diversified portfolio that generates income from dividends and interest.

6. Pay attention to long-term cycles, not short-term cycles. Bull stock markets last about twice as long as bear markets. Short-term thinking results in investment schizophrenia. "Buy *this* today and sell *it* tomorrow" is destructive to long-term wealth accumulation. Not to mention the fact that it's emotionally draining.

7. The price you pay for a capital asset, like a stock, is an important decision. Don't just buy great companies, buy great companies at a low price. Overpaying for a capital asset never makes sense.

8. When the majority of money flows to one or two asset categories (like large cap or small cap U.S. companies as it did prior to this last correction), bad things happen. Successful investing can be very lonely because you are being a contrarian to the "market." Enjoy the time alone because patience will reward you.

9. Macro economics are really interesting but often a waste of time. The direction of interest rates of the Federal Reserve, inflation, gross national product and many other macro factors are interesting, but mostly academic. As humans, we have limited time and cerebral capacity, so your thoughts and time should be "spent" on those things within your decision control … like the price you pay for an asset.

10. Forget market timing and investment formulas ... it's impossible to time the market or create a formula to make all the right decisions. It would take 100 newsletters like this for me to even list all the occasions I've seen this proven in the 30+ years I've been in this industry.

11. Be patient with the companies you own. Focus on the how the company is being managed, its products, sales and marketing over the long term. Rome wasn't built in a day.

12. Be a long-term investor.
Time is your ally.

Fundamental investing is a discipline and not well-served by being emotional or short-term-orientated. You must focus on the right things and be patient. After more than 30 years in the wealth management industry, I can be happy in a down markets because I know that is when real wealth is created. Thank you for letting all of us at FIM Group help you be happy in down markets too!

Investment Team Spotlight: Technopolis Oyj

Technopolis Oyj (Ticker: TCOSF, http://www.technopolis.fi/en)

Share Price | Market Capitalization (08/20/2015): €3.69 | €394mm

TECHNOPOLIS

Company Description: Technopolis Oyj is a Finnish real estate and services company with operations in Norway, Finland, Estonia, Lithuania and St. Petersburg. Technopolis campuses focus on knowledge-intensive entities where attracting professionals is more competitive. This allows Technopolis to leverage its unique business model, one that is more service-oriented than peers in the region. In turn, this has led to stickier tenants. Technopolis plans to expand organically and geographically within the Nordic/Baltic regions. Currently it has 20 campuses, 1,700 customers, 232 employees and rentable space of 738,100 m^2.

Investment Thesis: We believe that in Technopolis Oyj we have found an entity that, through market cycles, will consistently grow and provide solid shareholder returns/yields. Technopolis has proven to be skilled at acquiring underperforming assets and quickly capitalizing them. Management has been prudent with shareholder capital; it recently walked away from a deal that saw terms changing dramatically as negotiations were wrapping up. Additionally, while Technopolis sees great long-term opportunity in Stockholm and Copenhagen, patience is being exercised in finding an entry. FIM Group's largest fellow shareholders are Varma (23.9%) and Ilmarinen (10.4%), the massive Finnish pension entities that have proven to be calm, long-term investors. In other words, the shareholder base isn't pressuring management to make a deal; management is being given the support needed to prudently execute the company's long-term strategy.

A key part of Technopolis' strategy is to acquire/build campuses that are expandable and in good proximity to public transportation. This foresight has afforded Technopolis a solid organic growth pipeline while it scours Sweden and Denmark for its next big opportunity. Technopolis' recent expansion into Norway is doing great (giving it scale to expand there), as are its Baltic assets ... and perhaps to the surprise of many its St. Petersburg campus is firing on all cylinders at 99.1% occupancy. Services are integral, in its opinion, to creating sticky tenants; most recently service revenues were up 18.1%.

Technopolis is trading at ~ 80% of its net asset value (NAV), while regional peers are trading at ~126%, ~72% of its book value versus peers at ~119%, ~8.5x 2015 estimated earnings versus peers at ~21x, and expected to yield ~4.1% versus peers at ~3.4%.

We deem this discount to NAV to be unjustified given management's proven track record, high occupancy rate (94.1%, expected to climb), low dividend payout ratio (it could double) and expected yield compression in its markets (lower yield on peer assets = higher valuation, leaving upside in the NAV).

In Technopolis you are getting a prudent management team, patient board of directors and a company growing assets/revenues/earnings/dividends all at a discount.

Data Sources: Management Meetings, Company Filings, Bloomberg, SEB.

InvestNews

FIM group

CELEBRATING 25 YEARS OF SERVICE

FIM GROUP INVITES YOU TO

InvestNews - Question & Answer

Q: I noticed on my most recent statement there is a lot more "idle cash" in money market than normal. Why have so much cash?

A: The current higher than normal cash levels in portfolios we manage is an intentional but temporary condition. We are not using cash passively as an asset class allocation decision. That is not always the case but it is now. When money markets are paying rates well above the rate of inflation plus the cost of management

Q: Why have there been several sells in the past few months but few "new" buys?

A: See 3) to the left. We have several planned investments in our sights but after completing our "in office" homework on these investments we want to do additional due diligence on all of them. In the mean time, we do not wait to sell investments that warrant being sold.

Q: Why has the yield declined in my portfolio?

Announcements

SEE OUR SUMMER 2015 INVESTMENT WEBINAR REPLAY AT www.fimg.net

Members of our team reviewed some of the key "big picture" forces in financial markets today including recent volatility in foreign currency and commodity markets. We will discussed recent portfolio actions and our ever-evolving portfolio strategies.

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