

MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

4th Quarter, December 31, 2015			
	12/31/2015	% Change 4th Quarter	% Change Year to date
Dow Jones Industrials	17,425.03	7.70 % *	0.21 % *
S & P 500	2,043.94	7.04 % *	1.38 % *
Russell 2000	1,135.89	3.59 % *	- 4.41 % *
S & P 500 Value	876.09	6.05 % *	- 3.13 % *
Russell 2000 Value	1,380.60	2.88 % *	- 7.47 % *
BC Aggregate BD Index		- 0.57 %	0.55 %
10 YR Treasury Yield		2.269 %	
30 YR Treasury Yield		3.015 %	

* *Includes reinvested dividends*

Value versus Growth

Reflecting on difficult markets that have unfolded over the last 30 years, we found it particularly interesting to review a piece we wrote on March 3rd of 2009 when the markets were in the midst of a grinding decline with no end in sight. The article was titled “*Cycles not Trends*” and presented the basic argument that there is very little to be gained by simply extending the current trend lines and assuming that it defines the future. For those disillusioned by the current markets, it might be reassuring to revisit that article which is reproduced in its entirety under the information tab on our website, www.rodgersbrothers.com.

In today’s markets, it is equally futile to speculate exactly where the price of oil might bottom, or what shape economic policy in China might take or what political whimsy might move the Federal Reserve. Rather than guessing what will drive future markets, we believe that Value Investing, which is based on fundamental analysis, best serves investors.

From 2001 through 2008, after a tech bubble burst and a US recession, Value Investing outperformed Growth Investing. Since the depths of the economic crisis in 2008 however, Value Investing has been out of favor and Growth Investing has been in vogue. On December 16th, 2015 the Federal Reserve raised the Federal Funds rate, and for the first time since the financial crisis, there is now a cost to borrowing. We think this date is significant in terms of the investment style cycle.

There is a correlation between interest rate movements and investment style cycles. While Growth Investing dominates in periods of loose monetary policy, Value Investing tends to outperform in periods of rising interest rates. We strongly believe that we are at an inflection point in the markets

and that Value Investing will supplant Growth Investing over the next decade. The downturn in the markets in the first few weeks of the year may be a sign that the markets are beginning to transition from Growth to Value. In distressed markets, Growth investors, particularly leveraged Growth investors, will pause to reevaluate their growth forecasts. At the same time, Value investors will dig deeper to discover stocks trading below their intrinsic value.

The hallmark of Value Investing is buying when there is a serious dislocation between price and value. Value stocks by nature have higher dividend yield and lower price to earnings ratios. In addition, Value stocks tend to have paid a dividend on a consistent basis over many years as demonstrated by the chart below.

Security	Current Price 1-20-16	52 Week Range	Dividend Yield	Dividend Paid Since
Abbott Laboratories	39.96	39.00 – 51.74	2.60%	1926
Cummins	84.24	79.88 – 148.04	4.63%	1948
Emerson Electric	42.64	41.25 – 62.75	4.46%	1947
National Fuel Gas	42.12	37.03 – 69.00	3.75%	1903
Procter & Gamble	75.83	65.02 – 91.69	3.50%	1891

In periods of heightened volatility such as we are experiencing in the new year, markets overreact to both good and bad news. As a consequence of the 2008 financial crisis and resulting regulations like the Dodd-Frank reform, liquidity has been reduced in the markets. Large institutional firms used to hold inventory and so make “deep” markets. Today, these large institutional firms hold almost no inventory and rarely support or defend a bid/ask price. The resulting lack of liquidity has spiked volatility, always more noticeable (and painful) in declining markets.

Price discovery is now a much more violent process. Value investors provide the ultimate liquidity and eventually provide the buying which will set a bottom. Prices become so discounted that Value investors will eventually buy significant blocks of stock or, like Warren Buffet, attempt to purchase the entire whole company. In 2015, Warren Buffet entered a bid to take over all of Precision Castparts because he believed the company was significantly undervalued. Precision Castparts jumped \$38 that day.

Value Investing has always been at the core of our investment philosophy and will continue to shape our stock selection. As part of this transition from Growth to Value, value stocks like the group noted in the table, should provide superior returns. We believe these stocks at current levels should provide 25% total return over the next two years.