July 12, 2016

"Parting is such sweet sorrow"
-Juliet

The second quarter was full of eye-catching headlines; from Trump's domination of the Republican primaries to Britain's decision to exit the European Union. In addition, the Federal Reserve has put the brakes on additional rate increases after making an initial move toward normalization last December. Opinions that would have been considered conventional wisdom at the beginning of the year have been upended. With so many eye-catching headlines it is understandable that investors have become anxious. Our investment discipline helps us avoid being whipsawed by market sentiment and we're remaining focused on business fundamentals as we work through this period of uncertainty.

Since the beginning of the year the S&P 500 has moved in a range from 1810 on February 11 to the new high today of 2154. That is a range of 19% although the stock market is up only 5% as of today's writing. The damage done to active traders is evident when reviewing the performance of hedge funds, with the typical fund being down year-to-date. Spencer Jakab, a writer for the Wall Street Journal, has just written a book "Heads I Win, Tails I Win" in which he warns investors of market timing, while also providing a rebuttal to the pundits who rile longer term investors.

The cornerstone of our investment discipline remains one in which we emphasize purchasing well run businesses that are generating solid free cash flow and reinvesting those funds in shareholder friendly activities. There are times when businesses sell at a premium to historic valuations and this is one of those periods. However, when faced with the option of buying stock in a well-run business that has the potential to grow in the future or purchasing a US Government Treasury bond yielding 1.36% over 10 years, is there really a choice? We think the current interest rate environment is forcing investors into stocks (riskier investments) and that this will serve as a floor under stock prices while investors wait for stronger economic conditions to drive business sales and stock prices higher. Until that time arrives, the market is likely to remain in a trading range.

During the quarter we took advantage of market volatility to upgrade some of the positions in client portfolios. We established a position in Goldman Sachs, a blue chip financial company, because it had sold off during the market swoon and we felt it presented good long term value. We also added a position in Paypal Holdings, a leader in online and mobile payment systems. Our position in Paypal represents an extension of our investment theme into cashless transactions that we began with holdings in MasterCard and Vantiv Corporation. We sold the remainder of our long term position in Apple which we began reducing last fall. There are too many signs pointing toward weak iPhone sales to ignore over the intermediate term. Lastly, in early July we sold our investment in Hershey when it became the target of an unsolicited takeover attempt by Mondelez. We felt it was better to take the profit than to wait to see if the Hershey Trust, which controls the company, would agree to a deal.

As we enter the second half of the year we are monitoring the economic environment in which our businesses operate. GDP growth in the United States remains lethargic, stuck in the 2% range. We are encouraged that the labor market continues to show signs of improvement. Stability appears to have returned to the energy market which should support better reported results for the broader market in the second half of the year. Regarding the BREXIT vote, we believe businesses and countries will still seek to do business with Britain. Any separation from the European Union will occur over a number of years and new treaties and trade agreements will be created. Longer term, the BREXIT vote, along with the surprising political success of Mr. Trump and Mr. Sanders, signals a broader wariness of the challenges of a global economy in which jobs move offshore with no immediately visible benefit. Time will tell how this plays out in the coming decade.

As always, thank you for entrusting Ayrshire Capital with the management of your money. We look forward to speaking with you in the coming quarter.

Sincerely,

JM Sam Nevin, Jr.
Managing Partner