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"Too much of a good thing is wonderful!"
…Mae West, circa 1927

We know what two of a kind is. Even three in a row: a trifecta. If there is a person among you who knows the word to describe six consecutive events, we would appreciate a call. In the interim, we will take the liberty of borrowing a term from the maternity ward: a sextuplet. For that is exactly what the stock market delivered (no pun intended) from 2009 through 2014: six consecutive up years. There is only one other occasion in history when this occurred: 1898 through 1903. The rarity of this factoid raises the obvious question. How did year seven fare? Not so well: *down 18%.* But in modern times, breaking our sextuplet with an 18% set-back wouldn't even classify as a bear market (down 20%). So we are siding with Mae. Too much of a good thing is just fine with us. Let's go for the record!

2014: Good News / Bad News

The year was a challenging one for most investors, ourselves included. As late as mid October, the Dow was actually down for the year by over 4%. With weeks to go the market rallied on the back of lower-for-longer interest rates, strong third quarter earnings and lower oil/gasoline prices, a boon to consumers. The Good News>> One of the leading sectors of the market for 2014 was large cap technology, a space in which we were well represented. The Bad News>> We (meaning you) were also well represented in oil and gas stocks. As these things often go, the bad outweighed the good with the result that our clients' portfolios tended to give up a good portion of the progress made in the first three quarters. To be candid, we had no scenario for crude to fall from $105 a barrel in the Spring to $44 a barrel at this writing. We find ourselves grasping to explain that which we never saw coming: always a challenge. This writer has chosen to do what most writers do: leave the job to someone else. In this instance, that someone else is Spence Partners' own Chris Klavins who has developed a piece laying out the case for energy in the enclosed first edition of The Klavins Report. (My personal thanks go out to Chris for taking on this unenviable task and especially for not selecting the name Klavins Korner for his commentary.)

Actively Passive

One of the questions we occasionally receive revolves around the merits of index funds. When stocks perform as they did in 2013 through 2014, plenty of portfolio managers had superb years. Whether you were invested in individual companies or an index fund which mimicked the S&P 500 mattered little. What did matter was that you owned stocks (and preferably US stocks) to the exclusion of nearly everything else. With stocks no longer representing the value proposition which they once did, 2015 is a great time to visit the question of active investing (selecting individual stocks to own) as opposed to passive investing (index funds).

Let us stipulate at the outset that indexing does have two obvious merits which many people value: wide diversification and low costs. We believe in diversification (note the absence of *wide*) and respect the reality that fees constitute a headwind to the returns you earn. Then there is the fact that most money managers struggle to beat the market averages. So, if you can't beat index funds, why not join 'em?

The views presented herein are solely those of Spence Partners, and do not necessarily represent the views of RBC Wealth Management. Current status of issues discussed in this letter is subject to change based upon market conditions and industry fundamentals. Clients should work with their Financial Advisor to develop investment strategies tailored to their own financial circumstances. Past performance is no guarantee of future results.

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Given that we make our living picking stocks, among other activities, we may not be the most objective source to address this question. With this disclosure, our case for doing-what-we-do-in-the-way-we-do-it (a personal record for hyphens) follows.

- There is a concept in investing called "risk adjusted returns." What this term basically translates to is that stocks do not present a constant risk proposition. In some environments such as 2009, stocks sell cheaply in relation to virtually all metrics such as earnings, growth rate, book value, dividends etc. On other occasions, such as 2007 and today, stocks are priced expensively in relation to these same yardsticks. One of the jobs of an active manager is to adjust as necessary the funds which are invested in riskier assets (stocks) vs. those in safer categories such as shorter term CDs. The process is not market timing but rather allowing valuations to determine asset allocation. We do not compete with index funds in this space.

- Dividends: we like them. In recent years the S&P 500 and the index funds which mimic them have collectively produced a dividend return between 1.6% and 2.1%. Without much difficulty, we have been able to assemble portfolios with dividend returns meaningfully above those produced by the indexing crowd.

- International investing is a relatively modern invention. As recently as fifteen years ago, it was rare to see offshore companies listed on the NYSE. I can recall getting up at 4 am for weeks while we accumulated a large position in a stock traded only in Amsterdam. How all of that has changed. We appreciate the ability to hunt for quality companies selling at what we believe to be bargain prices whether they are carried within the S&P 500 Index or elsewhere.

- Earlier I referred to a nuance between being diversified and widely diversified. I believe we can all agree that owning a portfolio of 500 stocks would fit nicely into the definition of wide. As I have said, we believe in diversity. Just not 500 times. With exceptions, most of our clients' portfolios contain between twenty and thirty stocks. We feel this balance provides adequate diversification while still enabling us to concentrate your capital among the best situations we can identify. A similar approach, though one that is too concentrated for our tastes, is the old Dogs of the Dow strategy which involves taking the ten highest yielding stocks from the preceding year and owning those to the exclusion of the other twenty. Effectively capital is concentrated in large and mostly domestic companies which are down in price and most likely up in yield. This strategy doesn't outperform every year, but its long term track record is impressive and often market beating.

- We chose to title this discussion on indexing Actively Passive. Our last point is that being an active manager does not infer high turnover. This is not about trading. It is about holding a carefully selected list of quality companies, usually for years, and allowing management and the assets they run to do their thing. In this regard, there is very little difference between what we do and the conduct of index funds which are, by their nature, static.

Please accept our best wishes for a healthy and prosperous 2015. We look forward to seeing you and speaking with you in the weeks and months ahead.

The Klavins Report – Musings from Outside the Corner Office

Energy stocks have been core holdings for years. While there has been the occasional investment dry well, quality energy companies have been wealth creators. However, in 2014 the wheels came off of oil and gas *as commodities* leading to energy becoming the worst performing sector of the market. Given this shellacking, you may be wondering what attracted us in the first place. Great companies which are also great investments possess many of the following characteristics: more money coming in the door than going out, good management, a growing stream of earnings and dividends and a prudent amount of debt. If there is any art in this process it is buying companies with these attributes and adding to them when they are out of favor. The operative question going forward is: what now?

Over the course of our careers, we have been rewarded by being courageous in the face of controversy. There is no sector today more unloved and controversial than energy. Clearly we cannot know how low oil and gas prices will go or how long the bottoming process will take. (But it generally takes long enough to try even a long-term investor's patience.) We do know there are forces which will help to move the healing process along. A few which occur to us are…

- Low oil and gas prices will tend to stimulate demand.
- Global consumption of energy was growing at about 3% a year in spite of sky high prices and limited supply. This rate has slowed but our analysts still expect overall worldwide growth.
- Higher cost exploration will be postponed, slowing the increase in supply.
- Land acquisition and drilling costs are falling.
- Instability in important oil producing countries: Iraq, Libya, Nigeria, Venezuela, Brazil, etc.
- Some energy companies which borrowed aggressively to support exploration are not likely to make it through the commodity collapse. Their assets will pass through lender's hands and will almost certainly be taken up by more insightfully managed operators. The latter will have the ability to meet debt obligations and withhold production *until* pricing improves.
- Then, the proverbial ray of hope… Talking heads have commented that the last five times oil fell by 50% or more, six months later it had rebounded by at least 50%. While the past is not necessarily prologue, if directionally correct, this certainly bodes well for energy stocks.

There are portfolio managers who, when faced with a performance shortfall, will deviate from their normal investment philosophy in an effort to catch up. A similar motivation causes some individuals to jump out of one fallen five star fund into another based on how well the new fund has done in years past: the functional equivalent of driving with your rear view mirror. We do not view this as a recipe for success. Nor is it in our DNA.

As such, we believe it best to stick to our knitting, which means paying close attention to valuation, cash flow and balance sheets. As the commodity market does its job in searching for the "right" price for oil and gas, we expect to see the stocks for better energy companies follow suit. Industry adjustments are occurring and will continue. The strongest companies will likely feast on the weaker: the stock market's version of the law of the jungle. Warren Buffet describes the process thusly, "Be fearful when others are greedy and greedy when others are fearful." Seems pretty scary out there to us. *Good news!* By and large, this approach has served us well over many years.