January 19, 2017

Dear Fellow Investor:

2016—what a year! (For investors, at any rate.)

The stock market kicked off with one of the worst Januaries in history, a gut-wrenching plunge reminiscent of the dark days of 2008. The Standard & Poor's 500 Index finally put in a bottom in early February and by the end of June was marginally higher than it had been at the end of 2015. Then ensued two large and on the face of it counterintuitive upward thrusts, the first following the Brexit brouhaha, the second following the almost entirely unanticipated election of Donald Trump to the U.S. presidency. When all was said and done, the S&P 500 increased about 9.5% last year, 11.96% with reinvested dividends. The U.S. market outpaced virtually every other major market save the large-capitalization, export-oriented Financial Times Stock Exchange 100 (F.T.S.E. or "footsy" 100) of the U.K. Bonds and commodities such as gold trailed noticeably. The hedge fund universe suffered yet another sub-par year and *The Wall Street Journal* reports that fully 75% of active equity managers missed their benchmarks in 2016.

So it is my great pleasure to report that the accounts for which we are responsible, which are almost entirely invested in U.S. equities, outperformed the broad U.S. market, and hence, most of the rest of the world. Our accounts were up mid-to-high teens for 2016, with a handful (mostly older accounts) spilling into the 20%+ zone and another handful (mostly brand new accounts) closer to the market averages.

The two big market-moving events in 2016, Brexit in the U.K. and the general election in the U.S., triggered results that no one I know would have anticipated. In both cases we witnessed "the revolt of the deplorables"(to borrow a term from Hillary Clinton),older middle and working-class folk without advanced educational degrees, against their erstwhile superiors, the putative elite, the cosmopolitan "adorables".   Practically every expert consulted—and many were consulted-- predicted disaster should the U.K. decide to leave the European Union—but anyway, it would never happen. Sure enough, in late June, markets around the world sold off—for all of two days! Followed by, here in the U.S., a series of record high closings.

The next great uncertainty faced by our market was the U.S. election, particularly the selection of a new president. I told you in my last letter that markets hate uncertainty and that there was no more familiar entity out there than a politician with the last name Clinton. Thus I thought that a Clinton victory, forecast by the overwhelming majority of forecasters by overwhelming odds, would be cheered by the markets while a Trump triumph would most likely be met with disapproval. Well, I was right, but only for a few hours.

There's been lots of maintenance construction going on at the Lewis house lately, so on election night, Diane and I found ourselves without a TV. Friends invited us over to watch the election with them, but, we figured, you're not going to know anything until late anyway, so we'll just go to bed and in the morning read the newspapers to find out by just how big a margin Hillary won and whether or not the Republicans succeeded in holding on to the Senate. (Most said they wouldn't.) Just as we were climbing into bed, the phone rang, and it was Justin exclaiming, "This is crazy (the actual term he used was not "crazy", but is not printable in a family investment letter)!! He might just win!" I went ahead and went to bed, but got up at about 3:00 A.M. I thought, well, I'll just check my trusty IPad to see how things are going. 20 minutes earlier, Clinton had called Trump to concede, and now Dow Jones Industrials futures were down *880 points!*

I got to the office early Wednesday with my helmet firmly in place, greeted Tom, Jeannine and Justin with their entrenching tools, and braced for the kind of day we've experienced far too often in the last decade. The market opened down, but not by nearly as much as the futures had indicated at 3:00 A.M. By closing time, the market was actually *up.* Subsequently we vaulted from new high to new high. Even in the ensuing consolidation, ongoing at the present time, the averages barely budge to the downside.

Gusto is not limited to stocks. This week's *Barron's* tells us that, "The National Federation of Independent Business last week reported that its optimism index saw the biggest one-month increase since July 1980, rising some 7.4 points after November's 3.5-point gain…[taking] the small-business confidence gauge to the highest reading since 2004. 'The December results confirm the sharp increase that we reported immediately after the election.'" The same article continues, "Consumers are similarly upbeat, with the University of Michigan last Friday reporting January's preliminary sentiment index hovering near the 12-year high reached in December. 'Both this measure and the Conference Board consumer confidence index are now back to levels last seen before the Great Recession, with recent moves by both showing that the election result is being viewed on balance in a very positive light…'". Even in dark-blue Massachusetts, the Boston NPR station reports small business confidence at decade highs since the election.

Now Trump enters office as the least popular president since polling on these matters began. His economic agenda, if enacted, could well lead to devastating trade wars, particularly with two of our largest trading partners, Mexico and China. His call for lower taxes and large infrastructure and military expenditures threatens to blow out an already imperiled Federal budget. Many of his policy proposals contradict one another or are simply inchoate. At a minimum they fly in the face of conventional economic thinking. So why all the enthusiasm?

My guess is that the election gave us not only Donald Trump as president, but also a Congress firmly in Republican hands. The gridlock and dysfunction in Washington since at least 2010 may finally be coming to an end. And, for the first time in a long time, a major global economy, the U.S., is embracing an unequivocally pro-growth economic stance. The received wisdom concerning a "new normal" of sluggish economic activity, and "secular stagnation" is about to be put to the test. A strong dose of optimism is a good start.

I recount the surprising investment outcomes of Brexit and the 2016 election in the U.S. to highlight what strikes me as the futility of trying to base long-term investment decisions on proximate geopolitical events. Markets are not machines into which you put certain ingredients and expect a predetermined product to pop out on the other side. Markets are made of sentient, thinking human beings who constantly alter and adjust actions, reactions and expectations as events unfold. The process is, as George Soros put it, "reflexive", a term he gets from certain French verbs (*je m'appelle...*) which act on themselves ("I call myself…"). I prefer to think of the process as *dialectical*, though by no means in the sense that Karl Marx uses the term. While we have to be cognizant of big historical events—we're all affected, after all—the inherent uncertainty of their outcomes makes them a shaky foundation on which to build investment portfolios.

At Weybosset Research we try to stick to fundamentals. When you invest in, say, a stock, you become part owner of a *business.* (If you own 50 shares of Johnson & Johnson you are a very small part owner, but you are part owner nonetheless). Over time if the business thrives, so shall your investment. If the business fails to thrive, it is unreasonable to expect the investment to do well. We find analyzing individual businesses the most reliable route to investment success. It's easier to find and research thriving businesses than to predict how investors all over the world will react to the election of, say, Donald Trump, however improbable his election may be deemed.

The second consideration is the price we pay for an investment. Any productive asset—an apartment building, a business, a farm—will produce only so much over its lifetime. As an investor, your return on such an asset will depend on the price you pay for it. That's where the markets come in—the market will, from time to time, offer us a desirable asset at an attractive price. We are happy to accept the offer.

This approach to investing has worked well for me, my family and for long-time clients for decades now, and it is the approach to which we adhered in 2016. We plan to stay the course, to paraphrase a prior president.

Thank you for your support in 2016 and we look forward to working for you again in 2017. We would welcome the chance to sit down with you and discuss your investment and financial goals. Don't be shy, call, email, snail-mail or send a carrier pigeon. Let's get together.

Yours very truly,

Fla Lewis III
Principal