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Seek Sunlight

By Bill Koehler, CFA

In February of 1916, now over 100 years ago, President Woodrow Wilson nominated an attorney named Louis Brandeis for a seat on the U.S. Supreme Court. Prior to his nomination, Brandeis also served as an economic adviser to Wilson, helping persuade him to create the Federal Reserve Bank and the federal income tax system in 1913. The nomination process lasted four long months, a record at the time, but the Senate eventually confirmed Brandeis 47-22. The lengthy nomination process is evidence that fighting between political parties over judicial nominations is not confined to the current day.

Justice Louis Brandeis ultimately served as a widely respected member of the U.S. Supreme Court for 23 years from 1916 to 1939. He was a big believer in public disclosure, particularly with regard to the practices of large corporations. His writings and influence on the court helped shape corporate communications and disclosures pertaining to fees, commissions and profits. He authored a number of memorable quotations. However, his most memorable is likely, "Sunlight is said to be the best of disinfectants."

Sunlight Equals Transparency

Like Justice Brandeis, FCI firmly believes in the benefits of sunlight. In fact, we like to use another word that, in

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our view, is synonymous with sunlight. That word is transparency. We believe transparency

is a foundational element for investment success. Along with concepts like accessibility and communication, transparency is imperative if an investor is to have a superior experience. The U.S. capital markets are the deepest and most trusted in the world primarily because

PERSPECTIVES

Fourth Quarter 2016

of the transparency, or sunlight, around the practices of our public corporations. Corporations are held to very high standards of disclosure and our legal system imposes stiff penalties for those that do not adhere to practices ensuring adequate sunlight.

Transparency and Clarity

We look for sunlight in the companies in which we invest. Do we have access to as much relevant information as possible about the company? Is top management as forthcoming as possible? Does the organization have a history of open, clear communication? As an example, we own shares of Under Armor in our Select Growth equity strategy. The company's founder and CEO, Kevin Plank, is known for his open communication with investors as well as company employees. He believes his clear communication with Wall Street and his associates regarding strategic direction and financial results leads to speed, performance and satisfaction. In our view, the transparency displayed by Plank and his management team has been a large part of their successful corporate strategy and enhanced profit growth. It has also contributed to the stock market awarding a higher price/earnings multiple in valuing the company than it might otherwise have with a less transparent approach.

Currently Seeking Sunlight

From a macro perspective, we are focusing on a number of key issues as the fourth quarter of 2016 begins. Two of these are the impact of Federal Reserve Bank policy actions and the ramifications of the upcoming elections. Interpreting communications from the Fed can be challenging as other voices beyond that of Fed Chair Janet Yellen must be considered. However, at the moment, the Fed is signaling it wants to raise interest rates by the end of the year. The Fed's last two policy meetings will be held November 1 to 2 and December 13 to 14, with no decision virtually guaranteed at the earlier meeting. As the Fed

Expanding Possibilities

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attempts to normalize interest rates, a key question will be how much market volatility the Fed will be willing to tolerate in the process. Our sense is that the Fed will continue to be extremely volatility sensitive. We tend to agree with former Fed Chairman Alan Greenspan who has stated that monetary policy has carried an outsized load in supporting our economic recovery since 2008. It is time for fiscal policy to contribute in the form of public service officials critically reexamining the nation's taxing and spending policies. These issues have been unaddressed in meaningful ways for years and thus underscore the importance of the upcoming elections.

November 8th

The presidential candidate that most responsibly communicates a coherent, transparent plan will have the best opportunity to persuade a majority of the independent voters in the next few weeks. At the moment, the capital markets view Hillary Clinton as the more predictable choice. As financial analysts, it confounds us that so little attention is paid, in the presidential and congressional races, to the national debt and deficit situations. The issue may simply be too abstract. Therefore, interest levels in the topic are not high. Another factor, as we discuss above, is that monetary policy has enabled fiscal policy to be ignored. Lower interest rates have made it much easier to service our national debt even though the debt has nearly doubled to \$19 trillion over the last eight years. While the majority of polls show Hillary Clinton leading at this point, we are in an unusual election year. It bears remembering that virtually all the polling before the Brexit vote in June was completely wrong.

Look Ahead

Taking all of the above into account, the American economic engine remains a resilient machine. It has continued to grow, albeit at a historically low 2.0% rate, since 2010 in no small way due to the creativity, ingenuity, optimism and grit of the American people. We are confident those qualities will remain engrained in the vast majority of Americans regardless of the election outcome, ensuing Fed policy or dislocation in the European banking sector. Through the first nine months of 2016, U.S. stocks and bonds are up nearly 8.0% and 6.0%, respectively. We remain U.S. centric

in our approach and feel it is not a time to be overly fearful. If economic growth can be sustained and earnings can accelerate with interest rates staying low, current U.S. equity values can be justified at these levels. In that environment, it is not unthinkable that stock prices can rise 7.0% to 9.0% over the next 12 to 15 months.

Informed Judgments

The need for more sunlight is universally ongoing and thus the reason for constant research and vigilance around the investment effort. We will continue to seek sunlight as we attempt to fully evaluate the prospective risks and returns of any investment opportunity before the commitment of capital. In the spirit of Justice Brandeis, whom I suspect could have also been a pretty good portfolio manager as well as a judge, we all need

We all need to continue to demand sunlight and transparency from our business leaders and public service officials.

to continue to demand sunlight and transparency from our business leaders and public service officials. To get to the best decisions through the most informed decision-making processes, whether in the realm of investments or other domains, seek maximum sunlight.

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CURRENT DISCLOSURES

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