

### *Four More Years*

The much-anticipated 2012 election is at long last in the history books, and what is remarkable is how little of the national political landscape has changed. Following a campaign season of record length and expenditure, President Obama won his second term, the balance of power tipped slightly further toward the Democrats in the Senate, and the House stayed solidly in Republican hands. The government is bleeding red ink. In rough terms, the federal government is spending three dollars for every two it takes in in taxes. The accumulated national debt is larger than our economy's annual output, and many times larger when future promises of entitlement programs are considered. Meanwhile, our economy remains sluggish, growing at a 2% rate. The electorate remains sharply divided, and the Fiscal Cliff beckons.

Chairman Bernanke's Fed has largely assumed the role of our economy's principal caretaker, a role expected to continue under Obama II. In September, the Fed embarked on its third round of bond buying ("QE3"), and announced its intentions to hold interest rates at rock-bottom levels until, then beyond, the moment a durable recovery finally takes root. Not in memory have we witnessed such aggressive, open-ended commitment by the Fed in pursuit of its policy goals of full employment, and price stability. In addition to the Fed, central banks throughout the globe are moving toward something very close to

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"all-in" on their efforts to stabilize and stimulate the world economy.

### **Strategy in a Post-Election, QE World**

In keeping with the investing saw, we are mindful not to "fight the Fed," not least without good reason. Indeed, in September, much of Wall Street was in full-throated howl at the prospects of an easy Fed as far as the eye could see, lending a backstop to stock prices.

It's not a lay-up, though; the Fed is distorting normal signals in the financial marketplace, at a moment when economic fundamentals have slipped. Likewise, the Fed has held interest rates below the rate of inflation. Investors remaining heavily weighted in bonds are seeing their purchasing power erode before their eyes. Other investors, in search of income, have bid high-dividend stocks to lofty levels, and may have stepped outside of their preferred risk habitat.

Following are a few of Ascent's lodestars as we chart a course for our clients in these interesting times:

**Focus on managing capital, and not managing benchmarks.** We continue to believe that a high-quality equity portfolio, anchored by financially strong, dividend-paying companies, makes a great deal of sense for our client partners. But we don't build our portfolios to mirror a market index. Our Dividend Focus portfolio doesn't resemble the composition of the S&P 500, the Russell 1000, or any other popular stock index. Rather, Dividend Focus is built to reflect our best ideas for enduring value, and long-term capital accumulation. Our portfolio companies are financially strong, have sturdy, well-defined business models, and are generating excess amounts of cash, a portion of which is returning to shareholders in the form of increasing dividends and share repurchases. Important, as well, is what we don't do: we don't own stocks to capture fleeting trends, or invest based mostly on hoped-for "catalysts." Last, we are skeptical of the technology sector in general, owing to its intense competition, and to the ever-constant disruption of existing business models by new market entrants.

**Among equities, invest in income *with* growth.** We believe investors who are tilting too heavily at dividends in low-growth industries are setting themselves up for disappointment, especially if dividend taxes increase as part of the Fiscal Cliff resolution. At Ascent, we believe that dividend *growth* (i.e., a dividend stream's rate of increase) is a better predictor of long-term share performance than the mere indicated payout level on a stock today, such as with a slow-growing utility or telecom company.

As an example, a stock we own widely in client accounts is Comcast Corp., the largest cable provider in the US. The stock is a prime beneficiary of the demand for data services among consumers and businesses, and it

generates enormous cash flows off its multi-billion dollar installed infrastructure base. Comcast has raised its dividend 239% in the last three years, and we expect more cash to be returned to shareholders in coming years. However, Comcast's yield of 1.8%, viewed in isolation, might escape the notice of dividend-seeking investors. Similar dividend growth stories are found in names such as Qualcomm and Stryker Corp., both widely held in Ascent client portfolios.

**Tread cautiously in bonds. We are.** Investors need to understand that the Fed is suppressing interest rates below their natural level as part of its stimulus efforts, and owners of interest-bearing instruments are the losers. The 10-Year US Treasury note yields about 1.6% if purchased today, approximately in-line with current reported inflation, and well *below* the realized inflation that many consumers experience. An unexpected rise in rates, or inflation, will crater the purchasing power of that bond investment, and many others that trade at a spread to Treasuries. At Ascent, we are limiting fresh bond purchases to the minimum required by the client. Additionally, for suitable accounts, we are employing option strategies to produce and/or enhance income.

**Define risk.** Important to any discussion of investing is how a manager defines risk. We define risk, fundamentally, as *the possibility of a permanent loss in capital*. We believe a stock's risk profile is substantially diminished when the company is reasonably valued, with underlying earnings growth, and a growing dividend stream. Make no mistake, risk markets, and their member stocks, fluctuate and frequently overshoot, both down and up. In particular, many high-valuation growth equities embed rosy assumptions on perpetuating, extra-normal growth. When

growth disappoints, these stocks go down fast (typically a lot faster than they go up), leaving a costly lesson for investors who were invested in expensive growth stocks because...*that's what was in the benchmark.*

**Don't overthink the Fiscal Cliff.** Post-election, the stock market finds itself in a mild swoon, gripped by a sharp Apple selloff and fears over our fractious, divided government as we march toward the Fiscal Cliff. (The Fiscal Cliff refers to a series of tax hikes and spending retrenchments presently on auto-pilot, and scheduled to begin taking effect at the start of 2013, without government action.) We expect a degree of market weakness in the short term, as politicians posture, and the media parse every utterance from our elected officials, prompting feelings of "fight-or-flight" response in the primitive part of investors' brains. In the end, however, we believe a deal will get done. In the meantime, we expect to undertake some modest repositioning in client portfolios, to take advantage of attractive entry points to equities that we've been watching.

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