

the Connection

A Quarterly Review

1st Quarter 2017

THE BULL'S RUN CONTINUES

Our market outlook - we are in a late cycle recovery. Two important points; (1) This doesn't mean when the recovery is over, the market falls off a cliff again. (2) There are enough productivity changes going on, paired with increasing global demand that we may start entering a boom. That would be nice. Booms often lead to busts, so we have our eye on that as well.

As we review quarterly reports, we have changed our focus slightly on what we believe will indicate continued success in this market. Our core view holds that Revenue Growth is the key indicator of success; however the prospect of inflation does modify our outlook. Focusing specifically on margins, we would like to see companies increase product prices coming into an inflationary period, and pass those on to the consumer without paying more in expenses.

While that may sound complicated, it is simple. Let's take a common household name, Apple, and we will explain what we look for to make Apple attractive. We will use round numbers to make life easier for all us. Apple sells an iPhone today for \$700. Apple pays in parts, labor, service and shipping, \$400 to make that phone. If Apple is to remain successful, they must improve the phone. Simple competition dictates this is important. We will look for Apple to improve the iPhone, meaning that the unit cost will go from \$400 to \$430. Apple may need to hire some new people, increase the power of the phone etc. Before inflation starts to take hold, Apple needs to increase prices. Apple should be able to charge \$800 for that phone, thus improving margins. Their margin on the first phone is (profit) 300 /700 or 43%. The margin on the new phone is 370/800 or around 46%.

Margin improvement for Apple is different from some other sectors. Anywhere where people or companies are making a purchase follows the Apple example. Some other sectors need to be more efficient with their cost structures to improve margins, and in some sectors must create new products to improve margins. Banks, brokerage, energy, utilities, and steel are all examples of companies that must cut costs or become more efficient in order to improve productivity. Companies in less mature markets must keep innovating to stay ahead of the curve. Gencap is looking for companies that can successfully keep pace with inflation across the board.

The reason we are so interested in margins is because we do feel inflation will pick up, but don't believe it will be across the board. Investors should want to invest in companies where the demand is so strong that price increases do not diminish sales. Apple is an excellent example to use because it is in a mature industry. Cellular phones are an established market. If Apple can pass price increases, they can improve revenue and earnings without having to sell more units. This is the only way to increase productive capital without having to establish new products.

Across the board, we will be watching for companies who can improve margins, maintain reasonable sales growth, and can then re-invest in the business for the future. As companies no longer fit that mold, they will drop off. We have been bargain shopping lately, and will continue to comb through companies that are out of favor to establish new investments if we feel the pricing of the company makes sense for longer term. We at Gencap look forward to decreasing our news flow from politics to refocus on what we think is important, investment and economic news.

THE ACT OF GIVING

Below is an updated list of some organizations our clients are helping today. Please let Barbara know the names of organizations and their website you care about and we will include them on the list next quarter. Send email to bcorley@gencappm.com.

Bloom Marin

www.bloom.org

Maya's Music Therapy

www.mayasmusic.org

Friends of the Urban Forest

www.fuf.net

Guide Dogs for the Blind

www.guidedogs.com

Doctors without Borders

www.doctorswithoutborders.org

The Nature Conservancy

www.nature.org

National Kidney Foundation

www.kidney.org

Guide Dogs of America

www.guidedogsofamerica.com

Golden Gate National Parks Conservancy

www.parkconservancy.org

Fine Arts Museums of San Francisco

www.famsf.org

Canine Companions for Independence

www.cci.org

Alzheimer's Association

www.alz.org

The Foundation for Rotary International

www.therotaryfoundation.org

Wildcare

www.wildcarebayarea.org

Homeward Bound of Marin

www.hbofm.org

Whistlestop

www.whistlestop.org

FINCA

www.finca.org

Redwood Empire Food Bank

www.refb.org

Sonoma Land Trust

www.sonomalandtrust.org

Friends of the Earth

www.foe.org

The American Civil Liberties Union

www.ACLU.org/Donate

The American Friends Service Committee

www.afsc.org

Amnesty International

www.amnestyusa.org

The Friends Committee on Legislation Sacramento

www.fclca.org

Eastside College Prep

www.eastside.org

Northern Sierra Partnership

www.nothernsierrapartnership.org

American Bird Conservancy

www.abcbirds.org

The Cornell Lab of Ornithology

www.birds.cornell.edu

Mono Lake Committee

www.monolake.org

California Trout

www.caltrout.org

Tahoe Rim Trail

www.tahoerimtrail.org

Ocean Conservancy

www.oceanconservancy.org

Global Fund for Women

www.globalfundforwomen.org

