

# the Connection

A Quarterly Review

1<sup>st</sup> 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](mailto:bcorley@gencappm.com).

Bloom Marin

[www.bloom.org](http://www.bloom.org)

Maya's Music Therapy

[www.mayasmusic.org](http://www.mayasmusic.org)

Friends of the Urban Forest

[www.fuf.net](http://www.fuf.net)

Guide Dogs for the Blind

[www.guidedogs.com](http://www.guidedogs.com)

Doctors without Borders

[www.doctorswithoutborders.org](http://www.doctorswithoutborders.org)

The Nature Conservancy

[www.nature.org](http://www.nature.org)

National Kidney Foundation

[www.kidney.org](http://www.kidney.org)

Guide Dogs of America

[www.guidedogsofamerica.com](http://www.guidedogsofamerica.com)

Golden Gate National Parks Conservancy

[www.parkconservancy.org](http://www.parkconservancy.org)

Fine Arts Museums of San Francisco

[www.famsf.org](http://www.famsf.org)

Canine Companions for Independence

[www.cci.org](http://www.cci.org)

Alzheimer's Association

[www.alz.org](http://www.alz.org)

The Foundation for Rotary International

[www.therotaryfoundation.org](http://www.therotaryfoundation.org)

Wildcare

[www.wildcarebayarea.org](http://www.wildcarebayarea.org)

Homeward Bound of Marin

[www.hbofm.org](http://www.hbofm.org)

Whistlestop

[www.whistlestop.org](http://www.whistlestop.org)

FINCA

[www.finca.org](http://www.finca.org)

Redwood Empire Food Bank

[www.refb.org](http://www.refb.org)

Sonoma Land Trust

[www.sonomalandtrust.org](http://www.sonomalandtrust.org)

Friends of the Earth

[www.foe.org](http://www.foe.org)

The American Civil Liberties Union

[www.ACLU.org/Donate](http://www.ACLU.org/Donate)

The American Friends Service Committee

[www.afsc.org](http://www.afsc.org)

Amnesty International

[www.amnestyusa.org](http://www.amnestyusa.org)

The Friends Committee on Legislation Sacramento

[www.fclca.org](http://www.fclca.org)

Eastside College Prep

[www.eastside.org](http://www.eastside.org)

Northern Sierra Partnership

[www.nothernsierrapartnership.org](http://www.nothernsierrapartnership.org)

American Bird Conservancy

[www.abcbirds.org](http://www.abcbirds.org)

The Cornell Lab of Ornithology

[www.birds.cornell.edu](http://www.birds.cornell.edu)

Mono Lake Committee

[www.monolake.org](http://www.monolake.org)

California Trout

[www.caltrout.org](http://www.caltrout.org)

Tahoe Rim Trail

[www.tahoerimtrail.org](http://www.tahoerimtrail.org)

Ocean Conservancy

[www.oceanconservancy.org](http://www.oceanconservancy.org)

Global Fund for Women

[www.globalfundforwomen.org](http://www.globalfundforwomen.org)



