STOCKBOY

Columbia Asset Management, L.L.C.

October17 Yr. 25 Issue III

Don't Be So Passive!

Unusual Times…..for Now

Passive (index) investing is the latest investment trend and it comes with some obvious advantages. One, passive investment fees are very low – an important issue to all investors. Secondly, with index investing you'll never trail the market because you 'own' the market. When markets are going up, these benefits seem very compelling and this current stock market has been trending upward for over 9 years now.

Beyond simple indexing, there are also 'algorithm' or 'smart beta' index funds where very smart people (often PhD's from fancy schools) come up with complex formulas to try to ferret out minor market tendencies that the algorithms can exploit for profit.

During strong markets I can see why index funds of all types might be hard to beat. However, even John Bogle, the father of index investing at Vanguard, says there may be a bubble now with index investing as investors pile in. It may only take a falling market (something we haven't seen in a while) to prove this bubble out.

Often it's in bad markets where active investors – those who pick and choose specific stocks – can make a notable difference, particularly contrarian/value investors who look for companies that are unpopular at the moment. These companies, already discounted in many cases, tend to hold up better than the market averages when bad times come.

Computers Are Fallable

The Kansas City Royals are the baseball example of why indexes and algorithms are not perfect and how human decision making still carries weight. PECOTA is a major league baseball computer model that is known for its predictive abilities. However, as the *Wall Street Journal* pointed out, there's one team the model has difficulty predicting: the Royals. They've performed much better than modeled.

What this indicates is that computer-based logic does not always work best and there is still room for human decision-making. As the general manager of the Royals stated, their relatively underfunded team "has to search for undervalued assets and emphasize underappreciated aspects of the game – advanced metrics have a little more of a challenge measuring some of that (other) stuff."

Investing works the same way and it would be easy to imagine Warren Buffett saying something just like the Royals' general manager. Further, he likely would say such a thing from his office–not on Wall Street, but in the Royals' neighboring state of Nebraska (Buffett's home state). This underscores the notion that to beat Wall Street it helps to not be on Wall Street. The Midwest, flyover country to some, is not a bad place to look.

50% Left Behind Equals Failure

Though most Americans enjoy a higher standard of living than their grandparents (due to technological changes and the like), statistics show that the wealthiest Americans have enjoyed the greatest benefits in recent times.

This is the opposite of America's greatest expansionary time – the 1950's and 60's. Between 1943 and 1980, the 'lower 90%' saw their incomes double while the top 10% saw their real income go up just 25%. This is what created the modern middle class. Since 1980, 36% of income growth went to the top 1%, 68% to the top 10% and 100% to the top half of workers. In other words, the lower 50% of U.S. workers, overall, have seen no increase of real income in 35 years.

In correlation, back in 1980, not that long ago in corporate terms, average CEO pay as a multiple of average worker pay was 34x. By 1990 it basically doubled to almost 70x. However, in the '90's it went up another 5 times – and thus 10 times as much as only a decade earlier! Clearly, the '90's was a great time to be a CEO, and has been ever since.

One could argue that 'the top dog gets the spoils' and whoever's in charge of a company deserves those spoils. However, this top-heavy approach to distributing corporate wealth more reflects the America of a hundred years ago, and not of the 1950's and '60's, when most people think America was at its economic best.

The fallout from this inequity resonates over time in a number of ways – from our politics to our future economic growth. The U.S. economy can't grow as well when the 'meaty middle' is getting constantly squeezed thinner. Credit cards, home equity and student debt have picked up the slack in recent decades keeping spending power strong, but clearly there are negative ramifications to those dynamics as well. In its best form, economic growth in a balanced democracy raises all boats, at least to some reasonable degree.

A Banker Doing It the Right Way

Wells Fargo, long considered the best-of-breed for national banks, is instead now expanding the amount of account-holders affected by its fake account sales scandal. The new Wells CEO claims in large ads that customers and shareholders are rightfully 'disappointed' in Wells. I can think of some much harsher words that would be more appropriate. Setting up fake accounts for customers without their knowledge or permission to reach sales goals is an unforgiveable breach of trust.

Meanwhile, there is a bank in Buffalo NY apparently doing it the right way. Its long-time CEO is one-of-a-kind. His name is Bob Wilmers and he runs a bank called M&T Bank. I doubt you've heard of it.

Wilmers is different – very different. First, he's been CEO of M&T Bank since the early '80's (back when CEO's were paid a lot less). Speaking of the 80's, Wilmers is in his 80's yet often rides his (beaten-up) old bike to work…..in a suit. Until last year, when he was not riding his bike he drove a 1990 Toyota wagon.

Remind you of anyone? Probably not, and that's the point. He's a true contrarian and successful (thus I'm a big fan).

M&T was one of the few banks during the financial crisis to not cut their dividend (many well-known banks dramatically slashed theirs).

The bank's stock has averaged 16% annual returns over the 35 years he's been in charge. However, in this era of outrageous CEO pay, Wilmers recently took a pay cut even though the bank grew over 20% that year.

His commentary in the M&T annual report is in the spirit of Warren Buffett rather than the usual bone dry, worthless missives of most CEO's who overuse expressions such as 'challenging', 'right-size', 'vision', and 'well-positioned for the future'. Wilmer's approach is a refreshing change of pace and dose of honesty in a sea of overpaid, out-of-touch CEO emperors and empresses [M&T has been added to the Growth and Income Fund].

BrianWeisman,*CFA,CPA,CFP,CMA*

(734)6651454brian@columbiaasset.com