Broadleaf Partners, LLC

An Apple's First Worm

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Writing about Apple is painful. Not because I have lost money in recent months or have no insight to provide, but because the media will likely report on it ad nausea for the next few days. It is perhaps human nature that the news which is most readily produced is also the news that is most easily consumed. If you want to be read, it's best to write words that people will read. While this makes for great entertainment and advertising, it hasn't typically been the best way to get new investment ideas.

Allow me to explain.

As some of you know, I had my own experience with fifteen minutes of fame as a tech fund manager in the early 2000's. My thoughts about the hot tech sector were in high demand, from the cover of Barron's to the cameras of CNN and CNBC. Jim Cramer touted my fund in an online column for the Street.com one day, and at least partially because of his column, our fund family received over $150 million in new fund flows over the subsequent few days. Unless you are under the age of thirty, you probably don't need to be reminded that making an investment in the tech sector at that time didn't turn out to be a very good idea.

My thoughts were in demand not because tech stocks necessarily offered good value, but because they had done so well and it is always easiest for the media to produce, and the public to consume, stories about recent winners. In January, we want to read about teams that are going to the Super Bowl, not those that failed to make the playoffs.

It isn't always the market's bulls who win the attention of the media's spotlight, however. Three years ago, Dr. Doom – also known by the proper name Nouriel Roubini – became a media star. You could hardly turn the pages of a business magazine or change the channels of business TV without seeing his name. At the brink of an economic Depression, the media produced what we wanted to consume, stories of how bad it was and the ideas of those who had seen it coming. Unless you are under the age of twenty, you probably don't need to be reminded that going to cash at the height of Dr. Doom's media attention was a pretty poor idea.

In the past year and a half, neither I nor Nouriel Roubini have been in demand. Instead, the media has been obsessed with interviewing politicians and their pundits about the fiscal cliff, the debt ceiling, and the general undoing of our great nation. While it is hard for me to believe, I guess the public has been far too eager to watch it all. How have stocks done since the nation's debt was downgraded, a Socialist President elected, and the Fiscal Cliff approached? Yep, better than the popular media reports at the time would have implied.

Today, people will likely be talking about Apple's First Worms and the media will likely oblige those desires by interviewing everyone everywhere about Apple's ultimate demise. Whether you've owned Apple for years or just days, today's 11% move is painful, particularly after already declining thirty percent from the September highs.

Selling is absolutely the hardest thing to do as an investor. Fortunes are made in buying great stocks, but they can just as easily evaporate if you allow the emotion of greed to take control. No matter how much money a company has made for your portfolio, a stock is not a wife or child. It is simply a claim

on a company's future earnings. No one will think less of you if you cut a little loose or even ask for a complete divorce.

About a year ago, we published an Economic Update titled Waiting for Eighty. While I won't go into the finer details of the update, we highlighted the experiences that shape the decisions we make when selling stocks today. Acknowledging that great athletes like Michael Jordan age and eventually retire and that former business greats like Bill Gates eventually cede the spotlight to newcomers like Mark Zuckerberg, we announced our intention to take some profits in Apple. We didn't see anything in the fundamentals that would warrant a sale, but we did know that we'd enjoyed some phenomenal gains and would never time a complete sale at exactly the right time. In recent weeks we trimmed the shares once again, this time believing that the fundamentals for the company, while strong, are no longer without blemish.

Apple is a great company and its shares are likely significantly undervalued. A couple of years from now, its shares could be higher, perhaps significantly so. Unfortunately, the shares are also caught in institutional limbo. Growth managers are loaded to the gills with the shares after years of tremendous gains. Given maturing markets, more credible competitors, and uncertainty over game changing new product innovations, the company's shares no longer appear to have limitless new upside. While the shares look cheap in spite of slower growth, value managers are content to be patient before buying shares from growth managers who are eager to trim, having been burned far too often by technology shares that simply become value traps. The shares of Hewlett Packard and Dell are examples of how quickly technology trends can shift, standing in stark contrast to shares of J.M. Smucker, which show how stable, though not as exciting, peanut butter and jelly can be.

Do we still own Apple? Yes, but considerably less than we used to. Our selling discipline has been about taking some gains along the way and controlling the risks of our portfolio. If we had held our entire position or bought some more, it would be easy to fall into emotional complacency to a once fallen star, justifying a decision of Waiting for Eighty. Ten months ago, very few would have paid any attention to a media report recommending the sale of Apple. Today, the opposite may be the case. Whether or not Apple is or isn't a sale is not knowable today. What is knowable is how you feel. If you are content with your position and your thinking, your portfolio is where it needs to be. If you're stressed or uncertain, chances are great that you need a better sell discipline. Work on that first, and then think about Apple.

Deciding to sell can also be about new opportunities and on that front, we believe there are many in today's market. Over history, the companies that created game changing levels of wealth for investors and societal benefits for a nation's citizens have always seemed to share one characteristic in common. The steam engine, automobile, computer and internet have all made the world feel like and become a much smaller place.

A few months ago, after a high profile, bungled IPO and a complete bashing in the media, we established a very controversial, initial position in Facebook. To a large degree, Facebook is a polarizing company, one that has more than its share of lovers and haters. Personally, I believe the company is transformational, with limitless upside not too dissimilar to how Apple felt not too long ago. Because of Facebook and Google Translate, I am able to maintain a relationship with a thirteen year old Latvian orphan who stayed with us for a month over Christmas. He lives five miles from the Russian border. Not only that, my wife and I can also seek and share advice and encouragement from two hundred other families in the United States who hosted other children from Latvia and Ukraine, all from within a safe and private group on Facebook. To me, Facebook provides real, personal value, which I believe over time, will be rewarded by the marketplace.

As we wrote in our Fourth Quarter Review, we believe the economy will move beyond a recovery and into expansion during 2013. Even in an era of a New Normal, this would imply that we see new all-time highs in the stock market this year.

With emerging market growth heating up again, we are interested in the market's later stage cyclicals, particularly industrial goods companies. Historically, faster overseas growth has also contributed to rising inflationary pressures, a risk factor that we will be watching closely as the year unfolds. As the final stage of an economic cycle, expansions aren't usually as rewarding as recoveries; if for no other reason than economic contractions are one step closer. And those aren't very fun.

What could be different about the coming decade compared to the last ten years? While I'm not confident that Apple will be the same shining star it has been, I am confident that the future will have its new shining stars. In fact, if we are right about an economic expansion, stocks as a whole could shine as institutions reallocate from fixed income securities that outperformed for the last decade and move into stocks that have underperformed. In a similar vein, it might not hurt to ask where a large holder of Apple might be uncovering new opportunities for growth.

While stories about the demise of the United States have been running rampant, I neither believe we're on the road to ruin nor a path back to wanton excess. There are some potentially game changing opportunities worth keeping an eye on, including the U.S. renaissances in energy production and manufacturing. While no one talks about it, these two areas could do far more in helping resolve our debt crisis than either tax hikes or spending cuts. As Nancy Lazar, a respected economist at ISI Group recently said, "middle America" could very well be the best new "emerging market".

After what feels like decades of pessimism and economic darkness, Americans and American companies may need time to relearn what it's like to feel good about and confident in the future. The fact that the Depression era octogenarians I know remain frugal to this very day, suggests that may only happen gradually and overtime. It is said that markets climb a Wall of Worry; I would add that they are also at their most dangerous when there seems like nothing to worry about.

Be glad for worry.

Kindest Regards,

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