

Commentary – “Cohasset Currents” – October 2018

To put the recent market decline into perspective, with the bottom-line message being that market pullbacks are normal, note the following data; Despite what some have said, The Federal Reserve has not moved fast with their increases in interest rates. They have been on a 4x/year for a total of 1% per year pace. In past tightening cycles the average Fed rate increase has been 2.5% per year. With 2.5% inflation and 2.25% Fed Funds real interest rates remain negative (One cannot earn sufficient interest to offset inflation and retain purchasing power). Given low inflation and low interest rates the market was not overly expensive before the recent sell off. The market at the beginning of October was at 16.8x estimated earnings for the next 12 months, versus an average of the past 25 years of 16.1x forward earnings - given low inflation and low interest rates this is not overvaluation. After the sell-off, the S&P 500 at the October 11th close of trading was at 15.7x forward earnings, which is below the average of the last 25 years. The decline to that point from the recent market all-time highs was 7%. In January this year the market declined 10% in 10 days before recovering to reach all time high levels.

We believe the current global economic expansion will continue for several more years. We also believe that there remain significant opportunities to identify companies that are changing the way that their industries or categories are doing business and that offer compelling growth potential. The most recent example for your portfolio is the purchase of Lonza Group AG in late September. Lonza Group, based in Switzerland is a contract manufacturer for the Pharmaceutical and Biotechnology industries. Biotech and Pharma companies outsource their complex manufacturing needs to them and others at an increasing rate as the production of drugs that are biologic or gene therapies increases. Among other things, Lonza makes the virus's that are used for delivery of gene therapies to their targets. The global market for genetic modification therapies is forecast to grow at a 49.9% compound annual growth rate between now and 2023. This makes it one of the fastest growing areas in Healthcare. Admittedly, it is complicated and uncertain and has the characteristics of a “Gold Rush.” Since it is difficult to pick winners among Biotech and Big Pharmaceutical players in this segment, another approach is to invest in the companies that are “selling the picks and shovels to the miners in the Gold Rush.” Lonza is one such company.