CAMPBELL NEWMAN

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REFLECTIONS & PERCEPTIONS

FOCUS IN A SOMETIMES UNFOCUSED WORLD

The speed of change continues to quicken. We often think about the prescience of Intel co-founder Gordon Moore regarding how, over 50 years ago, he predicted the exponential increases in computing power and declining cost per component that have largely come to pass and changed our world. It was in 1965 that the journal *Electronics* asked Mr. Moore, then the head of R&D at Fairchild Semiconductor, to write an article on his prognostications for the industry which resulted in the elegantly titled "Cramming More Components onto Integrated Circuits." At the time, 50 components were used per circuit in cutting-edge technology. Using that period's recent history of component growth amidst a falling cost curve as his guide, he extrapolated that "by 1975, the number of components per integrated circuit for minimum cost will be 65,000" which implied an annual doubling of components over a 10-year period. Later dubbed "Moore's Law" (and adjusted as densities grew), this phenomenon became defined as the expectation that the number of transistors on an integrated circuit would double roughly every two years. The concept of ongoing exponential processing increases became a target for achievement in the technology sector in the decades that followed and led to the current state of technology which can cost-effectively "cram" billions of transistors on a single circuit—a truly amazing feat.

With change comes disruption. As investors, we see the proliferation of data and data sources as two of the most powerful changes that have occurred as a result of the advancement in electronic processing, the enormity of which can be demonstrated by the following: First, it's estimated that more data was created in 2017 than in the previous 5,000 years combined and, as a corollary, roughly 90% of all of the data in the world was created in the last two years alone. The statistics are mind-boggling, but it should also be noted that much of this data can be considered noise, as seen in the graphic from Domo, Inc. (page 2) that outlines the sources and volume of data generated every minute in 2017.

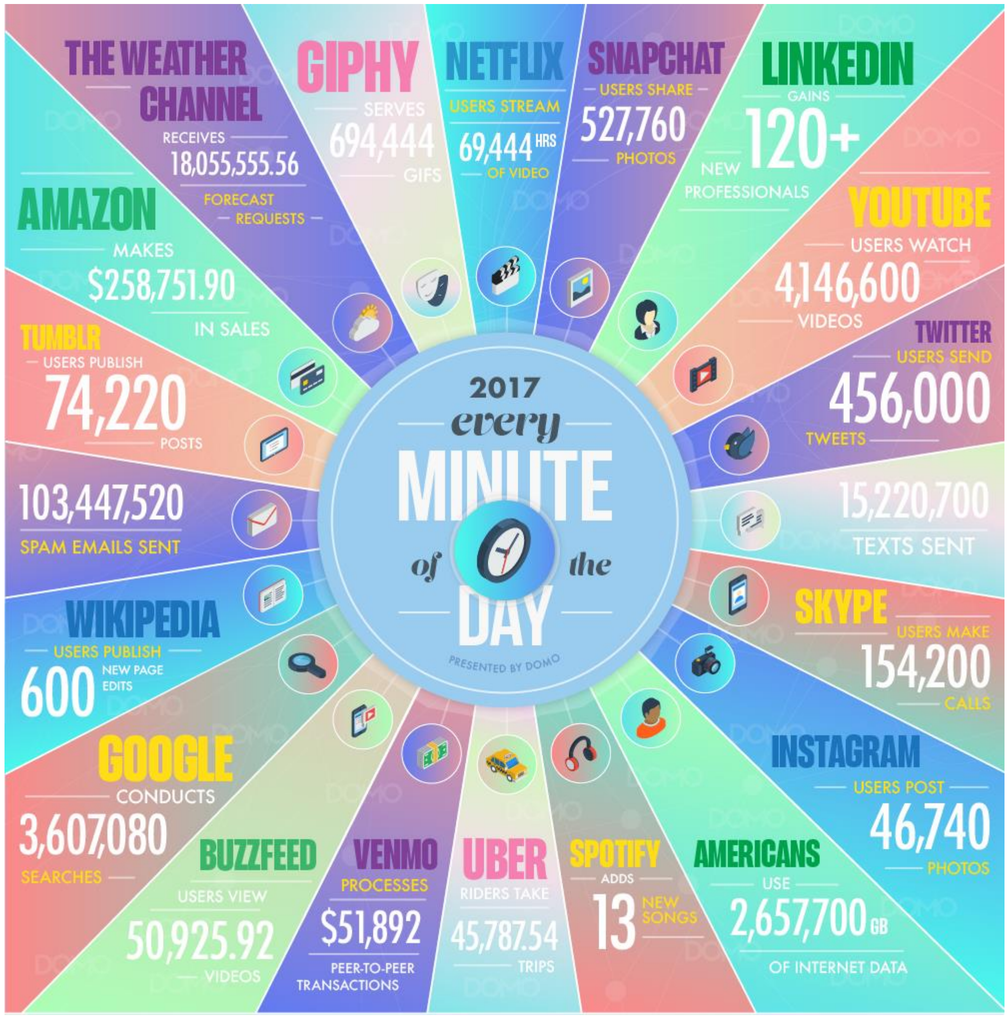
We believe this is important to recognize because managing money is a decision-maker's business. In many ways, the Internet and Reg FD have leveled the playing field so that everyone can basically get the same information at the same time. Access to a lot of data can be a blessing, but it can also be a curse if your focus is off. Key components of any successful investment process are the determination of which information is pertinent and how it is used to make investment decisions.

This brings us to the first quarter's volatility. Following a period of exceptionally low volatility amid climbing stock prices in 2017 and into the first weeks of 2018, the road became a lot bumpier for the US stock market as January came to a close. Volatility was reignited by concerns that the Fed was turning more hawkish looking into 2019 and that valuations were stretched as the 10-year Treasury made a run at 3%. Fears of a trade war perpetuated the volatility as President Trump began tweeting about tariffs, with China as his main target. In response, and despite a generally solid earnings report season with positive commentaries regarding business conditions, the S&P 500 declined in February and March by 3.69% and 2.54%, respectively. These declines wiped out January's 5.73% gain and turned the Index's performance negative for the quarter at -0.76%.

The weakness was broad-based with only 2 of the S&P 500's 11 economic sectors recording positive performance in the quarter: Consumer Discretionary (3.09% return) and Information Technology (3.53%). Additionally, these were the only two sectors that outperformed the Index return. The Financials held up better than most with a -0.95% return, followed by Health Care (-1.22% return) and Industrials (-1.56%). Interestingly, two sectors that are often thought of as having lower volatility characteristics, Telecommunications and Consumer Staples, were the worst performers in the period with returns of -7.48% and -7.12%, respectively. We believe these results highlight the importance of growing earnings (and dividends) in a rising interest rate environment.

DATA NEVER SLEEPS 5.0

Source: Domo, Inc.



The importance of fundamentals is precisely why we rely on our investment disciplines and years of experience over market cycles to regulate our focus in a sometimes unfocused world. We observe that much of the volatility came following the quarterly earnings report season, and during a period when there was a general absence of hard data regarding business activity for individual companies and the economy as a whole. As well, the items the markets focused on were primarily projections or attention-seeking volleys--things that will not have lasting impact unless they become realities, and it's too soon to tell whether they will. Longer-term success requires a keen focus on tangible evidence of the quality of earnings and earnings growth, demonstrated financial flexibility and balance sheet strength, and confirmation that end markets can support growth projections—while avoiding getting overwhelmed by the noise created by the plethora of data.