

Eads & Heald Investment Counsel

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Equity Investing

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Chapter 17: Future Investment Themes

Forecasting future investment themes can be a valuable exercise to assist you in achieving long-term investment success. As implied earlier, it is good to have as many things as possible supporting the fundamentals of the securities you purchase.

We define a Future Theme as an unfolding story that gives a dramatic boost to certain stocks over, say, at least a five year period of time. Another way to understand this idea is to look backward. That is, pick out some very successful stocks over the past five years. Then, ask yourself if there were any important themes that helped to propel any of these stocks to stardom. You could attempt to list as bullet items on one 8 ½ x 11 piece of paper trends that you believe could possibly have a dramatic effect on certain sectors of investing over the next five years. Better yet, form a small group that meets to define, and periodically refine, such a list.

It should be admitted that while this is an extremely fun task it is not an easy one. While it seems easy to blue sky some ideas they may turn out to be a bust so far as attaching stocks to the ideas. Also, a good theme can easily go a mere five years remaining totally unfulfilled. Ideas such as such as the extreme importance of plentiful water for the cities or reaping a bounty from the oceans are two past themes largely stillborn in so far as success in the stock market.

Let's go back to the introduction of the Interstate Highway system in the U.S. One theme might have been to forecast the springing up of successful chains of moderately priced restaurants and lodging (not traditional city hotels nor like the old motels on the two lane highways). Think of names like Cracker Barrel and Hampton Inn (Hilton). Ideally, a theme would be a "gimme" so far as it was destined to happen. Then, the catch would be to find stocks that could ride the theme to success.

Hindsight is always easy. When you look back at companies that achieved great success there might have been dozens of companies vying for that success at the outset. The new wave of discount mass merchandising allowed Wal-Mart to pick up the pace and sort of take over and do it better than K-Mart. Home Depot rode the DIY (Do It Yourself) boom and consolidated places like the local hardware store, lumber store, appliance, Handy City type stores and myriad others into one big orange box. Home Depot was joined by a redefined Lowes. Best Buy big boxed electronics retailing. In the late 1960's and on Intel rode the next wave of electronics miniaturization into integrated circuitry. The advent of the personal computer helped propel that wave. Never forget that early in the last century there were many U.S. automobile companies that later distilled down to mainly General Motors, Ford and Chrysler. Haloid Corporation (Xerox) had many challengers at the outset of copying. Years later, Xerox was redefining and fighting for its existence. At one time the Polaroid (instant self developing) camera was great

innovative technology. However Kodak and film still had a place to exist for a period of time. Digital cameras have the film camera world on end. Themes, themes, themes.....what are the great future themes?

It is great fun to search out Future Themes. However, good themes are difficult to locate and it is even more difficult to align good public companies with the themes. Below are a few themes we cite to get you thinking. Good luck!

A SAMPLING OF OUR FUTURE THEMES

- The last calendar decade has been the worst decade for the NYSE markets in history. The law of “mean reversion” would seem to indicate that the next decade would be witness to a positive long-term trend in equity returns.
- The U.S. economy appears to be stagnant, possibly because we are at a pivotal economic and political crossroads. This presents a thick layer of uncertainty to investors, which the market greatly dislikes. A reduction in this level of uncertainty combined with low interest rates, low inflation, and improving earnings would bode well for stocks.
- Inflation will stay moderate for now. However, seeds are being sown for the next round of upward pressure on inflation.
- Tax rates will rise as it becomes increasingly apparent that revenues will not be sufficient to meet future obligations. The Government faces increased public debt as a percent of GDP.
- A renewed focus on American politics has shifted attention away from economic and investment fundamentals for the time being. This trend will continue at least through the next election cycle.
- The steady increase in the U.S. standard of living is not guaranteed over the next decade. The U.S. will face greater international competition for global economic leadership.
- The U.S. will be forced to refocus massive efforts on renovating the educational system as emerging countries press ahead with better scores, especially in the areas of math and science. Failure to do so will further erode the U.S. position in the global economy.
- In the wake of the “great recession”, savings rates will trend along at levels higher than seen before the recession. The breadth and depth of the recession have likely etched a long-lasting scar into the minds of many, as the great depression did to another generation.
- Demographics will continue to point toward an aging population. An aging population will require an increasingly large portion of the federal budget devoted to funding entitlement programs.
- Those industries which face relatively less Federal regulation may prove to be more attractive investment opportunities. Federal over-regulation tends to stifle performance.
- After years of intense and successful competition from international automakers combined with the recent threat of domestic automaker collapse, some U.S. automakers will continue to show a renewed vigor in designing and selling cars. Ford especially is making a bold statement with its financial position and new car development.
- There is potentially more trouble to come on the housing front. A backlog of foreclosures in the system, combined with a large shadow inventory and a rising trend toward strategic defaults, will likely put additional pressure on the housing market.

- While the internet will continue to have profound effects on the transmission of information, it will continue to become yet another utility like the telephone or electricity.
- Personal computer and technology advancements will open up even greater use within the home and office. More routine functions will be handled by computer software, hardware, simple microchips and barcodes.
- Cloud computing will continue to evolve and gain greater acceptance. Adoption will be slowed somewhat by fears over privacy and security for critical applications.
- The networked home will become ubiquitous. Just as every home once had a VCR and currently has a DVD player and personal computer, every home will be networked for home entertainment. Sharing of files, photos, videos, etc. will be facilitated by a central “hub”.
- Faster data connections, mobile computing and networked homes are changing the media landscape. Electronic versions of books, music and movies are replacing the physical media.
- Demand for data storage will grow as all sorts of data and files are stored in electronic format.
- Healthcare will continue in transition as the federal government implements insurance exchanges and other elements of the health care bill. Additionally, the continued rise in drug prices, the threat of drug price controls and the price benefits of generic drug competition will become pivotal issues.
- Biotechnology/genetic engineering will continue to make exciting progress in the years ahead as more and more secrets about the human body and disease are uncovered. The potential medical benefits versus the controversial nature of the research will continue to be the subject of heated political debate.
- The move toward a one-world/international economy will continue at a solid pace as economic borders continue to shrink. Economic problems around the world will affect the U.S. economy to a troubling extent.
- China will continue to move toward capitalism and maintain a reputation as an economic powerhouse. This, combined with the innate Chinese work ethic, will have far-reaching effects around the world with the scope difficult to foresee.
- India will challenge China’s leadership position among developing countries. Economic liberalization and reform over the past 15 years will begin to bear fruit.
- The ever increasing trade deficit will be difficult to reverse if China remains steadfast in pegging their currency to the dollar and other parts of the globe continue to experience slow economic growth (Europe).
- Russia appears to be reasserting power and should continue to grow and establish itself in the world economy. However, the move toward a free and efficient economy may be slow. It will take many more years to see dramatic progress in the overall standard of living, but progress is evident.
- Terrorism is a permanent fixture in America. While we can work to reduce the risks of major attacks, well organized terrorist groups or individuals will always find a way to inflict damage. Terrorist attacks and the corresponding U.S. response may shock the market temporarily.
- Retailing will continue a trend toward no frills and low pricing. Low-priced retailing combined with fashionable trends and products will be a popular formula.
- We will continue to move toward a cashless/checkless society.