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The Company vs. The Stock Price

Whenever the stock markets suffer a big decline, the news media is always filled with stories about panicked investors selling their stocks. This time was no different.

During the recent turmoil, a number of articles described investors who tried to log in to their on-line accounts. Alarmed by the plunge in share prices, they were desperate to sell their holdings but were stymied by the crush of others attempting to do the same thing.

As in other market sell-offs, these "investors" were focused only on the current value of their accounts. If their stocks were down, they felt compelled to sell before prices went down even further. No one was asking the obvious question -- what, if anything, had really changed at the companies? Was Apple suddenly selling fewer iPhones? Had toothpaste sales fallen off a cliff at Colgate-Palmolive? Was Nike having trouble selling sneakers?

We have often discussed why it makes sense to focus on the fundamental characteristics of a company instead of its share price. By concentrating on what a company *is* as opposed to how Wall Street currently *feels* about it, an investor is focusing on what really matters for successful investing over the long haul -- the growth in a company's earnings and dividends.

The high-quality companies we favor tend to be financially strong with solid balance sheets and the wherewithal to withstand changing business conditions. They tend to be the leaders in their fields, with established track records of introducing new products and services and growing their markets. Their management teams are experienced and have been around the block more than a few times over their long careers. And their products and services tend to be steadily in demand regardless of fluctuations in the economy.

We thought this an excellent time to review our investment philosophy and why investing in financially strong, high-quality companies with superior fundamental characteristics and above-average growth in earnings and dividends should give investors the confidence to continue owning them through the ups and downs of Wall Street.

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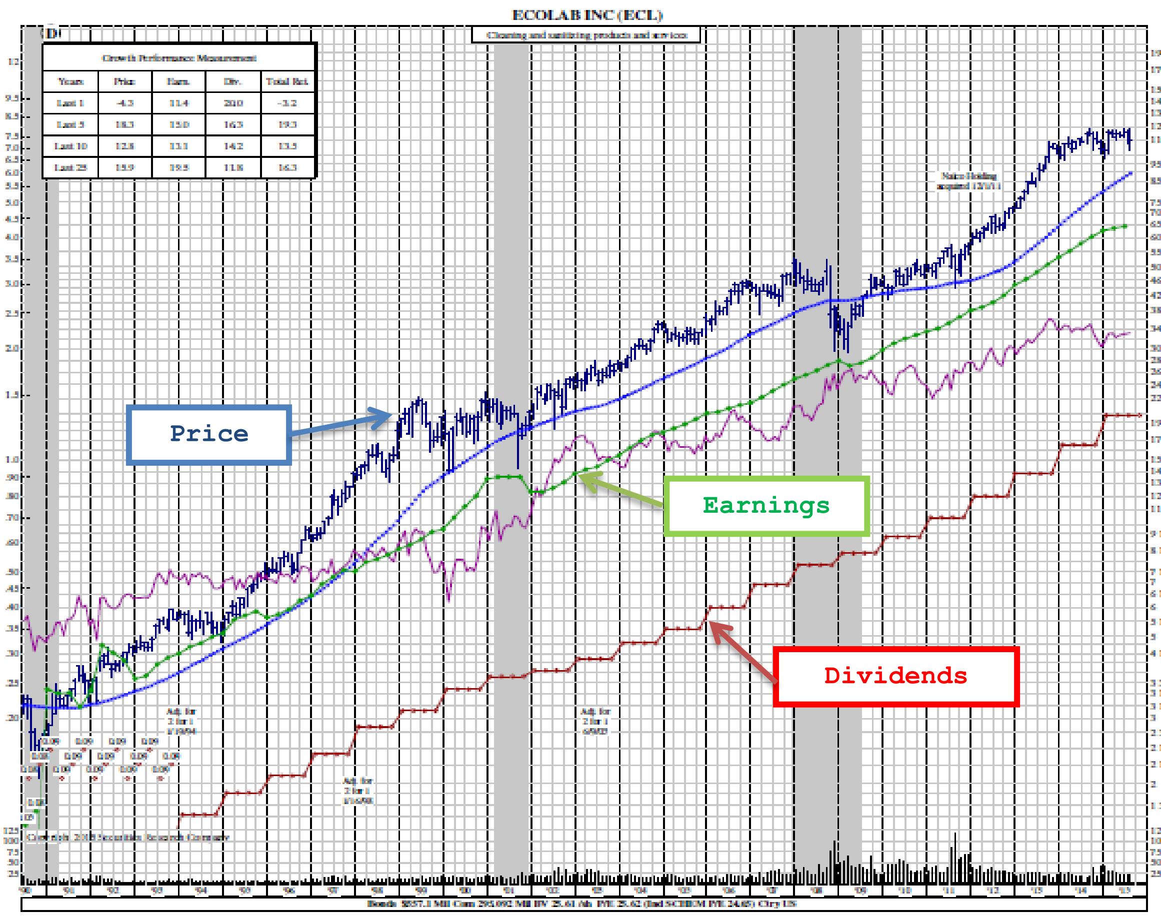
The chart shown below is from SRC Stock Charts, one of the resources we use in our analytical work. It shows the long-term record of Ecolab, a cleaning and sanitizing company, from 1990 until just a few days ago. The green dotted line shows the growth in Ecolab's earnings per share while the red open-circle line shows the growth in Ecolab's dividends. The dark blue squiggly line shows the price of Ecolab's common shares and the shaded bars running from top to bottom are periods of economic recessions.



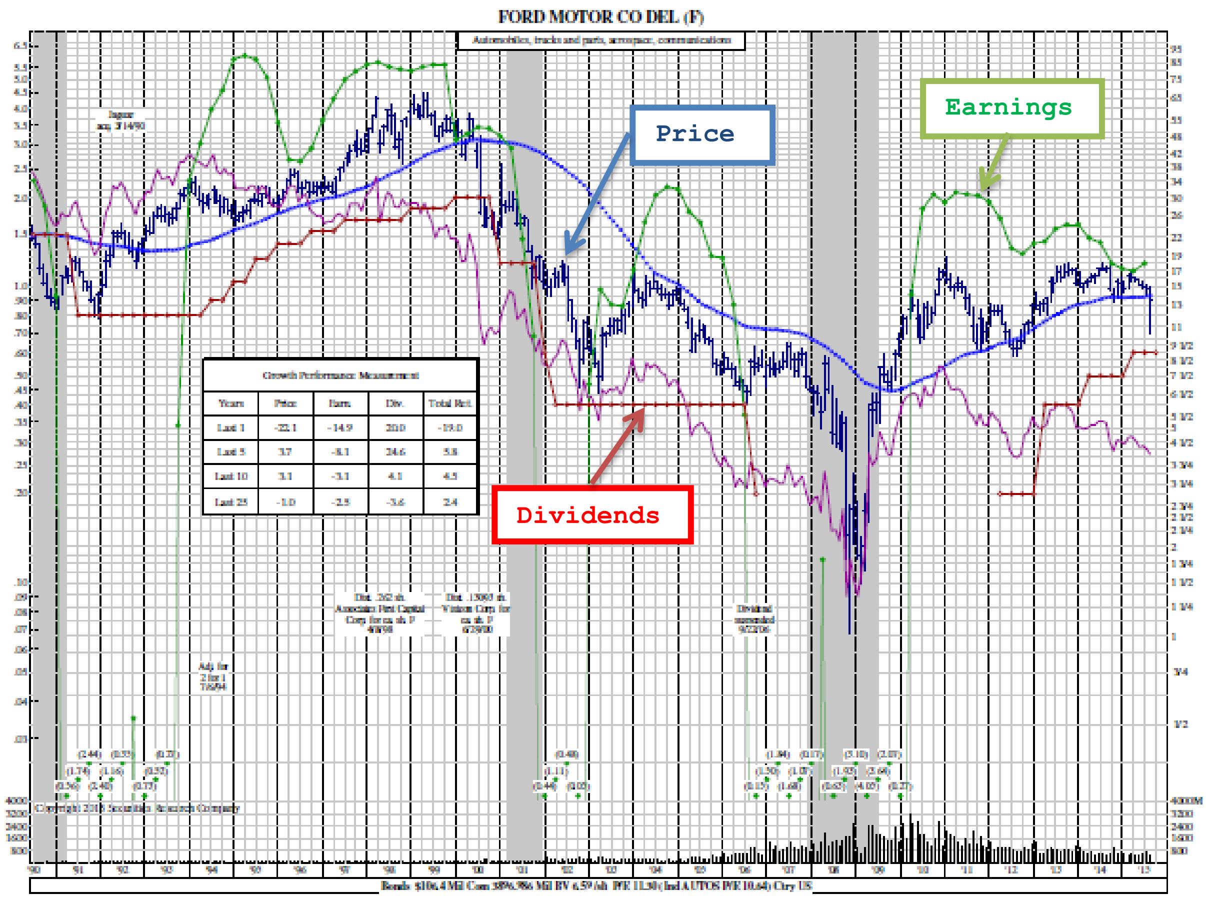
Source: SRC Stock Charts

Note the steady progress in Ecolab's earnings over the twenty-five-year period. While the growth in earnings does tend to slow or even fall a bit during recessions, it generally shows a nice, steady upward trend.

The dividend line also shows a consistent upward trend. Dividends are set by a company's Board of Directors and a shareholder-friendly company tends to increase its dividend every year.

Finally, note the record of Ecolab's share price. Even though the share price may drop 10% or more on any given day, with enough time the share price tends to follow the earnings line upward. And the dividends are extra icing on the cake!

Now let's look at the earnings, dividends and stock price record of another company. The chart below shows the long-term record of Ford Motor Company, which is in a very different industry from Ecolab *(full disclosure: the author and her husband are big fans of Ford products and currently own an Explorer SUV, a Ranger pick-up truck and a beautiful 1965 Mustang. In the past, they owned an SVT Mustang Cobra and an SVT Lightning pick-up truck).*



Source: SRC Stock Charts

As can be seen, the auto industry is quite sensitive to economic cycles. When the economy enters into a recession, Ford's earnings fall as fewer automobiles are sold and margins are cut to incentivize sales. In the 2008 financial crisis, Ford's Board of Directors was forced to cut and then stop the dividend altogether in order to conserve cash.

The price of Ford's stock reflects the cyclicality of the company's earnings, rising when they improve and falling as they worsen. The share price is much more volatile than Ecolab's share price, perhaps more sensitive to Wall Street's constantly changing outlook.

The point is that knowing a company and having some understanding of how it fares under different market and business conditions cannot help but give investors the ability to remain unfazed in times of stock market sell-offs.

Now let's look at the earnings, dividends and share price results of our firm's top twenty-five core holdings. They are the following companies:

Apple	FactSet Research	PepsiCo
Automatic Data Proc.	Fiserv	Praxair
Brown-Forman 'B'	Gilead Sciences	Roche Holding ADR
Celgene	Johnson & Johnson	Stericycle
Church & Dwight	MasterCard	Stryker
Coca-Cola	McCormick	TJX Companies
Colgate-Palmolive	Microsoft	Union Pacific
Ecolab	Nike 'B'	United Technologies
		Walgreens Boots Alliance

Since the dark days of the financial crisis in 2008, these companies have increased their earnings more than the average company in the Standard & Poor's 500 index:

	Earnings Per Share *(Calendar Year)*								**2008 – 2014 Cumulative Increase**
	2008	2009	2010	2011	2012	2013	2014	2015E	
25-Co. Average	2.10	2.21	2.55	2.98	3.20	3.48	4.04	4.51	**140%**
S&P 500	49.51	56.86	83.77	96.44	96.82	107.30	113.01	115.50	**128**

Sources: Value Line Investment Survey, Standard & Poor's

Their dividends have increased over four times as much as the S&P 500:

	Dividends Per Share *(Calendar Year, paid)*								**2008 - 2014 Cumulative Increase**
	2008	2009	2010	2011	2012	2013	2014	2015E	
25-Co. Average	0.71	0.78	0.88	1.00	1.17	1.35	1.52	1.65	**171%**
S&P 500	28.39	22.41	22.73	26.43	31.24	34.99	39.44	42.75	**39**

Sources: Value Line Investment Survey, Standard & Poor's

The share prices of our top twenty-five core holdings have also held up well during the recent stock market sell-off:

	------------------ **Mean Price Per Share** --------------------							9/8/15 Share Price	**2008-Present Cumulative Increase**
	2008	2009	2010	2011	2012	2013	2014		
25-Co. Average	37	34	42	49	56	69	84	92	**148%**
S&P 500	1100	902	1141	1231	1333	1623	1916	1969	**79**

Sources: Value Line Investment Survey, Standard & Poor's

Finally, another fundamental characteristic we pay close attention to is a company's reinvestment rate, which is an indication of potential future growth:

	Reinvestment Rate (%)							
	2008	2009	2010	2011	2012	2013	2014	2015E
25-Co. Average	23.8	21.9	21.0	22.5	21.0	19.3	23.2	25.3
S&P 500	4.7	6.7	10.5	11.4	9.8	10.1	10.1	10.0

Sources: Value Line Investment Survey, Standard & Poor's

Just something to keep in mind the next time the stock markets take a tumble.