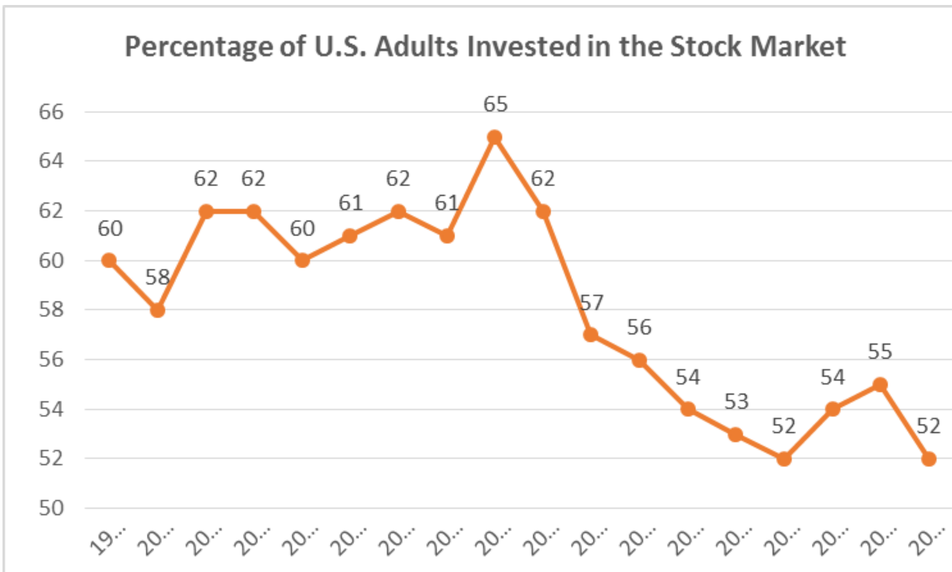
May 2017

Resources Management Corp

# MARKET COMMENTARY

## STOCK OWNERSHIP (PART I) A PARTNERSHIP WITH MANAGEMENT

A large portion of Americans today own publicly traded equity securities. According to Gallup polling, more than half of Americans either personally, or jointly with a spouse, have money invested in the stock market (as can be seen in the chart below).




Despite the fact that this number has been falling since 2007, higher levels of liquidity and ease of access to public markets has generated broader participation in the prosperity of America's largest companies. This dynamic, however, has created a shift in the perception of what a stock represents. Watching real time price updates of stocks on CNBC and listening to the "analysis" that pundits provide makes it easy to get caught up in the idea that these securities move in patterns separate from the performance of the underlying businesses. While sentiments like these can certainly influence price movements in the very near term, it is the actual enterprise alone that dictates value over the long term (see our January commentary for a further discussion on this topic).

Rather than being viewed as a stream of blips moving across a screen that periodically rise and fall, stocks need to be understood as ownership interests in businesses. This interest is effectively no different than being an owner of a private business, with the only exception being that a valuation is provided on a daily basis. If investors were to collectively adopt this viewpoint (as opposed to simply giving lip service to the idea), there would be a dramatic change in the relationship dynamics between shareholders and management.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Management teams are charged with serving as the "managing partners" in the business, with the Board of Directors representing the interests of shareholders (the "limited partners"). All too often, however, the long-term goal alignment that generally exists in private enterprises is lost as management teams become encouraged to exclusively pursue short term goals, frequently at the expense of long-term stakeholders. This reality that has become ubiquitous in corporate America is exemplified by the frequent dramatic stock price movements immediately following the release of quarterly filings. Reporting earnings per share that are one cent below average sell-side analysts' estimates, for example, can send a stock plummeting with very little regard for what the actual long term implications are for the company. To this end, the incentive packages given to high-level executives are commonly focused on things such as growing the business quickly, as opposed to total returns on capital employed (which is what should truly matter to shareholders). This vicious cycle that has both created and resulted from the pursuit of "fast money" can only be halted by a realignment of objectives on the part of both shareholders and their management teams.

The U.S. stock market has proven to be an efficient allocator of capital over extended periods of time, however, which creates opportunity for investors who focus on understanding the fundamentals of the businesses they own. This means ensuring that all actions are based on a conservative estimate of intrinsic valuation and being measured in any reaction to the news flow of the day. At RMC, we strive to capitalize on the short-sightedness of many market participants and only invest with a long view. Our approach is that of a private owner in the identification of high quality businesses with exceptional management teams. Purchasing securities with these characteristics has long proven to be a successful strategy, and we do not expect this to change.

Individuals and professionals whose approach to investing is focused on being "businesslike," coupled with a redirecting of management's compensation packages toward returns on capital, will continue to raise the quality of American businesses and increase the wealth of the many participants in the public equity markets. Inefficiencies will always appear in a market system, and only those who stick to the proper principles can consistently compound capital.

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