Economy & Market Valuation

The stock market in the US as measured by S&P 500 had a lackluster start in 2014. After providing a return of 29.6% in 2013, the S&P 500 went up by only 1.3% in Q1'2014. We at Oxford Chase do not expect to see 2013-like performance in the coming years. The reasons are multifold. The stock market is already trading at a very high P/E multiple of 16. The Federal Reserve is reducing the stimulus by decreasing the bonds it is buying every month. The Fed bond buying program has gone down from $85B/month to $55B/month and is likely to end in 2014. Janet Yellen, the new Fed Chair has indicated that the short term rates may go up in 6 months after the Fed bond buying program ends, which could be in 2015. Of course that does not mean that the market cannot go up any higher from where it is today. The stock market will probably go higher but with a lot more volatility and at a much slower pace. It is certainly getting harder to find undervalued companies. We think the economy is in its seventh inning of expansion and will continue to expand barring any external shock like war with Russia. Inflation is still very low and the Fed will keep the monetary policy accommodative till the time inflation is running low or the US reaches near full employment. The US economy can keep on expanding till the time interest rates are low. But the same cannot be said of the US Stock market. The US stock market can very well see a 10% correction in the near future.

Investment philosophy and Examples

We at Oxford Chase, try to invest in securities which are mispriced by the market for one reason or the other. We cannot predict when the mispricing in the security will disappear. It could be in one month, one quarter, one year or even more. We invest with safety of principal and long term time horizon in mind. We follow Warren Buffet's two investing principles. The first is never to lose the principal and second is never to forget the first principle.

Since this is our first quarterly newsletter, we would like to talk about some of our earlier investment picks. The first investment that we have picked to talk about is Bank of America (BAC). We started investing in BAC in 2012 when it was trading at around $8. The market had assumed that BAC can go bankrupt because of its legal issues related to Country Wide's mortgages. We were of the opinion that although the legal issues were very significant and would cost BAC a huge amount of money they cannot continue forever. BAC's earning power would become evident once its legal issues got sorted out. BAC is still working on its legal issues. But the market now is getting confident of its earning power. BAC meanwhile is trading at around $16. We also used leverage in our BAC investment by buying in the money (ITM) calls to amplify the returns.

The second investment that we have picked for the newsletter is Micron(MU). Micron is a classic example of how consolidation in an industry can benefit a company. Micron is a producer of memory chips that are used in PC's, servers and Mobile phones. The memory industry had many players (>10) and started consolidating as many of the players were losing money. Now there are 4 major players left in the memory industry. The margins for all the players are improving as there is demand supply balance that is favoring the remaining players. We started purchasing Micron when it was trading at around $15. It is now trading at around $26 and we think there is further upside. The above examples will hopefully help you understand our investment philosophy.

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