



Compass Points



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ADV PART II

We've encountered several institutional articles touting the success some investment managers have enjoyed with 'Factor' investing. There is an implied precision to the term that suggests something new or innovative. This is not the case. We've seen this approach under other names. 'Trend' or 'Thematic' investing comes to mind as earlier examples from a decade or three ago.

Since we do pay attention to demographics and changing patterns of economic behavior, it seemed like a good time to address some of the major shifts we see. The changes we are about to discuss do not 'drive' our investment process so much as they inform it.

Entertainment: Big vs. Small Screen

We wrote earlier about the transition to 'streaming' on demand for movies, television series, news, etc. The viewership of Netflix is projected to eclipse the combined viewers of network television and cable by the end of the second quarter of 2016.

Technological advances in a variety of areas including the widespread availability of high-

speed wireless service, feed the transition. Part of the shift pre-dates those changes by decades.

"Big and small screens have been locked in existential combat since their inception. In 1946 (the year one of us was born), 78 million Americans went to the movies a week. By 1971, that figure was 15 million, as the aging movie audience settled down in the suburbs and put their feet up in front of the TV." *"Is it curtains for the big screen?" Financial Times 27 May 2016*

Movie producers have compensated for the loss of viewers by 'bigger & better' format changes, repetitive 'blockbuster' series (e. g. Rocky 1 – 10) and price increases across the board. George Lucas predicted a near term future when viewers would pay \$50.00 to \$100.00 to attend huge theaters offering a smorgasbord of amenities.

The FT article referenced above quoted Jeffrey Katzenberg from 2014. He predicted "...that a film will come out in cinemas for 17 days – three weekends – which is where films make 95% of their revenue. On the 18th day, the film will be available everywhere and you will pay for the size: a movie

screen will be \$15.00, a 75 inch TV will be \$4, a smartphone will be \$1.99.”

Where Do They Live?

“For the First Time in Modern Era, Living With Parents Edges Out Other Living Arrangements for 18 – 34 Year Olds”

Pew Research Center May, 2016

In 2014 living with a parent became the most common living arrangement for young adults for the first time on record:

32.1% Living in Parent(s) home

31.6% Married or cohabiting in own household

14% Living alone, single parents, and other heads of households

22% Other living arrangements

The PEW report views the economic impact of the Great Recession as a minor factor in this trend. “The first (contributing factor) is the postponement of, if not retreat from marriage. The median age of first marriage has risen steadily for decades. In addition, a growing share of young adults are eschewing marriage altogether.”

Housing: Higher Prices for Smaller Living Spaces

The high price of residential housing in major urban centers is a recurring topic in the financial press. Recently, we encountered articles reporting on Venture Capitalist’s efforts to profit from the trend.

In some cases, there is little innovation involved. The approaches that intrigued us are essentially efforts to resurrect dormitory living in a slightly more palatable format for single, working adults.

The formula involves gutting an existing structure or new construction of multi-unit residential housing. Each floor is a distinct living unit with a set number of small private bedrooms each with ‘en suite’ bath facilities. There is a shared common area with facilities for laundry, entertaining, storing and preparing food, etc.

Some of the VC (Venture Capital) properties we’ve seen are starting out as rental units with the intention of migrating to condominium ownership at some point in the future. Whatever the ownership pattern, the design is simply a step up from dormitory living with private benefits and shared amenities.

In Indianapolis we’ve observed apartments targeting urban students with comparable –

smaller scale – designs. It is not difficult to find three bedroom apartments advertised for \$3,500.00 - \$4,000.00 per month. The ‘apartment’ is intended for three students sharing the rent and who enjoy private bedrooms and baths, in addition to shared common space.

This is a housing trend that we expect to see move beyond VC and Crowd Funding into the mainstream mix of residential housing.

Energy Conservation & Conflict

The goals of energy conservation often collide with the business objectives of public utilities. Stated bluntly, if the conservation effort of the consumer is effective, it will result in fewer sales (kilowatt hours) for the electric utility.

The lines of conflict are clearly drawn in the public policy arena with regard to so-called ‘renewable’ energy sources. Technology readily available today makes ‘net-metering’ possible.

If I install solar panels on my residence or business, I can generate power for my own purposes. On overcast days I’m not generating power and purchase it from the utility company. Net metering makes it possible to sell power back to the

utility when I'm generating more than I need. I pay for the 'net' amount of what I purchase directly.

That is to say that it is possible **IF** the public policy infrastructure is in place to support net-metering. This is another arena where the technology is being developed far faster than the public policy debate.

Our son Seth works as a professional in the energy industry. His employer works in the heart of this conflict between conservation efforts and public utilities.

Looking through their eyes (and the occasional white paper), we are given glimpses of a future that lies beyond the apparent conflicts of interest. We are more than a little hopeful regarding what we see. More later!

Economy

The Federal Reserve passed on an interest rate hike for June. This was a widely anticipated non-event. The prevailing logic being that the economic recovery is too soft to sustain the adverse impact of a minor increase in short-term interest rates.

We find ourselves wondering if action by the Federal Re-

serve at this level really matters one way or another. Clearly, some Federal Reserve members believe that their decisions - deferred or actually implemented - do matter.

Unemployment is back below 5% with lots of ambiguous qualifications. New housing starts are slowing marginally. New apartment construction is soaring nationwide. Crude oil benchmarks hover around the \$50.00/barrel mark.

Forecasters have yet to sort out the good news vs. bad news on lower energy costs.

So far all the doom and gloom in the oil & gas 'patch' is drowning out the wide spread benefits of reduced petroleum costs.

Changes at Schwab

Charles Schwab & Co. Inc. continues to make improvements to the services offered to us as a registered investment adviser and to our clients.

Quarterly Statements

In August, Schwab will begin generating quarterly – rather than monthly – statements on any account that have no transactions during the quarter. Transactions include deposits, withdrawals, trades and stock dividend distribution. In general, we think this

is a good idea. We also think that it is not likely to affect most of our clients.

Read Only Access

Later in the year Schwab will offer 'read only' access to client accounts. The account owner will need to authorize the access. 'Read Only' means what it says. The authorized person can read what is available. They cannot generate any transactions.

The purpose of this feature is intended to support other, third party professionals who would benefit from having access to account information. An example would be a CPA or other tax preparer. Rather than forwarding 1099s or other tax forms, an authorized user could access the accounts online.

As is the case with the Quarterly account statements, we think this a good idea in principle. We are not certain how many clients will make use of the offering. That said, we applaud Charles Schwab for continuing to improve the services they provide. If you have any questions, please call or send email.

ADV Part II

Every year we are required to offer a current copy of our ADV Part II to clients.

The form provides material information on our firm, its owners and our business practices.

We'd be glad to email or snail-mail a copy of the current form. Please let us know if you want a copy.

As always, we are grateful for your business and the opportunity to serve.

Thank You,

Stephen & Susan

Thanks for reading!

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