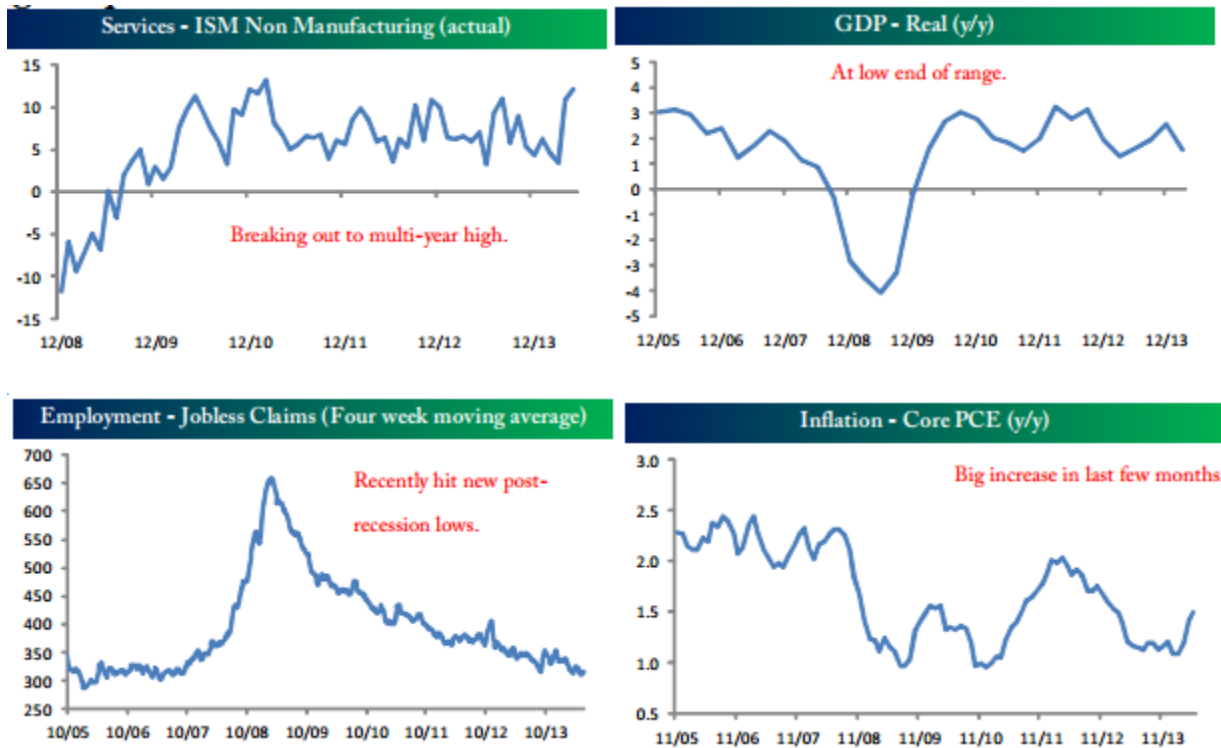


The Investment House Quarterly: June, 2014

| Index % | Q2 2014 | YTD | 2013 |
|-----------------------------|---------|--------|--------|
| S&P 500 | +5.23 | + 7.14 | +32.39 |
| Barclays US 20+ Yr Treasury | +5.06 | +13.19 | -13.88 |

Source: Morningstar

What's Counted and What Counts?



Source: Bespoke Investment Group, July 1, 2014

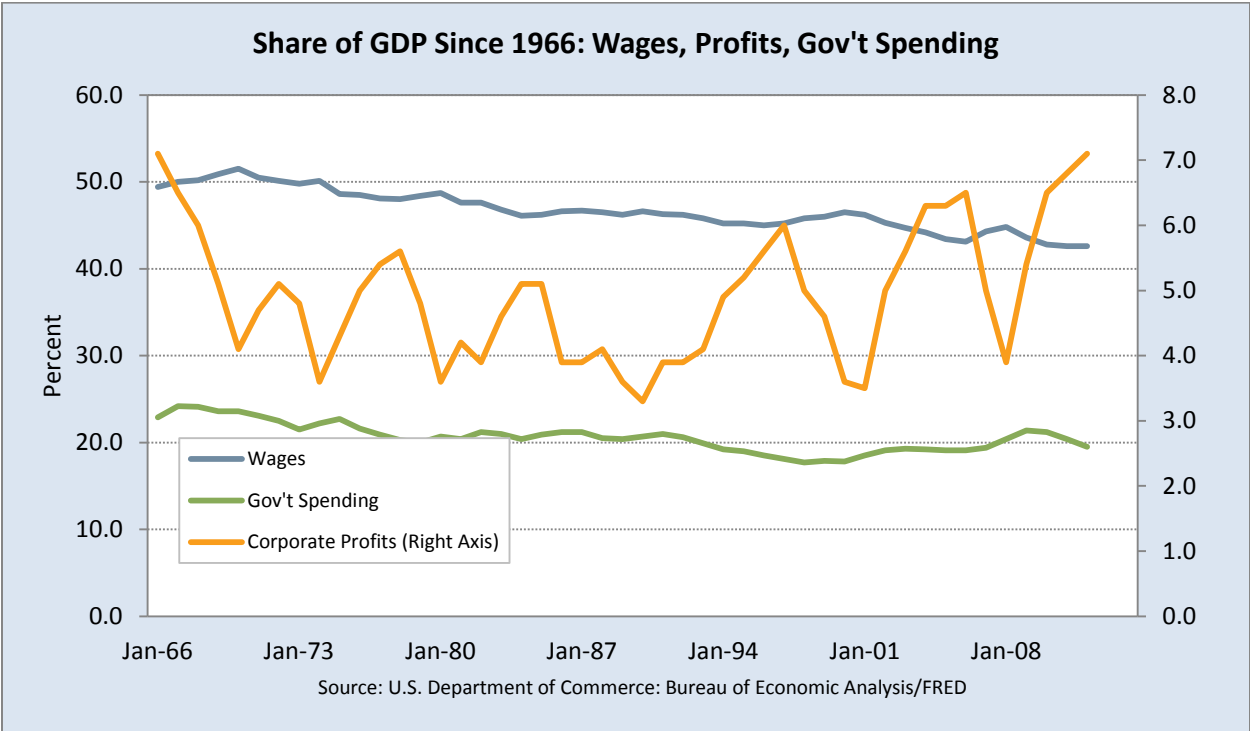
Numbers, numbers, numbers!

There are so many ways in which we attempt to track the health of the economy, the value of businesses, and the attractiveness of investments. Often, there are so many numbers, it is hard to decipher the meaning in all of them.

Let's take the economy, for example. As we see in the four charts above, the index tracking the services sector of our economy – which according to the Commerce Dept., accounts for over 80% of economic activity – is currently reaching a multi-year high (graph on upper left). Meanwhile (upper right), the rate of real (i.e. after inflation) GDP growth is only about 2% - not bad, but hardly a multi-year high. However, we can see that the employment picture (lower left) has been steadily improving for 6 years, while inflation (lower right), has been

extremely low, despite an uptick recently to an annual level of 1.5%, still far below the Federal Reserve’s 2% target.

How do we square these measures of raw economic activity with a corporate profits picture that seems to be improving over a very long period of time, as the table below shows?

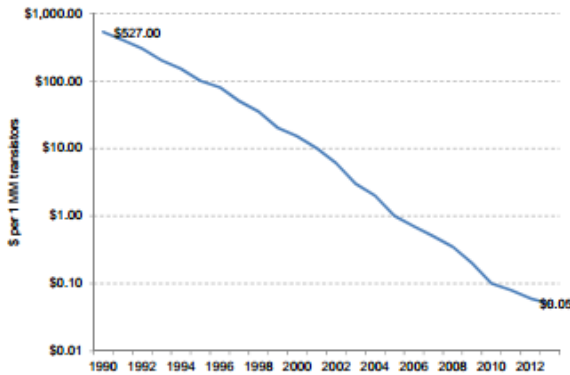


One way to square them is to consider the movement of really important productivity enhancers which are imbedded in every activity within our economy – things which *count* a tremendous amount in the way we work, our overall standard of living, and the productivity of our enterprises, but which are often not *counted* in raw economic numbers.

Take, for example, the cost of two critical things in our modern economy: -computing power and bandwidth: As the tables below make clear, the dollar cost of each million transistors has fallen from \$527 in 1990 to five cents (\$0.05!) today, even as the cost of bandwidth, measured in megabytes per second, has declined from \$1245 to \$16 over the same time period.

As our economy becomes more and more driven by intelligent devices and services which are enabled by computing power, it is hard to see the changes reflected in the raw economic numbers, because GDP measures the cost (or “value”) of goods and services, but cannot directly capture the economic value of increasing capacity at *decreasing prices*.

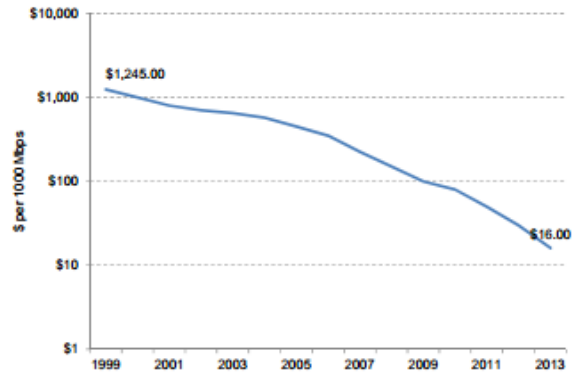
Exhibit 3: Cost of compute is a fraction of its 1990's level



Source: John Hagel, Deloitte, 5/14, Mary Meeker, KPCB.

Note: y-axis is on a logarithmic scale

Exhibit 4: ...so is cost of bandwidth



Source: John Hagel, Deloitte, 5/14, Mary Meeker, KPCB.

Note: y-axis is on a logarithmic scale

What, then, can we conclude from this? Simply that neither the health of the economy, nor the growth prospects of great businesses can be directly inferred from a simple look at raw economic numbers, no matter how numerous they are, or how frequently they come. Often, the great, transformational changes in an economy or a company occur underneath the surface – as we have seen in the radical decline of computing and bandwidth costs..

In other words, often in economics and investing, what is countable doesn't count so much as one thinks, but what really *counts economically* is not counted well, if at all.

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