April 2015 – Volume 5, Issue 2

Kosher Meat

"Welcome home, Dear," the young housewife said as she greeted her new husband. *"I have taken your suggestion and am practicing to be a better cook. While I know you will **always** love me whether we eat at home or out, with our first child on the way, I had better expand my repertoire of home-cooked meals. Instant noodles will only go so far!"*

"Oh, that's terrific, my beautiful bride," replied the husband. *"Just in time for the 'surprise' I have for you."*
"Surprise? What is it?"
"My parents are coming for dinner this Sunday. They really haven't seen us much since the wedding and now, with the baby on the way they …"
"That's terrific," interrupted the wife, *"I will enjoy seeing them. As a matter of fact I will have a surprise for **them** by cooking a dish I know they will love."*
"You remember their dietary restrictions as we've talked about, right?" asked the husband.
"Yes, certainly, that's what I mean. I am going to cook a Kosher meal."

Sunday came quickly. The husband's parents arrived a bit early (what else?!) but were cordial and nice and complimented their daughter-in-law on her new hairstyle and maternity dress (though she really didn't need one just yet). Pleasantries ensued, then a brief chat in the living room, a glass of wine and then … *"Come and get it; dinner is served!"*

The husband told his parents of the conversation he had with his bride about Kosher food. She didn't know much about its preparation but was very eager to learn. He recounted the brief talk they had, his explaining of the traditions, the meaning of Kosher as "clean" and why salt is used to draw the excess blood out of meat as part of the Koshering process.

"Are you sure she knows what she's doing?" asked the father.
"I sure hope so," replied the son/husband.

They sat at the dinner table. At first, all went swimmingly. Some fresh bread was served, then a light salad (the cubed beets were a nice touch) and, finally, the main meal. The wife brought out potatoes, a nice medley of steamed vegetables and some condiments, placing them family style in the center of the table. The husband was asked particularly ***not*** to help out, but to remain with his parents while she served. *"I want to do it myself,"* she said. Just when all seemed perfect, a giant GASP came from the parents as the wife brought out the main meat dish.

"Here it is, everyone. I Koshered it myself just this morning. So, please, dig in to our Salted … PORK CHOPS!"

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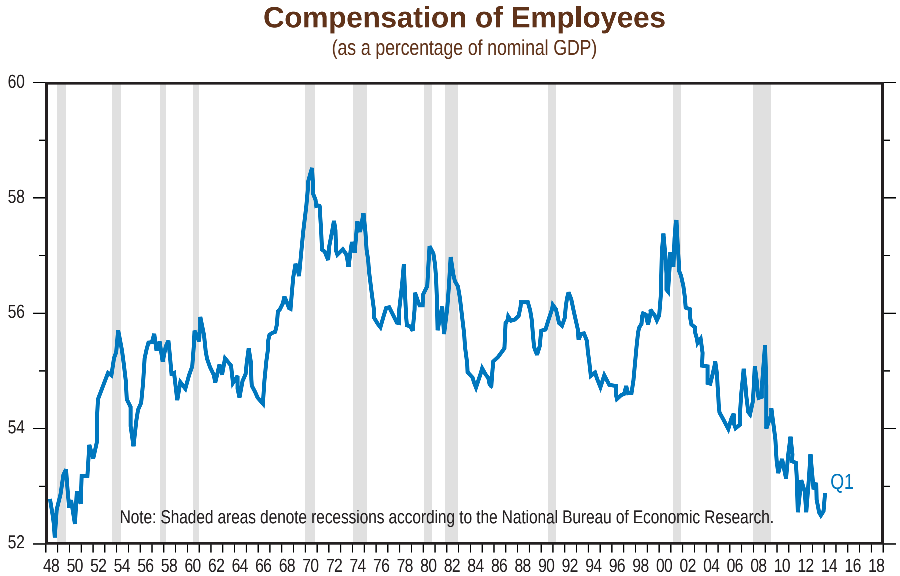
Apparently, when listening to her husband explain Kosher food, the new bride was unfamiliar and heard only part of what makes food Kosher. She identified with the salted meat and (incorrectly) thought that ***any*** meat that was heavily salted would become Kosher. In reality, and according to some religions, only certain animals are considered "clean" for human consumption, pigs **not** being one of them. She hadn't paid attention to the whole story.



Sources: U.S. Department of Commerce; Bureau of Economic Analysis; Yardeni Research

As an aside, this story could have been told precisely as is from the perspective of a Muslim. Kosher laws are quite similar to Halal (Islamic dietary laws). Amongst other rules, both forbid the eating of swine, both require strict methods for the slaughter of allowed animals (largely to ensure the quickest and most "humane" death possible) and both require that the blood of the slaughtered animal be completely drawn out. Kosher laws prefer the use of salt to extract excess blood, while some Muslim practices prefer vinegar.

So, what parallels may we draw between Kosher (or Halal) food and investments?

The Whole Story

The young wife in our story, well meaning of course, failed to acknowledge the entirety of Kosher laws. She picked up on but one part of a complicated practice. This resulted in her serving her new husband's parents (who eat only Kosher food) a highly un-Kosher dish. Economic stories may similarly be misinterpreted. We will present an example.

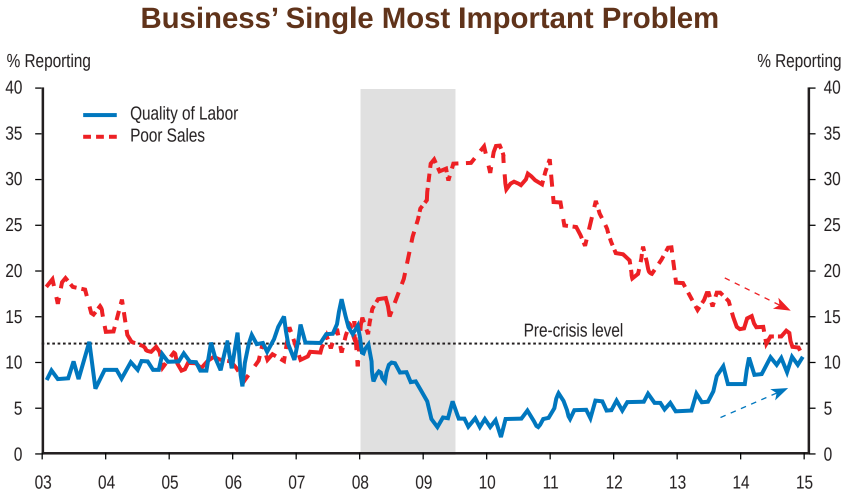
Each year, as required by law, the president of the United States puts out his "*Economic Report of the President.*" While it is filled with plenty of politically motivated narratives, we nevertheless give it a read-through. In the most recently released report, much emphasis was placed on employment and wages. We were pleased to see included in the report a cross-border comparison. This is consistent with our Global approach to investing. Most of the report, however, was U.S. centric.

The following graph highlights the points that were made regarding wages.

This graph (similar, yet incorporating a much longer time frame than that we presented in *The Essence* of October 2011 entitled "*Coney Island*") depicts compensation (wages, salaries and benefits) of U.S. employees as a percentage of nominal Gross Domestic Product from 1948 through 2014. Note that the 1960s witnessed a sharp increase in compensation relative to our nation's output of goods and services. The measure then stagnated (while still rising meaningfully in absolute terms as the economy grew) but has declined in recent years. Varied explanations of the reasons for the changes in relative compensation include: (i) first the rise of, then the decline in the number of unionized workers in the U.S., (ii) the advent of technology and its role in increasing labor productivity, (iii) the rise in the percentage of the workforce made up of women (and the still unequal compensation paid to them) and (iv) cyclical factors such as a decline in relative compensation after each economic recession (as depicted by the shaded portions of the graph).

But to understand a more complete picture, please examine the graph on the next page.

Here we see two factors in a survey of U.S. businesses asked what concerns them most. The red dashed line represents the percentage of those reporting who say that their single most important business problem is poor revenues. The solid line represents those who worry most about hiring capable people. Note that coincident with the Great Recession of 2008–2009, sales were poor and thus paramount on business' minds. Labor became plentiful with the unemployment rate rocketing up to 10%. Most recently, these two worries have normalized with both poor sales and the lack of quality labor now again being reported as the biggest problem of ~12% of the respondents. It may then be just a matter of time before compensation returns to its pre-recession portion of GDP.



Sources: NFIB; Haver Analytics; DB Global Research

Using this broader picture and an understanding of cyclical factors that may impact labor (and its cost), it could be that the decline in relative compensation of employees (since the great recession at least) is mostly a cyclical phenomenon. As with the young wife not seeing the entirety of the Kosher process, those who may be concerned with labor not receiving its fair share of the U.S. economic "pie" may not be considering the whole story.

EQUITIES STRATEGY

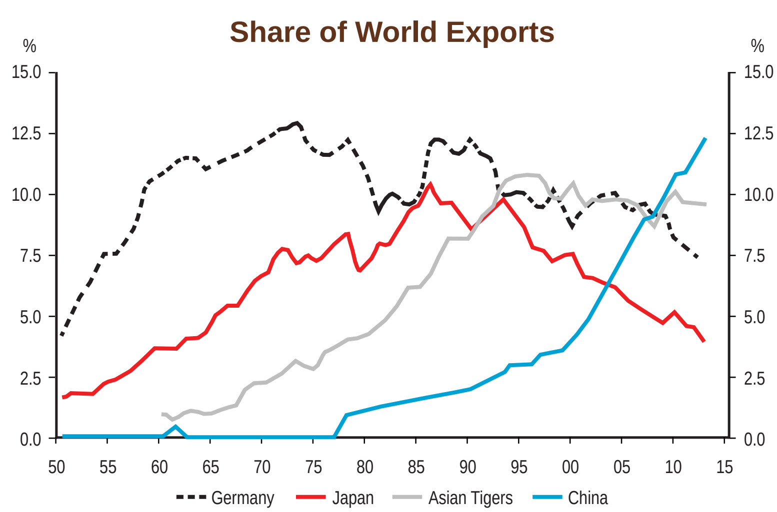
As discussed above, the U.S. economy is *normalizing* and appears to us to be entering a transition phase, the first one in more than five years. Most global economies have yet to enter this transition. This *transition* we refer to could be one from "defense" to "offense." That is, from an environment in which all external factors were supportive of keeping the economy from entering recession (even though we have not been in one since 2009) to one of a cyclical normalization of such factors. Examples:

➢ Low and/or declining interest rates may turn into (modestly) rising rates.
➢ A prevalence of low and/or declining corporate bond spreads may turn to an environment more heavily dependent on industry-specific factors. Corporate bond spreads for energy-related companies, for instance, have risen relative to other sectors.
➢ Very tight bank lending standards may give way to "realistic" loan practices (particularly as pertain to residential mortgages).
➢ Large fiscal deficits may give way to the government seeking more revenue sources.
➢ Cash accumulation (or even hoarding) by companies may now turn into the need for greater capital expenditures to meet the growing demand for products and services.
➢ Weak labor markets resulting in benign labor costs (as just discussed) could quickly turn into a tight labor market leading to escalating labor costs.
➢ Abundant office, factory, retail and commercial building space may turn into a supply-constrained building environment with the resultant increases in occupancy costs (plus reduced flexibility of work spaces).

While we cannot yet be specific, history suggests that "transitions" such as these are unlikely to be without bumps or unintended outcomes. As always, we will be mindful of and diligent in evaluating these factors in our analyses of businesses.

Looking outside the U.S., as we continue to believe in the globalization of our planet (socially, economically and otherwise), we'd like to highlight not only the U.S. president's economic report as we did earlier, but, as well, China's Premier Li Keqiang and **his** annual state-of-the-nation speech.

With the proviso that China is not anything near a "free" or "open" society, it is nonetheless an important player on the world stage of both politics and economics (with the strength of the latter perhaps bolstering the stability of the former). Li said that the government wants to reduce the nation's dependence on infrastructure construction and expand consumption: *"In expanding consumption, we need to ensure that every drop of spending builds to create a mighty river, so that the potential contained in an ocean of private consumers will be channeled into a powerful force driving economic growth."*



Sources: IMF; Haver Analytics; DB Global Research

Note from the graph on the previous page that China's share of world exports has grown from de minimis not too long ago to amongst the world's global export leaders today. The country's leadership may be well aware of its limitation to expand this domination further.

We take heed of Premier Li's statement as, historically, the centrally controlled economy of China has typically executed on what it said it wished to. Shall we now rush out to invest in General Motors and Colgate as beneficiaries of this focus on consumption? Perhaps, but we are mindful that China wishes its citizens to be consumers of *Chinese* goods, not necessarily foreign imports. So while we will consider that China may attain its goals, here is another transition (from a production-led to a consumption-led) economy with its own "bumps" likely along the way. We shall continue to learn more about the whole stories of China (and other important international markets).

INVESTMENT ACTIVITY

We would now like to highlight a recent addition to some or all of Aristotle Capital's equity investment strategies:

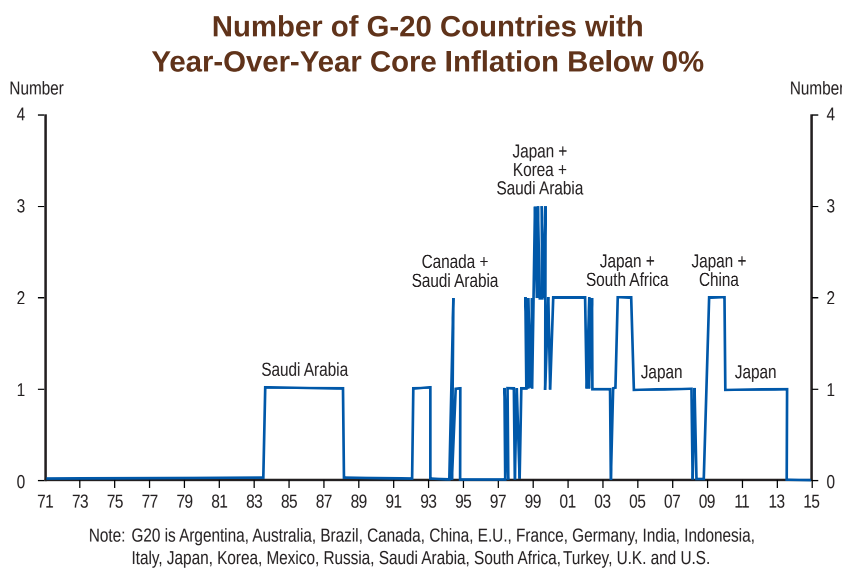
We began studying **National Fuel Gas Company** (NFG) in earnest about three years ago. Our process typically does not focus on finding "new stock ideas," but rather, our time is spent understanding what we consider to be strong and/or improving business models. Our holding of **Questar Corp.** at the time piqued our interest in NFG due to the two companies' similar business mixes. Located between the two Great Lakes of Erie and Ontario in upstate New York, NFG was one of the earliest gas utility companies in North America. Its roots as a utility laid the foundation for what we believe has become a conservative, well-run, integrated energy company; the conservative track record of management includes 112 years of consecutive dividend payments and 44 years of consecutive dividend increases.

National Fuel Gas has three main divisions: Seneca Resources is the company's rapidly growing exploration and production business focused on natural gas development in the Marcellus and Utica shale. NFG Midstream and Supply companies are focused on gathering natural gas, delivering it via pipelines and transporting the gas to other utilities, typically in the Northeastern U.S. NFG Distribution is the regulated gas utility business in and around Buffalo. As was the case with Questar, we believe NFG's integrated structure makes it powerful and unique. But it is often overlooked and misunderstood in the marketplace, thereby providing us the recent opportunity to invest.

FIXED INCOME STRATEGY

This past quarter witnessed a sharp increase in the value of the U.S. dollar relative to just about all foreign currencies. The lone exception is the Swiss franc which de-pegged from the €uro and, itself, rose sharply, but it wound up finishing the quarter very near where it began relative to the dollar.

Several European countries now have ***negative*** interest rates. One needs to ***pay*** the German government, for example, about ¼% (one quarter of one percent) interest for the privilege of owning its three-year debt. One may expect the prevalence of weak currencies and negative rates could be due to **de**flation. But while lately, reported rates of inflation have indeed been below zero, if one removes the effect of the dramatic decline of typically volatile energy prices since the middle part of last year, **in**flation (while perhaps slight) is still positive and hasn't changed much. The German core consumer price index (ex-energy, food, alcohol and tobacco) has hovered around ***positive*** 1.0% for the past five years.



Sources: Haver Analytics; DB Global Research

This graph shows that as of March 2015, there were no major countries experiencing core deflation. Even Japan, which has been struggling with declining prices of everything from real estate to cotton balls, has engineered increasing prices. There could be many reasons for this disconnect between inflation and interest rates. There are many hypotheses, yet we will not speculate on them here. We may not yet know The Whole Story. Instead, we will remain vigilant and cautious, attempting to learn more about why this phenomenon may be occurring, how long it may persist and what its investment ramifications may be. We will have more to report in future editions of *The Essence*.

Meanwhile, the fixed income portion of Aristotle Capital's value balanced portfolios has remained conservatively postured, both from interest rate (relatively short maturities) and credit (investment grade) perspectives. While most global interest rates are low and declining further, in the U.S. we may be poised for rates to ***rise*** (perhaps modestly and perhaps sustainably) for the first time in nearly 10 years. We shall carefully monitor the factors that influence the global fixed income markets and adjust our investments as appropriate—always with a long-term perspective.

The characters described and stories told herein are often, but not always, based on true incidents. Poetic license is taken to dramatize a point about an investment topic. Not all securities mentioned herein are necessarily owned in all Aristotle Capital portfolios. Differences due to restrictions, tax considerations, cash flows and other factors may have impacted the decisions to buy and/or sell certain securities at specific times. Inclusion does not imply that investments in these securities have been profitable. A list of at least five contributors to and five detractors from performance is available upon request.

CONCLUSION

A Kosher (or Halal) meal is not simply thrown together by salting one's meat. With its origins dating back to biblical days, there exist myriad rules regarding what types of animals may be slaughtered, the process of their killing, how their meat may be prepared and even with what other foods they may be served. This quarter, our recounting the story of the newlywed couple and the "Kosher" meal prepared for their parents was used as an example of how one must learn The Whole Story before making dinner … and before reaching investment conclusions.

We welcome Lauren Caston, Ph.D. to Aristotle Capital's investment team. Dr. Caston joined us late last year in the newly created position of Director of Structured Research. He will help us better understand The Whole Story from another unique perspective.

Please refer to our recently published 2014 Annual Letter at www.AristotleCap.com. It details the corporate events of the year just passed for our firm and our affiliated companies.

"My best friend is the person who in wishing me well wishes it for my sake."
~ Aristotle ~

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