Martin Capital Partners

Quarterly Point of View
Comfortable Crossing the Line

October 14, 2016

We are long-term, patient investors and analyze companies as if we have no recourse to sell, focused intently on durable and growing dividends and the powerful compounding effects they provide. Our low portfolio turnover is evidence of this philosophy. At the recent quarter end, our annualized turnover was running in the low 20% range, implying a holding period of four to five years – much longer than the average investor in America that holds a stock for just 8 months[1]. This predisposition to longer time horizons and an ownership perspective defines the difference between an investor and a speculator, in our opinion. As the investment world seemingly focuses ever more intently on short-term results driven by stock price action and trading, we counter by looking to take advantage of ownership in great companies capable of paying us durable income for many years into the future.

The only way for long-term, patient investors like us to meaningfully profit, is to make sure the companies in which we invest, operate their businesses in a wise, sustainable and durable fashion. If our companies do this, years and years of profit sharing in the form of cash dividend payments have the opportunity to produce very attractive returns without undue risk. If the businesses in which we invest do not operate in this fashion, any potential benefits will end up being a mirage. It's incumbent on us every day to make decisions about the sustainability of the enterprises in which we are invested, and though we don't like having to sell companies that are paying us attractive current income, at times it is required.

Early last month the Consumer Financial Protection Bureau (CFPB) fined Wells Fargo, one the nation's biggest banks, a total of $185 million for "the widespread illegal practice of secretly opening unauthorized deposit and credit card accounts."[2] On the surface the fine is immaterial considering the bank's massive scale and total assets that are currently nearing $2 trillion. Underneath the surface though, this disclosure is extremely troubling and a sign of an infected culture.

Wells Fargo has always prided itself, and has been revered for, its ability to 'cross-sell' products and services to existing customers. When done in an effort to generate more business based on strong customer satisfaction and client service it is a common and accepted business practice. However, what has been uncovered at Wells Fargo speaks to, at the very least, serious oversight issues, but more likely a significantly flawed corporate culture. Regulators say that for years, employees attempting to meet sales goals and earn additional compensation secretly issued credit cards without customers' consent. They created fake email accounts to sign depositors up for online banking services. They set up sham accounts that customers only learned about after fees started to accumulate. They requested and issued debit cards without prior consent, even going so far as to create PIN's without telling consumers. The company now says it has fired 5,300 employees dating back to 2011 who were involved in these activities - which apparently consisted of establishing a total of nearly 2 million 'fake' accounts, and 565,000 credit cards - never authorized by customers.

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This issue is certainly not limited to the 5,300 fired employees; it unfortunately speaks loudly about a culture from the top down. Maybe not purposefully, but clearly this culture was allowed to germinate over a number of years, and when recognized - if it ever truly was - was not dealt with forcefully. Former CEO John Stumpf (who retired under pressure October 12th), speaking during a Senate hearing in September in which he was summoned, said, "I am deeply sorry that we failed to fulfill our responsibility to our customers, to our team members, and to the American public. I want to apologize for violating the trust our customers have invested in Wells Fargo." He added, "I want to apologize for not doing more sooner to address the causes of this unacceptable activity." How is it possible a fired employee group of that size did not draw the attention of the Chief Executive Officer sooner? If it did draw his attention, possibly even prior to 2011, how could it not have prompted fast, forceful action to have it corrected? One of Wall Street's leading banking analysts, Mike Mayo of CLSA, said, "It's a head-scratcher why so many employees felt comfortable crossing the line." The only real answer is that the culture created at the company, inadvertently or not, fostered it.

This is the antithesis of sustainability. Actions for short-term 'gain' were tolerated, or possibly even aided, at the expense of doing the right thing for the long-term health of the enterprise and it's customers, employees, shareholders and stakeholders. At Martin Capital Partners, our process framework is coined *QDG: Quality, Durability and Growth*. A culture that promotes sustainable decisions plays a vital structural role in all three of those categories. Companies that don't foster wise, long-term, sustainable decision making, put the growing cash dividends, we prize, at risk.

We sold our stake in Wells Fargo last month. It's always frustrating having to sell, particularly when the less subjective characteristics of the company appear positive, such as a favorable current dividend yield and an attractive valuation. The stock could rise in the near future simply on those factors. It's our responsibility, and our discipline, however, to analyze our investments in light of their ability to remain a quality concern that pays us durable and growing dividends well into the distant future. The bank's cultural issues put that at risk in our view.

It's possible the company could be re-purchased at a future point, if actions taken forcefully indicate honest, concrete change is occurring. But for now, Wells Fargo does not fit the criteria we require when defining and seeking businesses that make sustainable long-term decisions to solidify the durability of cash dividends, and ultimately enhance their ability to grow.

Please feel free to call or email with questions you may have regarding our strategies or Martin Capital Partners in general. You can also find information on our website at www.martincp.com.

It is a sincere privilege serving those that have entrusted us with their capital.

Respectfully,

Cameron K Martin
Chief Investment Officer
Martin Capital Partners, LLC

1. Ned Davis Research, December 2015.
2. Consumer Financial Protection Bureau, Press Release September 2016.

Statistical and analytical data provided by Thomson Reuters Datastream, Eikon & Baseline.

If you would like additional information on how Martin Capital Partners, LLC conducts business, we can provide a copy of our SEC Form ADV part II, firm brochure. As always, past performance provides no indication of future results.

The market views and opinions expressed above reflect the opinions of Martin Capital Partners, LLC and are not intended to predict or forecast the performance of any security, market, or index mentioned.

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