CADINHA&CO

REGISTERED INVESTMENT ADVISERS / INVESTMENT COUNSEL

PIONEER PLAZA, SUITE 1240
900 FORT STREET MALL
HONOLULU, HAWAII 96813
(808)523-9488 PHONE
(808)526-9725 FAX
CADINHA.COM

Investment Outlook & Commentary
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With the latest budget battle in Washington and the end of the Federal Reserve's latest and largest "Quantitative Easing", investors are increasingly anxious as they think about what to do after the stimulus-punchbowl is removed from the party.

Add to this disappointing economic data and an unemployment rate still above 9%—a rate we assume might be much higher when discouraged and part-time workers are considered. Little solace is coming from politicians and Keynesian economists now shocked, *Shocked!* that dumping trillions of borrowed and printed dollars into the economy didn't produce much stimulus at all.

Rising deficits along with the costs of food and fuel are creating new skeptics of Bailout Nation and a call for a new sobriety. Whether an increased debt ceiling will be matched with sizable expenditure cuts; or taxes will be raised; or the Fed will launch QE4—we don't know with any certainty. Nor do we know how long the U.S. and others will continue amassing previously-unthinkable deficits until the real problems begin: massive debt defaults, deflation, hyperinflation, etc. We think, or at least hope, that our leaders still have a few more chances to save us before we pass a fiscal point-of-no-return. In any event, this 100,000-foot-level issue will be a constant consideration for an investment team accustomed to taking just a 50,000-foot view.

About cash holdings

The rising uncertainty and angst has caused us to pare down some of our stocks—still our favorite investment—and raise cash allocations. To be sure, cash, specifically money market funds, yields nothing today. *0.01% annually* to be exact. Yet cash remains to us a viable investment consideration, even at 0.01%, even as the Fed prints money in an explicit effort to devalue all the dollars in existence. With all the uncertainty, we think an elevated defensive posture is prudent at the moment.

The posture should be temporary, because we also hold the cash with a lot of Offense in mind. Our bullishness remains regarding certain kinds of stocks, namely, fortress companies with substantial earnings power. Many are already cheap, in our estimation, and many are already held in portfolios. We look forward to buying more at even cheaper prices.

Now a word on *how* we're holding cash. While most money market funds offer just 0.01% yield or thereabouts, we realize not all funds are the same. It has been quite unnerving to learn that "prime" money market funds—the ever-present, "safe" cash vehicles most investors have in their brokerage accounts—contain more risk than is generally assumed.

Take, for example, the holdings of the nation's largest money market fund:

By region:		
	Europe:	45%
	U.S.:	30
	Canada:	10
	Australia:	9
	Japan:	6

By instrument:		
	Certificates of deposit:	45%
	Repurchase agreements:	20
	Financial company-commercial paper:	15
	U.S. Treasury debt:	11
	Other:	9

This particular fund holds some $118 billion in assets, but currently invests only 30% of its holdings within the U.S. This fund and virtually all other large prime funds have put a majority of their assets with international banks in CDs and repurchase agreements. Most of these banks are European, are struggling with over-levered balance sheets and dubious holdings, and are exposed, both directly and indirectly, to deteriorating countries like Greece, Italy, and Spain.

While we may not be able to ascertain with precision the risk of these funds' investment strategy, or know the probability that, say, a Greek debt default could domino through European banks and beyond; we know with absolute certainty that, at 0.01% interest, prime money market funds have shouldered more risk for their investors with no additional return. Today's $1.6 trillion prime money market industry can only be described as: *return-free risk*.

Consequently, we are moving cash assets, as much as your particular brokerage or bank will allow, into U.S. Treasury bills and/or Treasury-based money market funds. They, too, yield nothing but at least have the full faith and credit of the U.S. Treasury behind them.

The yield question

We're astonished at the extent to which individual and institutional investors, when starved of a risk-free return, will throw caution to wind and accept a combination of lower credit quality and longer maturity. We don't feel the cash burning a hole in our pocket yet, especially when the yield on Treasurys at any maturity falls short of its corresponding anticipated inflation rate. Just doesn't whet the appetite. James Grant of *Grant's Interest Rate Observer* recently said Treasurys today are but a wager on a certain economic outcome: a Japanese-style deflation. Hard to argue with that, and hard to take the over on that bet at the moment, what with Ben Bernanke swearing he'll print as much money as needed to prevent such an outcome.

For the time being, we expect to earn our fees with a combination of sniffing out the overall risk picture and timely investments in a cadre of businesses that resemble cash machines, trading at relatively low multiples of their earnings and cash flow. As for yield, it helps that many stocks today offer income streams higher than longer-term bonds, especially on an after-tax basis. Even better is that, unlike bonds, those income streams should in all likelihood continue rising over time. With this in mind, we expect our sizable cash holding won't remain for long.

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Neil Rose, CFA
Chief Investment Officer