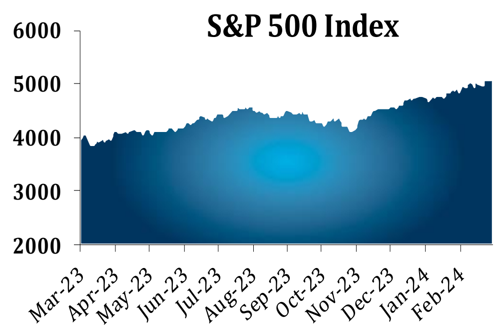
Public

This Month in the Markets

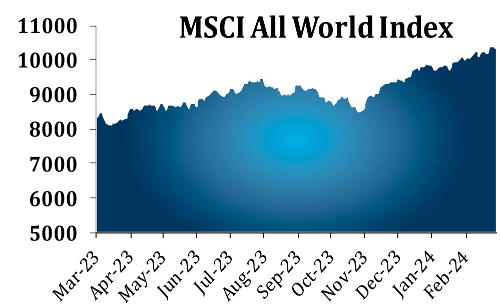
February 2024

Equity Commentary

Wisdom of Buffett



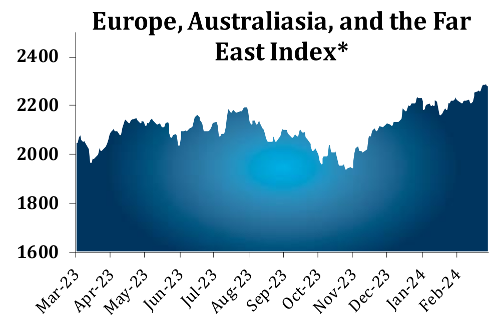
The equity markets continued to march higher in February due to stable economic data and strong corporate earnings. The MSCI ACWI Index was up 4.3%. A Chinese rebound helped to lift the MSCI Emerging Markets Index by 4.8%, but the S&P 500 continued to dominate with a gain of 5.3%. Growth solidly outperformed value again, with the MSCI All Country World Growth Index jumping 6.0% while the MSCI ACWI Value Index only managed a 2.6% gain. MSCI ACWI Consumer Discretionary Sector was the biggest gainer with a jump of 7.9%, helped in part by rallies in luxury goods companies and select auto manufacturers. The MSCI ACWI Utilities Sector Index was the sole loser, with a decline of 0.4%, mainly due to a significant slide in select European utilities as European power prices continued to normalize after spiking following Russia's invasion of Ukraine.



The Berkshire Annual letter came out over the weekend, and we'd like to touch on two pieces of wisdom from Warren (we wrote on the late Charlie Munger's wisdom in the November letter). Italics are from the letter, and our comments follow.

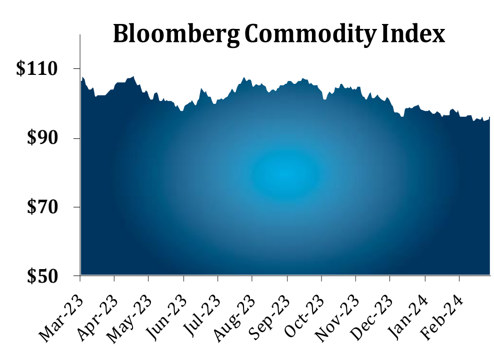
"Though the stock market is massively larger than it was in our early years, today's active participants are neither more emotionally stable nor better taught than when I was in school. For whatever reasons, markets now exhibit far more casino-like behavior than they did when I was young. The casino now resides in many homes and daily tempts the occupants."

Investing, done right, we would argue, is not akin to a casino. The key of course is "done right". Unlike a casino, the odds tend to be in your favor as a long-term investor because the economy and the world progress positively over time. If it didn't, the stock market would not show such a spectacular long-term rise in value. A rational thought process with sanity checks is needed to be "done right" and not imbue the tenants of gambling. We think it's important to know "why" you own something, "what" you feel is a plausible valuation, and "how" you will deal with unconfirming information. Buying something because the narrative is compelling may work but can be immensely dangerous if the narrative changes or shifts at the margin. You may be gambling if you are unsure why you own a position, how you will deal with disconfirming information, or what a reasonable value is.



"Thanks to the American tailwind and the power of compound interest, the arena in which we operate has been – and will be – rewarding if you make a couple of good decisions during a lifetime and avoid serious mistakes."

In our business, getting things right more than 50% of the time can confer success. Since the odds of success are not stratospheric, it is essential to take advantage when you are right and curtail the damage when you are wrong. Active investing, by its very nature, is an act of hubris. When you buy a stock, you believe it is mispriced and disagree with millions of participants and the market as a whole at that point in time. Thus, it is important to give weight to that fact and allow for this "arrogance" to be checked when you miss something and get an investment wrong. An escape valve is helpful, and this can be found in signposts of the "why" and/or decidedly negative relative price action. Many catastrophic financial calamities in history often revolve around brilliant individuals' refusal to admit they were wrong. On the flip side, it takes some courage to stay in a winning position and allow compounding to compound. Stocks that go up 500% had to have gone up 100% previously. Quickly grabbing gains can be expensive if you fail to account for the effects of compounding and exponential math. Significant compounding investments offering multiples of initial invested capital are uncommon and tend to be rare exceptions. One common successful trait for concentrated active managers is allowing the winners to compound.



*MSCI EAFE Index

Equity Commentary

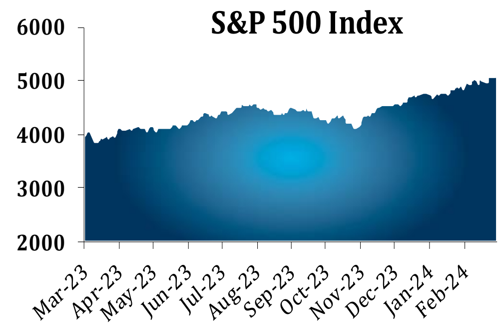
This is hard in an industry filled with very smart type-A individuals armed with data and spreadsheets. As Warren states:

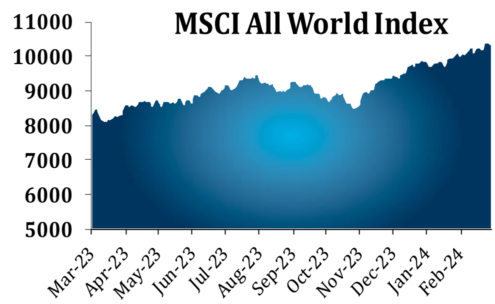
"America has been a terrific country for investors. All they have needed to do is sit quietly, listening to no one…. When you find a truly wonderful business, stick with it. Patience pays, and one wonderful business can offset the many mediocre decisions that are inevitable."

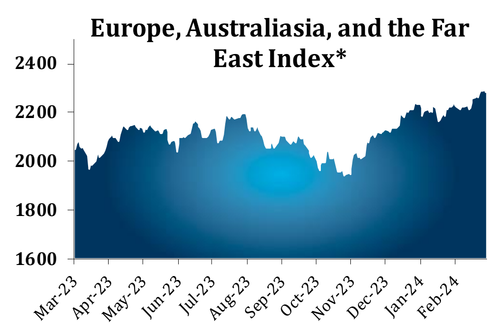
Sony Group was the month's largest underperformer, falling 12.2% after jumping 34% in 2023 and giving conservative guidance on PlayStation sales. Meta Platforms was the top performer, rising 25.8% as analysts continue to raise their profit forecasts on online advertising trends, improving operating margins and artificial intelligence prospects.

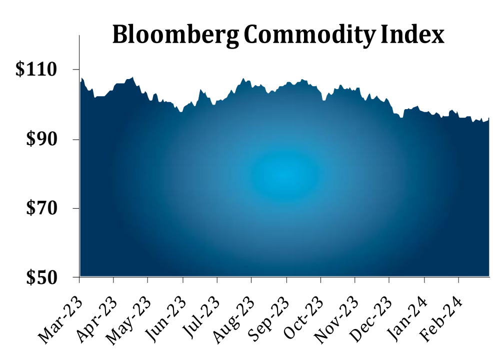
February was more of an active month than usual for us. We sold three positions and bought three positions. On the sales side, we sold a long-term winner Palo Alto Networks, as its earnings report revealed a new strategy of offering certain products for free for several months to try and capture market share, and it missed billings estimates for another quarter. We were concerned with its shift in strategy and the implied cyber security spending fatigue that may be developing. We also parted with Manulife Financial Corp, after it hit our target price. After a brief holding period and a significant gain, we moved out of Mitsubishi Heavy Industries. This was a switch to another name, which we felt offered more upside.

On the buys side, we identified several opportunities. We bought Shell PLC as we wanted to increase our exposure to oil. Despite rising tensions in the middle east, the associated risk premium embedded in the price of oil shrank to virtually nothing and we felt the risk/reward was heavily skewed to the upside. Shell trades with a free cash flow yield of over 11%, pays a dividend of 4.3%, and should buy back upwards of 6-7% of their shares in 2024. We bought Starbucks which is the World's largest coffee restaurant chain and is under-valued based on Anchor's models, its growth prospects and significant investment moat. According to Brand Finance, the company is the top brand in the restaurant industry and has a 30% return on invested capital. We also bought Match Group, which owns and operates the largest global portfolio of popular online dating services, including Tinder, Match.com, Meetic, OkCupid, Hinge, Plenty of Fish, OurTime, and other global dating brands. Gen X, Y and Z are the generations of online daters and young people are finding partners online and once again taking them on physical dates post Covid restrictions. Online dating apps represent one of the fastest-growing and most profitable apps on the internet. According to a Stanford University study by Michael Rosenfeld, 40% of heterosexual couples met online from 2009 to 2017, up from 20% in 2010. The shares sell at 15.8 times trailing 12-months EPS with a 17% return on invested capital.









*Merrill Lynch Global Broad Market, Ex US Dollar Index

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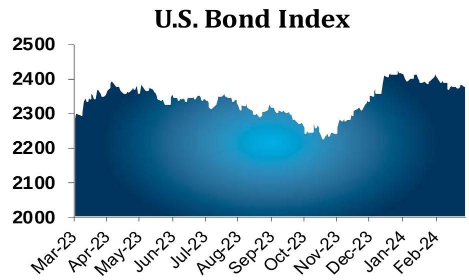
Fixed Income Commentary

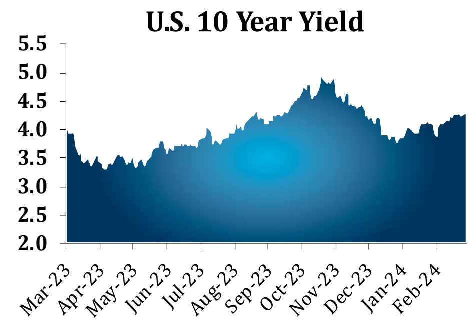
Buoyant Data

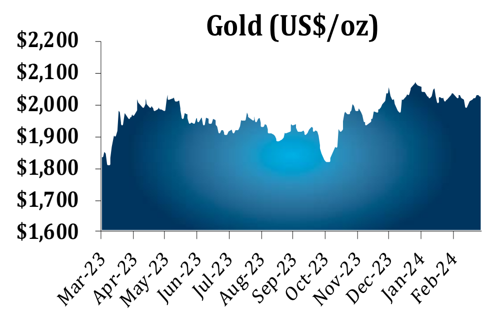
February saw a raft of strong economic and inflation data. In early February, the Institute of Management Supply’s Manufacturing Purchasing Managers Index (PMI) was released showing an increase to 49.1 from 47.1 the previous month. Note, this level still suggests contractionary economic growth, however it was the increase in the New Orders component (from 47.1 to 52.9) and Prices Paid component (from 46.9 to 52.9) that caught the eye – both are leading indicators that jumped from contractionary to expansionary readings. The next day, the Nonfarm payroll report came in almost double the consensus estimate; the prior month’s payroll figure was also revised higher. Then in mid-February, the Consumer Price Index (CPI) and Producer Price Index (PPI) data were released. Both beat expectations on a year-on-year (YoY) and month-on-month (MoM) basis in both the headline and core (excluding energy and food). In the CPI report, the shelter component surprised to the upside. This appears to be driven by a large jump in the owner-occupied rent (OER) component, which accounts for ~24% of the CPI. The 0.55% MoM increase in OER was the largest since April 2023, sharply bucking the declining trend. According to an email from the Bureau of Labor Statistics sent to Bloomberg “super users”, the rise in owners-equivalent rent was due to an increase in the weight of single-family detached homes relative to multifamily units. Nonetheless, some market commentators have expressed doubt in this explanation given the magnitude of the move.

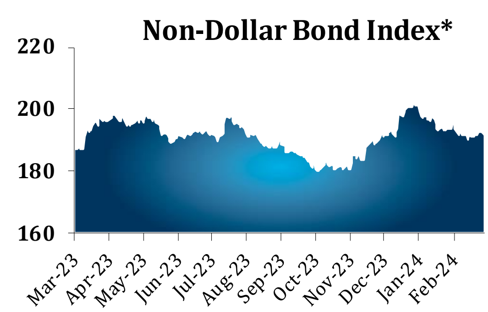
At the end of February, the Personal Consumption Expenditure (PCE) data was released, showing the MoM readings for headline and core inflation were higher than the previous month’s (though in line with expectations which had been revised higher after the CPI and PPI data). The PCE is less volatile than the CPI and is reported to be the Fed’s favored measure of inflation. While CPI and PCE have different component weightings, most notably to shelter, both measures tell a similar story—namely, weakness in goods inflation and stubbornly sticky services inflation. If we exclude shelter, the narrative remains. The MoM figures for so-called “super-core inflation” (which strips out food, energy, and shelter) rose for both the PCE and CPI.

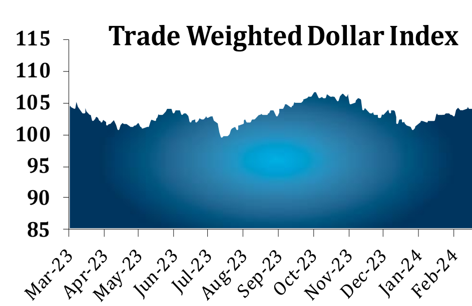
The market ended January with the market expecting six 0.25% rate cuts as per Fed Fund futures. By the end of February, this had fallen to just over three 0.25% rate cuts as the market reacted to the higher-than-expected inflation cited above. Market expectations for rate cuts are now essentially in line with the Fed’s latest dot plot released in December 2023. As a reminder, the dot plot is each FOMC (Federal Open Market Committee) member’s individual expectation for the fed funds rate. We will get an updated dot plot at the March 20th FOMC (Federal Open Market Committee) meeting. These rates expectations filtered throughout the treasury curve. The 2-year rose by 0.41% to 4.61%, while the 10-year rose 0.33% to end the month at 4.25%. With regards to credit, investor demand remained buoyant as investment grade new issuance (~$198 billion) set a record for the month of February. Credit spreads have benefitted from a strong Q4 earnings reporting season and strong economic data, which has in turn led to increased expectations from market participants for a soft or no landing scenario. Credit spreads reflect this expectation and in our opinion the risk/reward trade-off is not favorable to chase corporate credit at these levels.











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