This Month in the Markets

October 2021

Equity Commentary

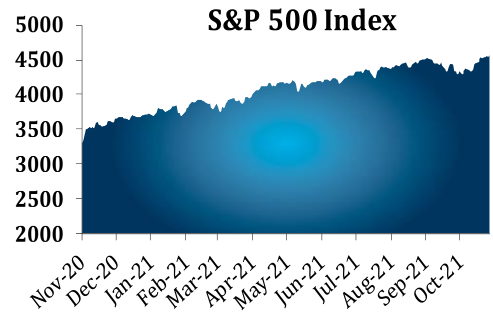
Political Risk

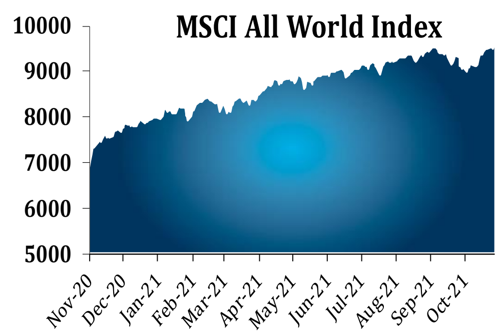
"When I am asked what I worry about in the market, the answer usually is "nothing", because everyone else in the market seems to spend an inordinate amount of time worrying, and so all of the relevant worries seem to be covered. My worries won't have any impact except to detract from something much more useful, which is trying to make good long-term investment decisions."

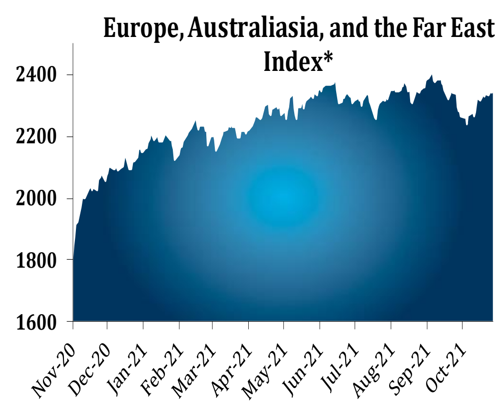
- Bill Miller 3Q 2021 Market Letter

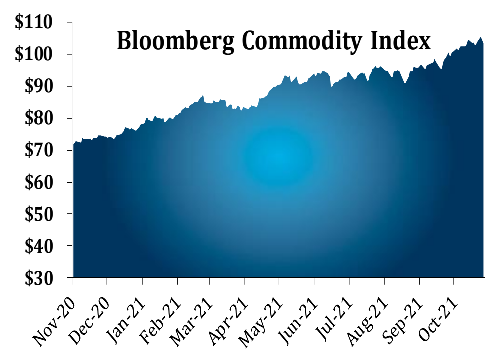
For October, the MSCI ACWI Net Total Return posted a 5.1% return. The S&P 500 rose 7.0%, while the MSCI EAFE Net Total Return index lagged with a 2.5% gain. Growth beat value, with an increase of 6.7% vs. 4.5% for the MSCI World Growth and Value Indices, respectively. The ACWI Consumer Discretionary Sector index was the top performer, climbing 8.0%. The MSCI ACWI Communications Sector was the under-performer with a -0.3% loss due to the declines in telco and cable companies. Microsoft was the best portfolio performer for the month, with an increase of 17.6% after posting solid quarterly results, which highlighted its strength in cloud computing. The biggest detractor in the month was Fiserv which fell 9.2%, likely due to factors such as the limited potential for positive earnings revisions and legacy tech positioning.

This month we'll briefly discuss two subjects that come up from time to time in conversation. The quote above by Bill Miller is the first, and it revolves around fretting the macro. As Mr. Miller rightfully acknowledges, there is always something to worry about. It is not that we don't consider various macro issues, nor are we blind to how they could affect our companies; it is just that the micro is far more critical in most cases. Most macro issues are fun to discuss and exciting to debate but impossible to truly predict in any meaningful way to give you an edge in investing. This is mainly for two reasons. The first is that they are essentially impossible to get correct. In fact, it is not even necessary to get them correct if you focus on a great company. If your outcome is predicated on getting, for example, the GDP growth right for your company, then one would argue it is not that great, i.e., its business is at the whims of the general economy and not due to its excellent delivery of goods or services in high, consistent, and profitable demand. The second factor is that even if you did worry correctly and somehow predict the outcome of an event, you might get the market reaction wrong. The recent pandemic is probably the best near-term example. We are still in a global pandemic, but the stock market is at an all-time high. The macro things to honestly worry about are the ones nobody knows are coming. If this is true, how would you worry about them?









*MSCI EAFE Index

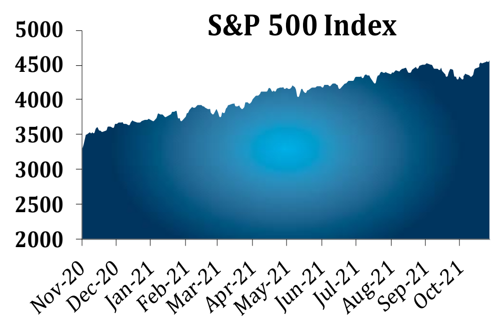
Equity Commentary

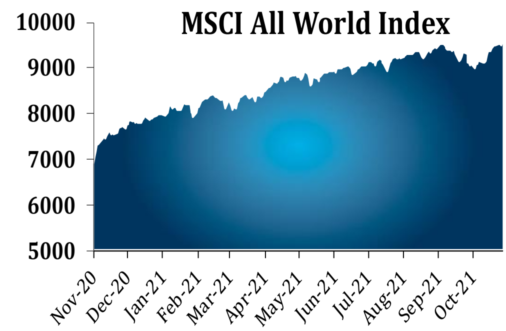
The second discussion point that often comes up is absolute valuation. Since our primary strategy is growth at a reasonable price, we believe growth matters. In fact, it can matter a great deal if it's consistent, which is why we spend a great deal of time trying to find growing companies with defensible business models that allow them to grow profitability for years. Look at the matrix below:

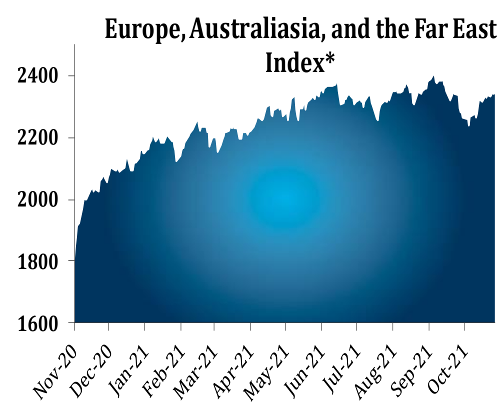
5 Year Compounded Return				
		% Change in P/E Multiple		
		-35%	-20%	0%
% Compound Earnings	10%	**1%**	**5%**	**10%**
Growth over	15%	**6%**	**10%**	**15%**
5 Years	20%	**10%**	**15%**	**20%**

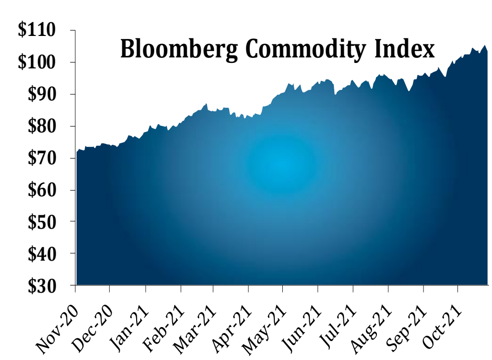
What this graphically illustrates is how significant, consistent growth is. Even with a much higher starting price-earnings multiple, a constant high grower can do better than a "pure value" company. For example, a company growing 20% per year can suffer a 35% contraction in its price-earnings multiple and return as much as a 10% grower with no multiple contraction. Growth and value are intrinsically tied together.

We added one new position in October. Comcast is a very high-quality company with several individual businesses (NBC Universal, Sky etc.), but at the end of the day, the mail gets delivered by their solid broadband business. Shares pulled back over the past two months as some investors became concerned that the net subscriber additions for the industry were slowing from elevated levels during COVID and many speculated that increased competition could be the culprit. We prefer to look longer term and see a current footprint of roughly 60 million passings (potential customers) and just 33 million current subscribers. With 50%+ of their existing network where they are the only provider, we think the decline in subscriber additions isn't a testament to ramping competition but a natural slowdown from elevated levels due to COVID. With record low churn, we believe strongly that there remains a long runway for future growth. Over the next several quarters, we also expect a strong recovery at NBC, Universal Studios, and the company's theme park business.









*Merrill Lynch Global Broad Market, Ex US Dollar Index

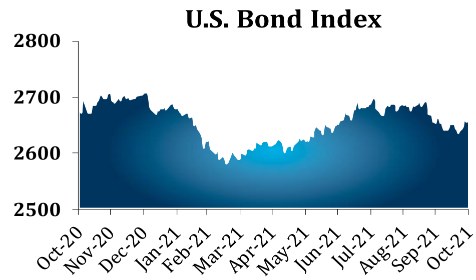
Fixed Income Commentary

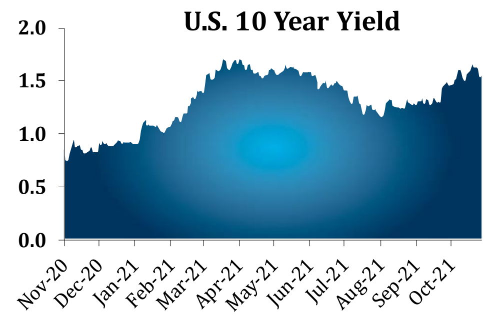
Curve Your Enthusiasm

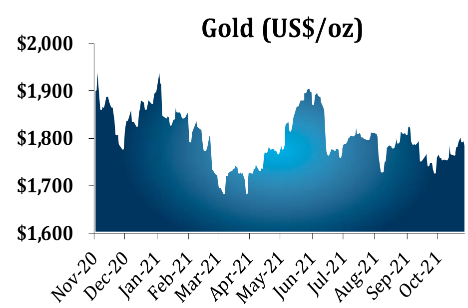
As I drove down Flora Duffy Hill in late October, I was thinking about the upcoming season 11 debut of Larry David's "Curb Your Enthusiasm" when POOF! The title for this piece was born... I realize fixed income can be quite boring to most. I can only imagine Larry David's opinion on the yield curve and credit spreads! Nonetheless, I would be remiss if I did not report that expectations regarding fed fund rate hikes increased notably in October as per fed fund futures. Fed fund futures now suggest two rate hikes (0.25% increments) by year-end 2022 (YE22), up from only one in September. The increase was more pronounced in fed fund futures maturities at YE23, YE24, and YE25, where almost two additional fed fund rate hikes were priced in from levels seen at the end of September. Indeed, this shift in sentiment was reflected in the yield curve, where rates moved notably higher in the 2-year to 5-year part of the curve outpacing moves on the long-end. For instance, the yield on the 2-year increased 22 bps to 0.50%, while the yield on the 10-year treasury increased just 6.5 bps to 1.55%. As a result, the 2Y-10Y slope flattened 0.15% to 1.05%. Looking out to the 30-year treasury, the curve is much flatter. Indeed, the 30-year treasury peaked in March 2021 and has quite steadily fallen ever since. As such the slope of the curve between the 10-year and 30-year treasury is only 0.40% compared to 0.56% at the end of September and 1.62% since the March peak.

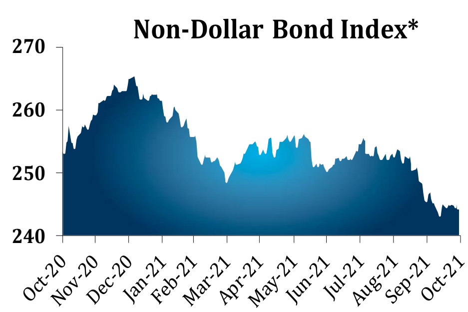
In other news, credit spreads remain at historically tight levels reflecting the reach for yield environment and low default rate expectations. It continues to be a very favorable time for companies to tap debt markets. Elsewhere procyclical currencies, such as the CAD, AUD, NOK, and SEK appreciated versus the USD in October. The Bank of Canada has started tapering, while the Norges Bank (Norwegian central bank) has already raised rates this year. The Bank of England (BOE) can also be added to the list of central banks shifting to a more hawkish stance. The BOE is expected to raise the official bank rate by year-end. Meanwhile, the ECB is likely years away from raising interest rates, and the BOJ is still mired in yield curve control.

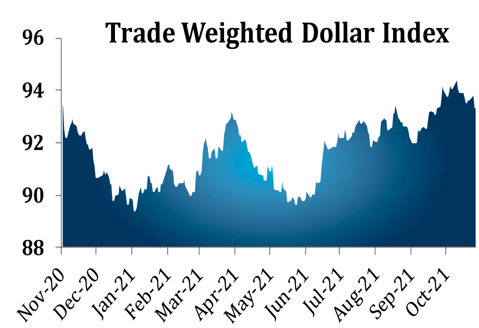
The Fed has a dual mandate of maximum employment and price stability. The Fed's interpretation of price stability is low, steady inflation (2% target). Currently, inflation is rampant, driven by strong consumer demand, supply-chain disruptions, and rising commodity prices. For example, the September core personal consumption expenditure (PCE) index, the Fed's preferred inflation measure, came in at 3.64%, well above the Fed's 2% target (and has been for the last 6 months). While the Fed had been consistent in viewing inflation as "transitory", the messaging has shifted to more of an acknowledgment that it will be more persistent than initially anticipated. Thus, it appears the inflation mandate has been reached and then some. This brings us to the labor market. National Federation of Independent Business (NFIB) surveys indicate a shortage of labor; the "Job Openings Hard to Fill" index is at an all-time high. In addition, the Bureau of Labor Statistics Quits index is also at a record high. While these statistics indicate a tight labor market, the labor force participation rate (61.6%) is still well below the pre-pandemic level (63.3%). This puts the FOMC in a difficult position. The inflation mandate is flashing red, while the labor market (arguably) isn't there yet. For now, at least, Powell made his opinion clear in an October 22nd speech: "I do think it's time to taper; I don't think it's time to raise rates." Clearly, Powell has little enthusiasm to raise rates; however, if the labor market participation rate does not drift higher, he may be forced to change his tune...











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