Public

This Month in the Markets

November 2021

Equity Commentary

The Folly of Forecasts

"*I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children*" - Warren Buffett

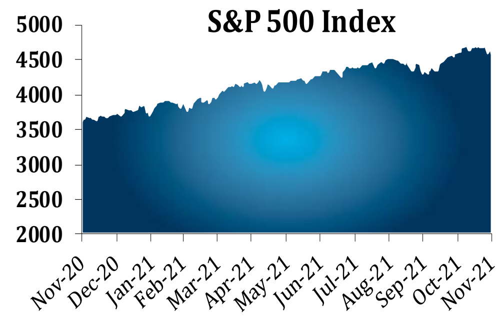
"*The only function of economic forecasting is to make astrology look respectable*" - John Kenneth Galbraith

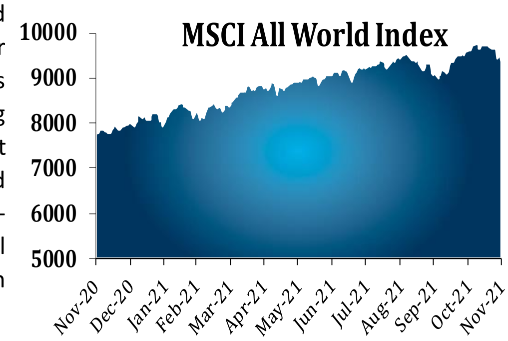
For November, the MSCI ACWI Net Total Return ended lower with a -2.4% return. The S&P 500 fell 0.7%, while the MSCI EAFE Net Total Return index lagged with a -4.7% loss. Growth beat value, with a drop of 0.7% vs. 3.8% for the MSCI World Growth and Value Indices, respectively. The ACWI Information Technology Sector index was the top performer, climbing 2.5%. The MSCI ACWI Energy Sector was the under-performer with a -6.9% loss due to declining energy prices resulting from the Omicron variant's growth concerns. Bath and Body Works was the best portfolio performer for the month, with an increase of 9% after posting solid quarterly results, highlighting continued strength despite concerns about post-Covid weakness. The biggest detractor in the month was CoStar Group, which fell 9.6%, likely due to concerns surrounding future advertising spending in apartment listings, which are seeing unprecedented low vacancy rates.

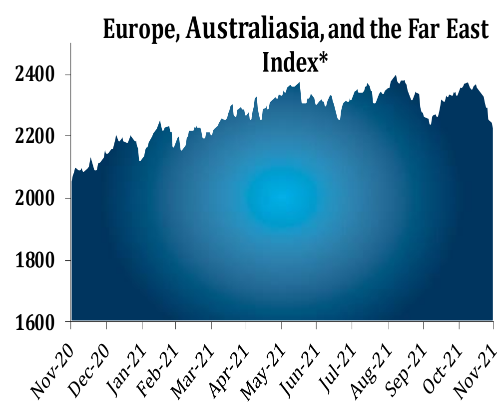
We are entering the financial markets silly season – market forecast publications for 2022. The quotes above do a great job of explaining the futility of forecasting. Static forecasting is junk. Situations in financial markets are fluid; thus, all prognostications are almost instantly stale. Trying to guess what the market will do next is like trying to nail Jell-O to a tree. No one can genuinely claim with certainty that they know what tomorrow will bring, and if you meet someone who does, you should put your hands in your pockets to check for your wallet and slowly back away. Voltaire sums it up best: "Doubt is not a pleasant condition, but certainty is absurd." Besides, successful investing involves following the correct principles and prescriptions, NOT the right predictions. Spending inordinate amounts of time trying to predict things you can't forecast or worrying about imagined outcomes is rarely, if ever, productive use of mental capacity and time.

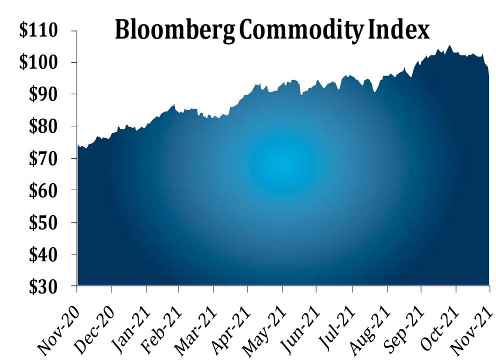
So why do we listen or pay attention to forecasts in the first place? Why are people drawn to them and especially dire ones? Morgan Housel probably wrote the best-summarized theory on this:

"*The correlation between high stakes and people's willingness to believe quackery is high. And it's rational. A low-probability, high-stakes prediction should always be taken seriously. And if your world is so confusing that you can't determine probabilities, defaulting to assume that prediction will come true may increase your chances of survival. When things are calm people believe what they tell themselves. When things are crazy, they believe what other people tell them. That's why we listened to bad forecasts 500 years ago. And why we listen to bad forecasts today.*"









*MSCI EAFE Index

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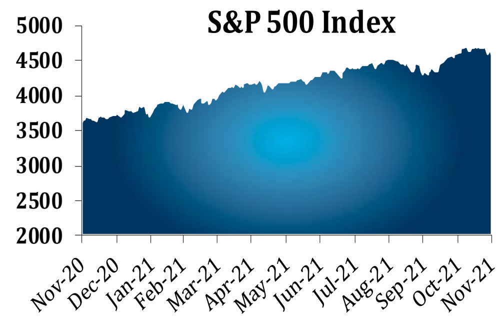
When it comes to investing, which can appear nebulous, scary, and complex to many, comfort is sought in some semblance of perceived understanding. Unfortunately, as with all complex adaptive systems, you will never have certainty.

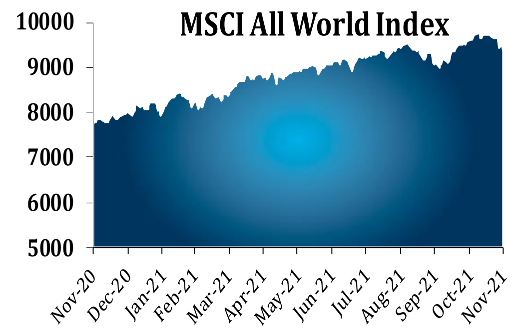
If you are still not convinced, try to find a 2021 forecast that predicted the following things:

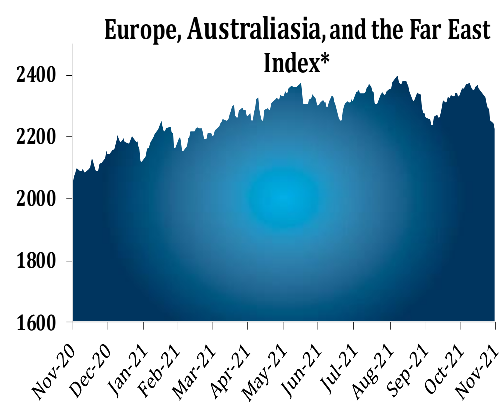
1. Two new Covid variants will develop and rip through the world – the market rallies over 20%.
2. Supply chain issues disrupt production – retail sales in the U.S. surge with unprecedented gains, and personal consumption expenditures soar well above trend.
3. Inflation rockets to levels not seen since the 90s – 10 yr treasury bonds yield less than 1.5%.

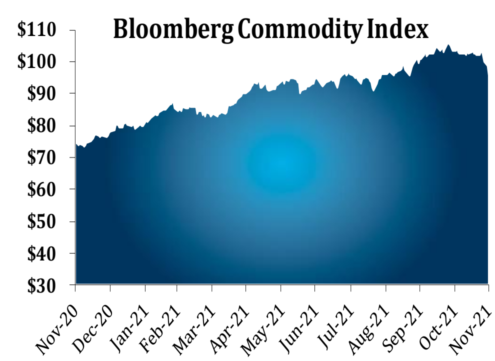
We added two new positions in November. Willis Towers Watson (NASDAQ: WLTW) is a leading global advisory, broking, and solutions company that helps clients around the world turn risk into a path for growth. WLTW sells at a significant valuation discount to its major competitors Marsh & McLennan and Aon. Activist investor Elliot Management, Starboard Value, and other hedge funds are pressuring management to narrow the valuation gap between WLTW and other insurance brokers. They have made significant changes to the company's Board of Directors and are selling lower return businesses. We believe the shares have at least a 25% upside.

We also added shares of Deutche Telekom AG (DTE). While the company is known for its German and European telco business, over 60% of its earnings and nearly 2/3's of its value is in its 48% stake in T-Mobile U.S. (TMUS). Following its merger with Sprint on April 1, 2020, TMUS became the third national carrier in the U.S. Given its lead in 5G coverage and density, coupled with significant synergies from the Sprint merger, we see a solid operational trajectory for its U.S. business. The German and European businesses are also executing well with GDP+ growth characteristics. Shares of the stock pulled back over the past three months, and with the company recently increasing its Free Cash Flow guidance for the year, we felt the risk/reward was skewed in our favor. With the stock trading with a free cash flow yield of over 10%, we see excellent return potential in addition to a solid dividend yield of nearly 4.0%.









*Merrill Lynch Global Broad Market, Ex US Dollar Index

Fixed Income Commentary

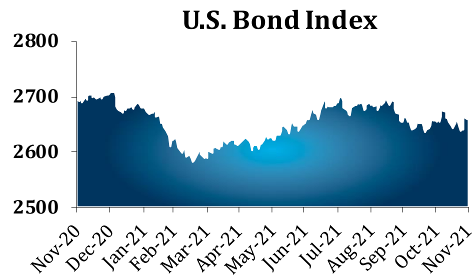
Powell Ditches "Transitory"

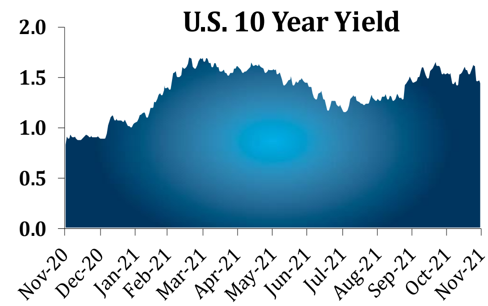
In November, we saw the return of volatility, which spanned equities, interest rates, and currency markets. Proxied by the MOVE index, interest rate volatility began creeping up in October as investors began pricing in a more hawkish fed which we mentioned in our last review. This trend continued into November, however, it swiftly reversed on Friday, November 26th, on news of the Omicron variant. Treasury rates fell across the curve, led notably by the short-end and belly, as investors reacted to the uncertainty (potency of Omicron and the economic impact) by reducing monetary tightening expectations. The move was likely heightened by limited liquidity, given it was the day after the Thanksgiving holiday.

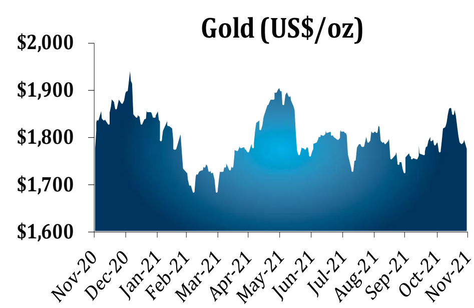
A few days later in Powell's testimony to the Senate banking, housing, and urban affairs committee , he noted the Omicron variant's potential risk to the economy. However, he also said that he no longer views inflation as "transitory" and that it was a good time to retire the term. He commented that he had underestimated the supply shock and its impact on inflation. This was important as Powell had consistently publicly referred to inflation as transitory. Indeed, it has been the buzzword throughout financial media all year. With regards to increasing the pace of tapering (which a few FOMC members had publicly supported earlier in the month pre-Omicron variant), Powell said that it is "appropriate in my view to consider wrapping up the taper of our asset purchases, which we actually announced at our November meeting, perhaps a few months sooner."

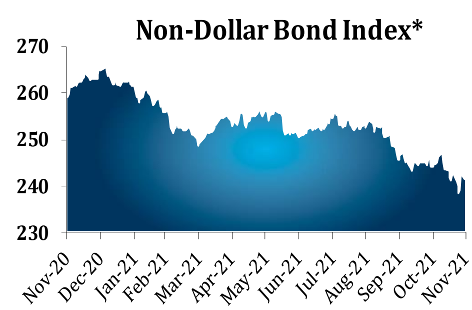
This change in view on inflation was a total 180-degree pivot by Powell. Ironically, Powell has made this pivot when U.S. growth is expected to slow next year (much lower fiscal thrust) and year-on-year inflation base effects will be considerable. Indeed, inflation break-evens (the difference between a nominal treasury yield and inflation-protected treasury of the same tenor) have fallen since peaking in mid-November, suggesting fixed-income investors' inflation fears have eased on the margin. On the back of Powell's inflation and tapering comments, short rates rose, reversing much of the November 26th decline, however, rates further out the curve (10Y and over) were essentially unchanged. As such, the yield curve continued to flatten. This is most notable in the 5Y-30Y portion of the curve, where the spread differential is only 0.62% compared to the 1.63% at the 2021 peak of late February. The yield curve suggests growth is set to slow and, ironically, that inflation will, in fact, be transitory. Time will tell who is proven right…

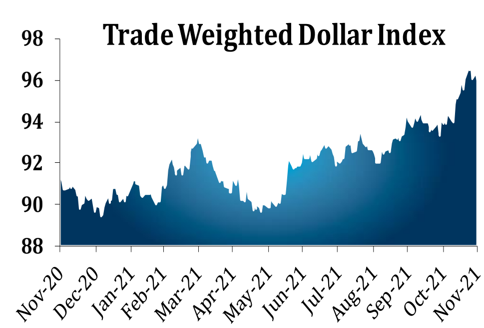
Elsewhere, the U.S. Dollar (USD) appreciated as proxied by the DXY index's 2% rise in November. The USD has benefitted from favorable (nominal) interest rate and growth rate differentials (no lockdowns, unlike Europe). Credit spreads widened, driven by the Omicron news in late November. Nonetheless, we still believe the environment for corporate bonds is still quite supportive of credit spreads - in particular, strong demand for corporate credit (buoyed by the 'reach for yield' environment) and low expected default rates. Our high yield exposure is mostly less than 5 years and rated in BB category (the highest rating among high yield issuers). The majority of which are credits we expect to be upgraded to investment grade in the next 12 months. As such, on the margin, we have taken a more cautious approach to credit risk in the highest risk portion of our bond portfolios.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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