Q1 2024 Investment Update

Big Picture

The world still has its share of problems, and they are not going away anytime soon. War in Ukraine appears to be settling into a long-term stalemate. Meanwhile, the Middle East is boiling over, with the potential for a wider conflict. China continues to threaten Taiwan with forced reunification. The "West" consisting of the United States, most of Europe/NATO, Japan, South Korea, Philippines, Australia, Canada—and possibly India in the future—provide a bulwark against the Dictator's Club of China, Russia, North Korea, Iran, Syria, Venezuela etc. Not an easy global environment to navigate right now. The dictators are on the wrong side of history and will struggle to prevail. Their paranoid insecurities necessitate forming a club. Even dictators need friends.

This uncertainty, though important to all of us as citizens and people who care about the world, isn't directly tied to how markets move and recent history bears this out. You can't predict. But you can prepare. We're always prepared for the markets to surprise us. Which they did. On the heels of last year's stock market rebound, the major stock market averages continued to rise during the first 3 months of 2024.

Actually, we're not all that surprised. One thing that's absolutely guaranteed (right up there with death and taxes) is a lumpy stock market result. As long as investors continue to react emotionally and irrationally to whatever daily events pop up in the news, we can be sure that market volatility will stay with us.

The stock market has now recovered from the 2022 bear market downturn. Major stock market indices such as the S&P 500 are currently about 5% higher than January 2022 levels…but, not much progress over the past 2+ years. Other indices such as the smaller company Russell 2000 are still around ***12% below early 2022 levels***. Market movements in the short run will be lumpy and don't move in sync with business results. Over the long run, they do…and stock markets have advanced substantially over time. There is no reason to think that "***this time is different***." When you hear someone utter these four famous words, run!

But what about inflation? The good news is we're probably done with interest rate increases. But the persistence of 3.5% to 4% inflation, above the Fed's 2% target, means no rate cuts soon. A trip to the grocery store or gas station is an easy reminder that inflation is still with us. As an aside…at the start of the year most "***experts***" believed interest rates would decline between 1% to 1.5% in 2024. Now the experts aren't sure if rates will decline at all, and if so whether this year or perhaps next year. Remember, forecasting is hard and fortunately not necessary for successful investing.

The upcoming U.S. Presidential election provides another reason for the Fed to exercise restraint in rate cuts to avoid the appearance of influencing the election. Higher for longer rates might mean a weaker economy later this year as higher rates have an impact on big-ticket items like housing, automobile sales, buildings and factories, business equipment, etc. But, when rates do decline, the cuts will have a stimulative effect on the economy, business sales, and profits. Which should further benefit our investments.

Real progress in the real economy by real companies is what the stock market rewards over long periods. Our high-quality companies collectively are making progress largely behind the mostly negative headlines one year at a time. We continue to believe the investing environment provides us with opportunity, despite the global problems, setting the stage for attractive long-term results.

The Value of Patience

Here's an interesting thought. Suppose you invested in a company's stock. The stock went nowhere for 5 years. What's the chance you'd continue to hold it? Be honest. Not likely. Below is a chart for just such a company, where the stock price went sideways from June 2013 until October 2022, not just 5 years, but 9 years of little progress.

Progress can take time, but when you don't see tangible evidence of that progress in the stock price, it can become irresistible to lose patience and move on from a seemingly "loser" investment. At times it's not easy to know whether to continue holding or move on to other opportunities.

John was interviewed a decade ago by an investment publication. He discussed a company with a decades-long historical track record of business growth that seemed likely to continue in the future. We stumbled across the article recently while searching for something else and wanted to share it with you. In case you haven't guessed yet, the chart above is the stock price chart for the company he described in the article. Here's the rest of the story:

Had you invested in Fairfax Financial Holdings in June 2013, you would have had a long wait, a very long wait, to earn a satisfactory return. As the chart shows, in October 2022, over 9 years later, the stock price wasn't much higher than 2013. Since then, or over the past 18 months, the stock price has more than doubled. The total return with dividends reinvested over the past almost 11 years works out to around 12% per year.

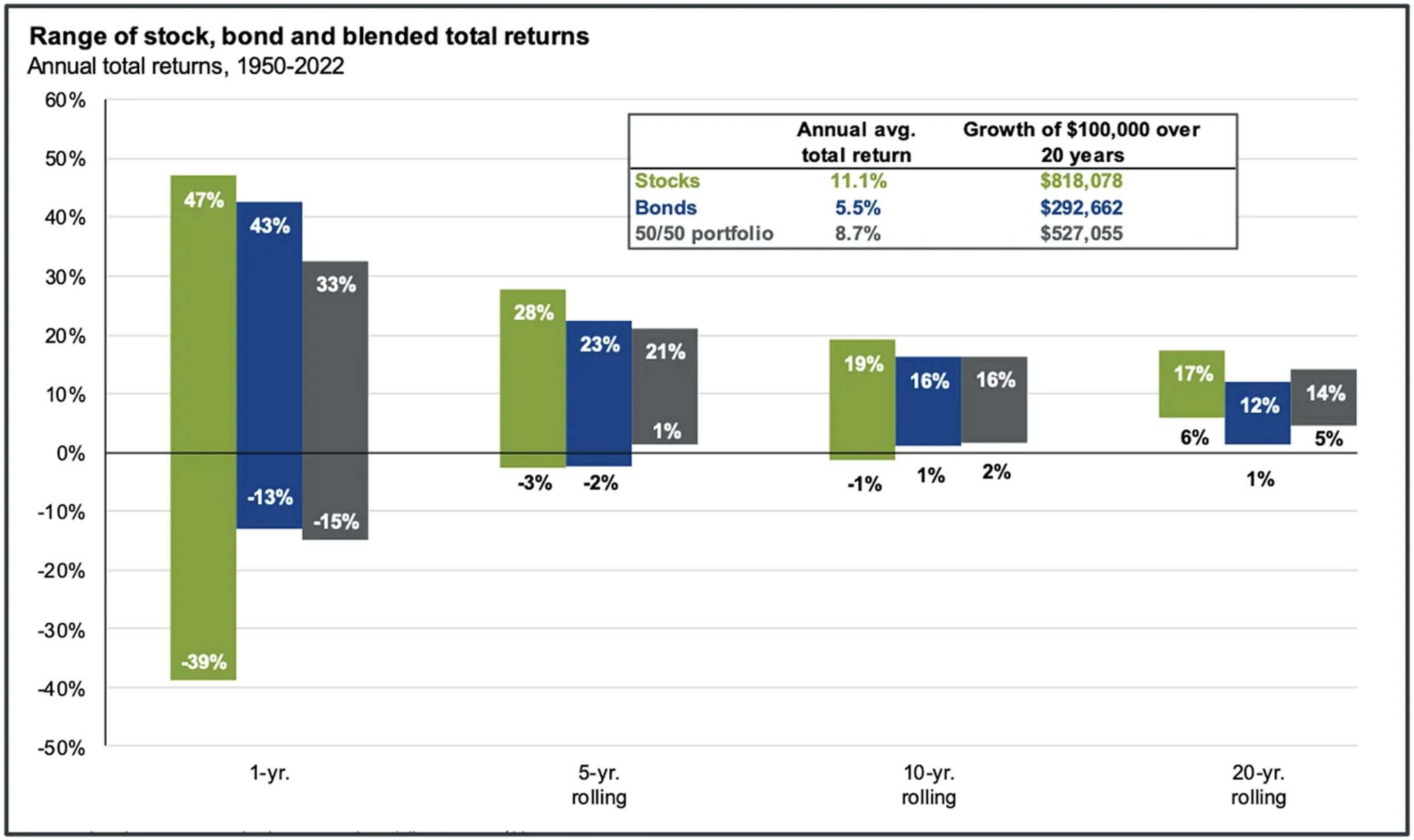
This example shows how lumpy stock market returns can be. To get very little return over 9 years, and then get most of the entire return of 11 years in a compressed period of 18 months, is unusual, but it can and does happen. There's an old saying: "***Markets can stay irrational longer than you can stay solvent.***" We'd modify that slightly to say ***markets can stay irrational longer than you can stay rational.*** Patience is a virtue, especially when investing.

Here's another example, again not a previous recommendation but an illustration of what can happen over a long period. Everyone knows Microsoft, right? Below is its stock price chart from January 2000 until December 2015, a total of 16 years. You will notice that the stock price made little headway. Why? In our opinion, 2 things. The stock valuation was inflated at the beginning of 2000 as the "***Internet Bubble***" of the late 1990s was just starting to deflate, and it deflated big time, and for a long time. Add a new CEO who didn't exactly set the corporate world ablaze (Steve Ballmer replaced Bill Gates in February 2000) and the result was as shown here:

The point here is Microsoft shareholders had to ***endure 16 long years in the investment wilderness***. Ballmer was replaced in 2014 by Satya Nadella, who changed course, making an immediate impact. It also helped that over the previous 16-year drought Microsoft made some business progress and the shares were no longer wildly overvalued. Had shareholders hung on after that long drought their patience would have been rewarded as this chart shows:

Patience is a key and necessary attribute for long-term investment results. You could call it Delayed Gratification. Or Extremely Delayed Gratification Endurance, or EDGE for short. In the investing world, patience might offer an edge against competitors.

This chart demonstrates that as you extend your investing time horizon, you increase the probability that you'll earn a positive investment return. Over one year anything can happen…but over ten or twenty years, positive returns have been next to inevitable.



Source: JP Morgan Guide to the Markets

And finally, this chart reminds us that investors have been rewarded over the years through numerous crises, pandemics, natural disasters, recessions, political upheaval, rising interest rates, wars, terrorism, market declines, inflation, deflation, etc. The stock market has historically provided above-inflation returns to those who remain patient, accept periodic volatility as normal, and remain focused on their long-term goals. While the upward trend is never a straight path, history tells us that significant rewards come to those who patiently hang on:

There have always been reasons to sell, but markets have been resilient

Sources: Capital Group, Refinitiv Datastream, Standard & Poor's. Chart shows daily returns from March 31, 2009 through September 5, 2023. Past results are not predictive of results in future periods.

Important Beliefs (Another Reminder!)

- Whether it's retirement funding, income replacement, travel, charitable contributions, college costs, or financial assistance to children or grandchildren; our job is to help you determine your future needs and chart a course to help get you there. To accomplish these long-term objectives, ***you need a long-term plan***.

- Regarding your investment policy, nothing has changed, because nothing ever changes. That is: ***we are long-term, goal-focused, plan-driven equity investors***. We own diversified portfolios of quality companies; these companies have demonstrated the ability to increase earnings (and in many cases dividends) over time, thus supporting increases in their value.

- The graphic below provides a good visual of how to think about financial matters and your emotional well-being. Focus on those things within your control and try to avoid the all-too-human tendency to dwell excessively on those things well beyond your control. Yes, it's easy to say, and more difficult to do. We acknowledge that. We're ALL subject to these occasional feelings. ***Recognizing these feelings but not acting upon them is a critical part of long-term success.***

General Principles

Together, we are **long-term, goal-focused, planning-driven investors**. We've found in our experience that the best course for you is to formulate a financial plan—and to build portfolios to serve the plan—based **not** on a short-term guess about economy or the markets, but on **your most important lifetime financial goals**.

- Since 1960, the S&P 500 Index has appreciated approximately **76 times**; the cash dividend of the Index has gone up about **33 times**. Over the same period, the Consumer Price Index has increased **10 times**. So historically, equities have functioned as an extremely efficient hedge against long-term inflation and a **generator of real wealth** over time. We believe this is likely to continue in the long run, hence our investment policy of primarily owning successful companies rather than lending to them.

- We believe that **acting continuously on a rational plan**—as distinctly opposed to reacting to current events—offers the best chance for your long-term investment success. A good recent example of sticking to the plan was seeing the market's reaction to COVID-19. Simply stated: **unless our goals change, there is little reason to alter your financial plan**. And if our portfolio is well-suited to that plan, we don't often make significant changes to that, either.

- **We do not believe the economy can be consistently forecast, nor the markets consistently timed**. We're therefore convinced that the most reliable way to capture the long-term return of equities is to ride out their frequent but ultimately temporary declines. In practice, this means being mentally prepared to handle roughly 15% short-term declines annually, and roughly 33% declines every 5 years or so. **Avoiding costly changes in reaction to short-term volatility provides you the potential to earn higher long-term returns.**

- The performance of your portfolios relative to their benchmark(s) is irrelevant to your investment success as we define it. **The benchmark we care about is the one that indicates whether you are on track to achieve your financial goals**. One of the biggest goals is ensuring you don't run out of money during your lifetime.

- Our investment philosophy is to invest in businesses with a history of providing essential products and services. We prefer significant management ownership to create an alignment of interests with us. We seek to invest at reasonable prices and hold these exceptional businesses for many years. Assuming no nuclear annihilation or World War III…we expect this approach will do well over long periods.

As always…please keep us updated with any changes to your financial situation that might suggest altering your asset allocation and investment portfolio and let us know if you'd like a current copy of our Form ADV Part 2.

Your LOYALTY and PATIENCE remain our secret weapons. We value our relationship with you and appreciate the opportunity to continue to serve you and your family. Thank you for being our client. It is our privilege to serve you.

Sincerely,

John | Dave

John Heldman, CFA | Dave Hutchison, CFA

April 22, 2024

"The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go. In the end, what matters isn't crossing the finish line before anybody else but just making sure that you do cross it."

-Benjamin Graham, <u>The Intelligent Investor</u> (Warren Buffett's mentor)

"Forecasts are highly uncertain. Forecasting is very difficult. Forecasters are a humble lot with much to be humble about."

-Jerome Powell, Federal Reserve Board Chairman