Investment Advisor

CONVERSATIONS ON INVESTMENT MANAGEMENT

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> *"There are three constants in life: change, choice and principles."* Stephen R. Covey [Bio]

Given the unexpected outcome of the November election, change is certainly in the air. Investment markets are reacting quickly, with large changes in various prices, yields, and currency exchange rates. Clearly, many investors are making significant decisions. At the same time, certain investment principles are worth keeping in mind, as the markets move.

Choosing how to respond to change while holding on to key investment principles requires research, thinking, reflection, and sound decision making. This edition of Investment Advisor focuses on investment markets after the election [including potential tax changes], some timeless investment principles to consider, and insights from two excellent books.

This cartoon caught our eye because many investment firms these days are bland, generic and uniform in their advice and decisions. Bland and generic is not something we aspire to at Miller Capital. We are dedicated to research, thinking, clear recommendations and sound decision making, customized to each client. If you would like to learn more about Miller Capital and the investment advisory services we provide, please feel welcome to call us or e-mail us at info@millercapital.com.

Investment Update - After the Election

Although the Dow Jones Industrial Average and most other broad U.S. stock markets have hit new, all-time highs after the November election, several U.S. stock sectors and non-U.S. stock markets [especially emerging markets] are well below all-time highs. Strong U.S. stock markets after the November election were a reversal of stock market declines in October caused by pre-election uncertainty. Most bonds and bond funds have declined in value since the election as interest rates have increased.

PRE-ELECTION STOCK SELLING. Most of the post-election stock buying was by large investment funds that sold heavily throughout the year, but intensified their selling just before the election. In fact, the selling of U.S. stocks during 2016 [through October 31] was nearly as large as in 2008, the year the Global Financial Crisis hit with full force. After the election, as U.S. stock markets stabilized and moved higher, these investment funds rushed back into U.S. stocks, hoping to avoid poor results from being "out of the market".

CHALLENGE AND COST OF TIMING THE MARKETS. Trying to predict or "time" when stock markets will go up or down rarely works in the short-term. The last several months have been a good example, as many investors, large and small, sold prior to the election in fear of one or both presidential candidates. A major brokerage firm has analyzed the price returns of U.S. stocks [excluding dividends] for every decade since 1930. Being out of the market on just the best ten days per decade produced dramatically lower returns, as shown in the next table. At Miller Capital, our focus is not on market timing, but on identifying attractive investments that meet the longer-term objectives of our clients.

S&P 500 Returns by Decade [Excluding the Ten Best Days]

DECADE	PRICE RETURN	RETURN EXCLUDING TEN BEST DAYS
1930s	-42%	-79%
1940s	35%	-14%
1950s	257%	167%
1960s	54%	14%
1970s	17%	-20%
1980s	227%	108%
1990s	316%	186%
2000s	-24%	-62%
2010s	95%	34%
Since 1930	10,055%	31%

[Source: S&P; BofA Merrill Lynch US Equity & Quant Strategy 11/10/16].

CHANGE IS COMING. There are some "big picture" changes going on in the world to be cognizant of, but a major change coming for investors [particularly those in higher tax brackets with taxable portfolios] is likely to be in the tax area. Certain companies and industries will also benefit or face challenges from the election outcome. As always, we are monitoring the fluctuating markets to determine attractive purchase opportunities and sale candidates for our clients.

TAX CHANGES. Although tax changes are unlikely to be enacted as proposed, several key tax changes proposed by the president-elect during his campaign are worth noting, such as:

- Lowering the top federal income tax rate from 39.6% to 33%, with three brackets instead of seven.
- Elimination of the 3.8% Net Investment Income Tax [for taxpayers in higher tax brackets].
- No change in the top capital gain/dividend tax rate.
- Much lower estate taxes [limited to a 10% tax on capital gains over $10 Million, with various exemptions and limitations] and no gift tax.
- Top corporate tax rate of 15%, down from the current 35%.
- Lower tax rate of 15% on pass-through income if retained in the business.
- Lower tax rate of 10% on foreign profits of U.S. corporations [whether returned or not] compared to the current top tax rate of 35% which can be deferred until returned.

While these are just proposals, subject to the give and take of the legislative process, changes toward these proposals should increase the after-tax returns of investor portfolios. For larger estates, generally above $5.5 Million for a single person and $11.0 Million for a married couple, these changes could preserve more principal and earnings for investors and beneficiaries after income and estate tax. Once tax changes begin to take shape, a visit to an estate planning attorney, CPA, or other financial advisor should definitely be on the "to do" list for individuals impacted by likely tax changes.

BIG PICTURE CHANGES. The U.S. election results follow the decision by England last summer to exit the European Union. Current polling shows a growing number of Europeans believe that individual freedom is best protected and exercised in a democracy operating within a sovereign state, not as part of a political union such as the European Union and its euro currency. It would not be surprising for this movement to continue in old, proud countries such as Italy and the Netherlands, which may decide that the European Union is too much of a drain on their national sovereignty and freedom. This may, in turn, cause France and Germany to cave to demands for reformation or termination of the European Union and the euro currency. Such an outcome would likely cause substantial disruption but could lead to a more market based European economy. This could be a more bullish scenario long-term for Europe and the U.S., but with extreme volatility and upheaval along the way.

Four major European countries [Italy, Netherlands, France and Germany] will soon have important referendums and elections. Italy, one of the larger economies in the European Union, is the first up with an important vote in early December. With an unemployment rate of 11.7% [higher than a year ago] and a young adult unemployment rate of 37.1% [for ages 15 to 24], the fireworks for the European Union could soon be lit. Conversely, the voters in EU countries could vote to maintain the current system or push for reforms that ultimately tighten their union. Disintegration of the European Union is not a given, but certainly a much greater possibility than ever before.

The big picture changes occurring around the world, as exemplified by England, are most likely a recognition of, and preparation for, the greater economic challenges to come for these rapidly aging countries. Facing these challenges as a fully sovereign nation as opposed to being part of a global or regional union [with a loss of full country control], appears to be the popular course. The U.S. election, following on England's Brexit vote, is likely a pre-cursor to big changes coming around the world, although the nature of those changes is unknown.

KEY POINTS. In closing, here are some key points from the election:

- Clearly, there are positives and negatives for various investments, which we monitor for our clients.
- We do not have big conclusions, post-election, but modest observations:
  - Less regulation is likely, and will be beneficial to most U.S. businesses, large and small.
  - Lower corporate taxes will be positive for U.S. companies seeking to reinvest in their business [helping the U.S. economy], increase dividends, buyback more stock, reduce debt, or purchase other U.S. companies or businesses/assets.
  - More infrastructure spending is likely in the U.S., benefitting the U.S. economy.
  - Income and estate tax changes are likely to be beneficial to after-tax returns for certain clients.
- Foreign policy and geopolitical risks are the biggest unknown risk, including the European Union.
- Remember, we have $20 Trillion in U.S. debt and much more in future entitlement spending.
- We are likely to make changes in client portfolios for tax reasons, and due to developments within certain industries and companies, but primarily for changes that are longer-term in nature.

Investment Principles Amid Change and Uncertainty

Ever since the Global Financial Crisis of 2008, there has been an enormous focus in the media [shared by many people] on potential economic disasters. There are many serious and concerning situations in the world, most of which cannot be forecast. It has been this way most of the last hundred years.

Given the large amount of change and uncertainty today, we find the following excerpts from Warren Buffett's 2013 Annual Letter to Shareholders of Berkshire Hathaway to be helpful. These quotes come after a discussion of his personal investments many years ago in a Nebraska farm and a New York City commercial building. Buffett writes:

- "You don't need to be an expert in order to achieve satisfactory investment returns. But if you aren't, you must recognize your limitations and follow a course certain to work reasonably well. Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick 'no'. "

- "Focus on the future productivity of the asset you are considering. If you don't feel comfortable making a rough estimate of the asset's future earnings, just forget it and move on. No one has the ability to evaluate every investment possibility. But omniscience isn't necessary; you only need to understand the actions you undertake."

- "If you instead focus on the prospective price change of a contemplated purchase, you are speculating. There is nothing improper about that. I know, however, that I am unable to speculate successfully, and I am skeptical of those who claim sustained success at doing so. Half of all coin-flippers will win their first toss; none of those winners has an expectation of profit if he continues to play the game. And the fact that a given asset has appreciated in the recent past is never a reason to buy it."

- "With my two small investments, I thought only of what the properties would produce and cared not at all about their daily valuations. Games are won by players who focus on the playing field – not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays."

- "Forming macro opinions or listening to the macro or market predictions of others is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important. (When I hear TV commentators glibly opine on what the market will do next, I am reminded of Mickey Mantle's scathing comment: 'You don't know how easy this game is until you get into that broadcasting booth.')"

- "My two purchases were made in 1986 and 1993. What the economy, interest rates, or the stock market might do in the years immediately following – 1987 and 1994 – was of no importance to me in making those investments. I can't remember what the headlines or pundits were saying at the time. Whatever the chatter, corn would keep growing in Nebraska and students would flock to NYU."

- "There is one major difference between my two small investments and an investment in stocks. Stocks provide you minute-to-minute valuations for your holdings whereas I have yet to see a quotation for either my farm or the New York real estate."

- "It should be an enormous advantage for investors in stocks to have those wildly fluctuating valuations placed on their holdings – and for some investors, it is. After all, if a moody fellow with a farm bordering my property yelled out a price every day to me at which he would either buy my farm or sell me his – and those prices varied widely over short periods of time depending on his mental state – how in the world could I be other than benefited by his erratic behavior? If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm. If the number he yelled was absurdly high, I could either sell to him or just go on farming."

- "Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments."

- "Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of 'Don't just sit there, do something.' For these investors, liquidity is transformed from the unqualified benefit it should be to a curse."

- "A 'flash crash' or some other extreme market fluctuation can't hurt an investor any more than an erratic and mouthy neighbor can hurt my farm investment. Indeed, tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your friend when investing; a euphoric world is your enemy."

Buffett's 2013 Annual Letter offers other valuable insights, as do all his annual letters. Buffett's annual letters are available at www.berkshirehathaway.com, under the link for "Warren Buffett's Letter to Berkshire Shareholders".

Not every investor or investment firm can follow Buffett's principles the way he can; not only because he is uniquely talented, but also because he invests corporate assets for the very long-term and his private investments are a very small percentage of his overall net worth. Clients usually have concerns and objectives that Buffett does not in his corporate role and in his personal investments. Yet, properly controlling emotions and risk while having sound logic and discipline are common threads to most successful investment strategies.

A Few Good Books

Here are a few good books we would recommend for investors, and families that are interested in educating the younger generations on financial responsibility, protecting assets, and/or prioritizing family while pursuing other endeavors.

SHOE DOG: A Memoir by the Creator of NIKE, by Phil Knight

This book recounts the early up and down years of NIKE more so than the booming growth years that followed. The scrapping and determination it takes to build a new business is front and center. Yet the most powerful aspect of the book are Phil Knight's reflections later in life on the enormous personal price paid by his family, and his deep regret in putting so much time and effort into building NIKE. While Knight clearly had a genuine love for his family, his inability to devote enough quantity of time to create the quality of time his family needed was the most moving part of the book. *Shoe Dog* is an excellent read for those interested building a business or career, but with a reminder of the importance and value of family and personal relationships. An article/survey instrumental in the founding of Miller Capital identified the two top regrets of people in their 90s, both of which can be found in *Shoe Dog*:

#1 REGRET: Not spending enough meaningful time with family.
#2 REGRET: Not taking enough risk in life.

BEER MONEY: A Memoir of Privilege and Loss, by Frances Stroh

Stroh's, Schlitz and Old Milwaukee were all famous beer brands once owned by the Detroit based Stroh's Brewery Company. The Stroh family owned and operated this company for generations. This book was written by a younger family member, Frances Stroh, who lived during the glory days of the Stroh Brewery Company in the 1970s and 1980s. Shortly after the family wealth increased substantially during Frances' youth, it then imploded in the decades that followed. *Beer Money* reveals how the family fortune was dissipated, leading to dramatic lifestyle changes for the younger generations compared to the older generations.

One of the most helpful insights from the author is her realization, as the implosion climaxed, that her future could be fulfilling if dictated more by her own initiative rather than by family money. *Beer Money* is a case study for wealthy families and their advisors in how to think about, discuss, and implement family philosophies that can be helpful in elevating life for family members and others in need.

ABOUT MILLER CAPITAL

- Miller Capital was established in 1999 and is independently owned and operated.
- We are a Registered Investment Advisor.
- We offer both investment management and investment consulting services.
- We represent individuals, corporations, investment partnerships, and private trusts (serving individual and corporate trustees).

CAUTIONARY DISCLOSURE