



# Investment Advisor

CONVERSATIONS ON INVESTMENT MANAGEMENT

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**“ Investment is most intelligent when it is most businesslike.”**  
**-- THE INTELLIGENT INVESTOR, PROFESSOR BENJAMIN GRAHAM --**



Recently, a private U.S. company prepared to go public through an initial public offering [IPO] of stock. It would have been the second largest IPO [in the U.S.] of all time. The company had the financial backing of some of the nation's largest banks and private equity funds, and some of their clients. The company's mission statement was quite bold, perhaps as unrealistic as its financial outlook:

***“Our mission is to elevate the world's consciousness.” [Company's Form S-1 Registration Statement]***

The IPO was terminated at the last minute due to financial concerns. The ordeal reminded investors that risks can be masked by bold marketing, peer pressure, and the involvement of big name, big money supporters. The

motivations of sellers are often not aligned with the best interest of the buyer, whether it be a product, service, relationship or idea.

Greed and fear along with optimism and pessimism are timeless emotions that are pervasive in business, investing, and in our personal lives. In making investment decisions, our own emotions and the motivations of others should be checked and tested by a well-reasoned and tailored investment strategy, disciplined operating guidelines, and a full understanding of all current and potential investment selections.

We hope you find the articles in this edition of Investment Advisor of interest. If you would like more information, please feel welcome to contact us.

# Impact of Low Interest Rates on Investment Portfolios: Follow-Up

**U.S. INTEREST RATES EVEN LOWER.** In our last newsletter, we discussed several investment strategy issues to consider should interest rates stay low, or go even lower. Since that time, most U.S. interest rates have in fact moved lower, with the 10 Year Treasury Bond yield declining from 2.60% in mid-June 2019 to 1.75% in late November 2019, after hitting a low of 1.43% in early September 2019. Just to put these low interest rates into perspective, the 10 Year Treasury Bond yield was 6.50% twenty years ago, and 9.50% thirty years ago.

Despite the U.S. economy appearing stable, the global economy has remained weak, notably in manufacturing, and the trade dispute with China has yet to be resolved. Yet these lower interest rates have helped support U.S. stock returns, which are up nearly 25% year to date through late-November [S&P 500 Index]. This harkens back to a quote in our last newsletter on the power of low interest rates, in which Warren Buffett repeated a claim he has made many times in the past few years:

*"I think stocks are ridiculously cheap if you believe that 3% on the 30 year [U.S. Treasury] bond makes sense." [Warren Buffett, CNBC Interview, May 6, 2019]*

## **THE IMPACT OF LOW INTEREST RATES BECOMING MORE REAL ON FIXED INCOME PORTFOLIOS.**

More than ten years after the onset of the Global Financial Crisis, the impact of low interest rates is becoming more noticeable for the fixed income portion of portfolios, given the further step down in yields in 2019.

- A growing number of callable corporate and municipal bonds [bonds that can be paid off early by the issuer] are being called away prior to maturity.
- Most newly issued bonds are being issued at much lower interest rates than called or matured bonds.
- Bond funds are experiencing this same reality.

Lower yields mean lower income for new fixed income/bond purchases; a continuation of the lower interest rate trend of the last forty years. However, this latest leg down is making the ability to achieve desired portfolio returns more difficult, without a change in investment strategy or investment selections. Our views on the primary cause for lower interest rates has been discussed in previous issues of Investment Advisor.

For irrevocable trusts, this issue is important for trustees to address in their investment strategy process. Trust beneficiaries [and/or their advisors] could reasonably inquire how the trustees are addressing the impact of lower interest rates on the trust's investment strategy. The default Prudent Investor Rule in most states requires the fiduciary or trust to consider a variety of factors with regard to investment and management decisions. For example, Michigan's Prudent Investor Rule states the following, in part [bold added for emphasis]:

## MICHIGAN'S PRUDENT INVESTOR RULE

MCL 700.1503 Portfolio strategy; risk and return objectives.

Sec. 1503. (1) A fiduciary's investment and management decisions with respect to individual assets shall be evaluated not in isolation, but rather in the context of the fiduciary estate portfolio as a whole and as a part of **an overall investment strategy having risk and return objectives reasonably suited to the fiduciary estate.**

(2) Among circumstances that a fiduciary must consider in investing and managing fiduciary assets are all of the following that are relevant to the fiduciary estate or its beneficiaries:

(a) **General economic conditions.**

(b) **The possible effect of inflation or deflation.**

(c) The expected tax consequences of an investment decision or strategy.

(d) **The role that each investment or course of action plays within the overall portfolio, which may include financial assets, interests in closely-held enterprises, tangible and intangible personal property, and real property.**

(e) **The expected total return from income and the appreciation of capital.**

(f) Other resources of the beneficiaries.

(g) The need for liquidity, regularity of income, and preservation or appreciation of capital.

(h) An asset's special relationship or special value, if any, to the purposes of the fiduciary estate or to 1 or more of the beneficiaries.

(3) **A fiduciary shall make a reasonable effort to verify facts relevant to the investment and management of fiduciary assets.**

(4) A fiduciary may invest in any kind of property or type of investment consistent with the standards of the Michigan prudent investor rule. A particular investment is not inherently prudent or imprudent.

(5) A fiduciary who has special skill or expertise, or is named fiduciary in reliance upon the fiduciary's representation that the fiduciary has special skill or expertise, has a duty to use that special skill or expertise.

*History: 1998, Act 386, Eff. Apr. 1, 2000.*

**THE BOTTOM LINE FROM LOWER INTEREST RATES.** Portfolio owners, including individuals, irrevocable trusts, pension plans, or foundations and endowments, should evaluate their long-term return requirements and how best to achieve those returns from various investments under a variety of scenarios. This would clearly include a scenario of low interest rates which persist for quite some time. We view this as a critically important investment issue, worthy of this follow-up article.

## Client Connected Investment Research

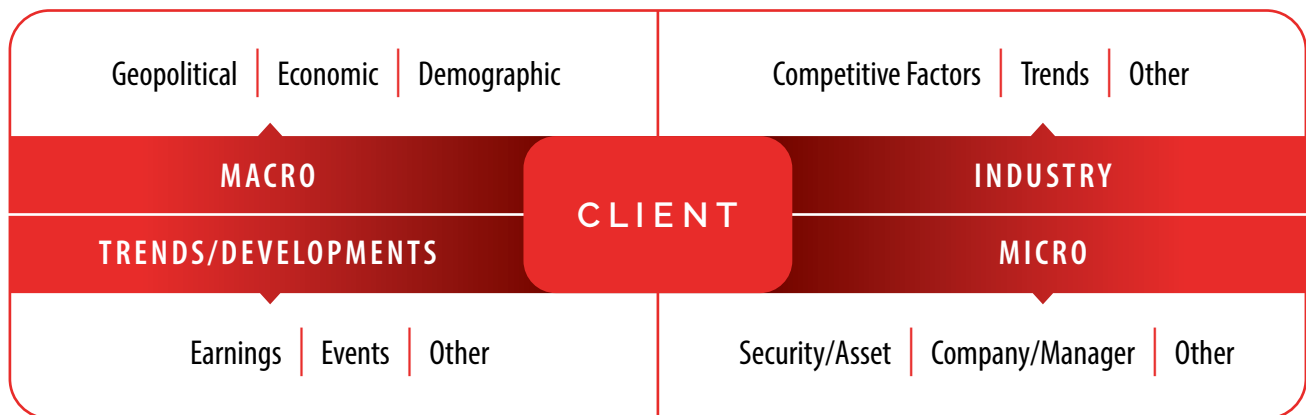
**MANY INVESTORS PREFER FULL OPTIONS BACKED BY RESEARCH.** Many investors prefer knowing they have access to a full range of investment opportunities and approaches available to best meet their needs, preferences and goals. They often prefer an investment strategy backed by well-reasoned research, not only addressing the proper asset allocation, but also the investment techniques and specific investment choices available to implement the right strategy.

**MILLER CAPITAL IS SOMEWHAT UNIQUE.** At Miller Capital, we offer custom investment solutions drawn from a full range of investment options, backed by our devotion to research. If a client prefers a certain approach, we make every effort to meet their preference, if possible. As we often say, if it's legal, moral, within our capabilities, and does not detract from our commitment to other clients, we will consider nearly any investment strategy or technique [within reason] to meet a client's financial needs and preferences. That's who we are and likely why most of our clients work with us.

We are a bit unique in that we tend to work with clients with portfolios in the millions of dollars that often have unique circumstances or preferences. For example:

- A new client may have existing stocks with lower cost basis or an individual bond portfolio they prefer not to sell simply because an investment firm does not monitor or manage individual securities.
- A client may receive a large distribution from a terminating trust and prefer to keep securities or assets that are appropriate, and sell what should be sold, depending on taxes and other factors.
- A client may have a large tax-loss carryforward that permits a non-index investment approach that actually favors capital gains generation.
- A client may prefer the tax flexibility that comes from owning individual securities that can be used to gift, or sell via specific tax lots for personal or business liquidity needs, or for risk reduction needs.
- A client may prefer knowing what they specifically own and the risk, return, income, and tax aspects of individual securities or assets. Only owning funds that do not disclose their holdings on a timely basis, or can change in nature over time, may be inconsistent with the client's goals.
- A client might actually enjoy engaging with our research thoughts and opinions.

**OUR DEVOTION TO INVESTMENT RESEARCH.** As to our devotion to investment research, we organize our research it into four broad categories, all with our clients at the center.



With our dedication to research, connected to our clients at the center, we aim to provide an excellent client experience, using a custom investment approach designed for each client. The next sections provide a glimpse into some research insights within these categories [excluding micro or company/asset specific insights because we prefer to not mention specific investments by name except for our clients]. As detailed on the back page [Cautionary Disclosures], our references to certain economic views, companies, industries, or trends and developments is not intended to be, and should not be viewed as, investment advice. We only provide investment advice to our clients.

# Macro Insights

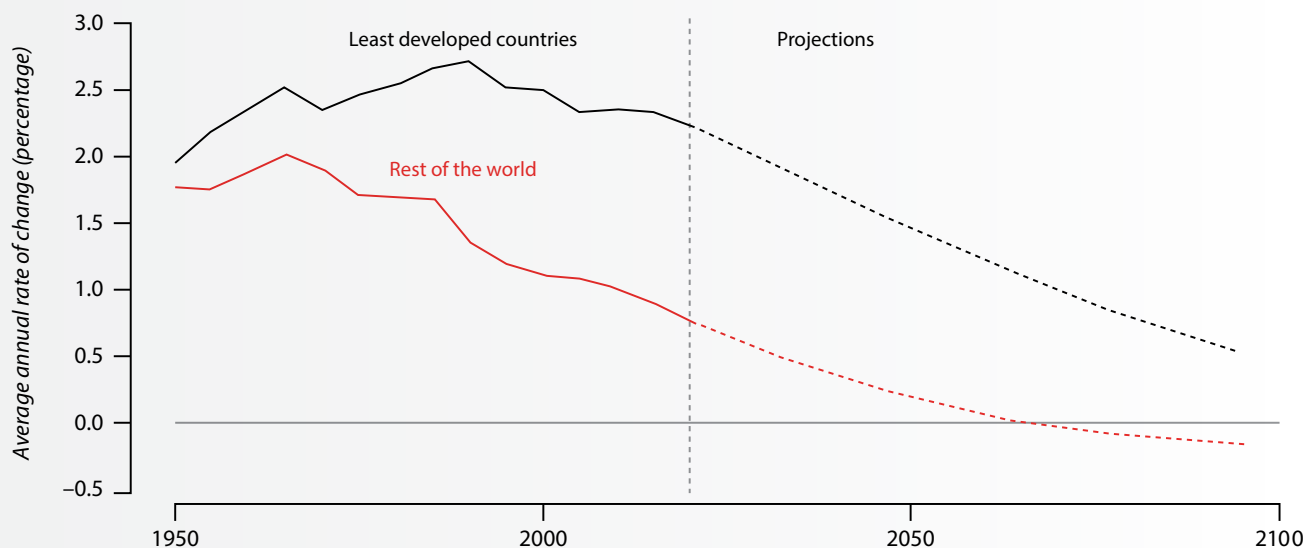
## ECONOMIC OUTLOOK AND GLOBAL TRADE

- Leading up to the 2001 recession, one leading indicator was the amount of the average sales ticket at checkout, per a major U.S. hardware retailer. [Q1 2018 Conference Call, 5/15/18]
- According to a major semiconductor manufacturer, a large number of customers are starting to move their production outside of China, going to Malaysia, Thailand, Vietnam, and some to Mexico. Customers say business conditions are weak in Europe and China. The largest economy in Europe, Germany, is near recessionary levels, with auto production down significantly. [Q2 2019 Conference Call 8/6/19]
- According to a major semiconductor manufacturer, the U.S. China trade dispute makes everybody stop in their tracks. They cut down the inventory on the loading dock to the manufacturing lines, to the raw material, to the finished goods, to the transportation hubs. Everywhere, people draw down the inventory, because they do not know what the landed cost is and what they can pass to their customers. That is the impact we have seen in many, many of the markets. And when there is the clarity on the tariff front, then you will see the rebuilding of that supply chain inventory, which would have a very positive effect on us. [Q3 2019 Conference Call 11/5/19]

## DEMOGRAPHICS

- By 2020, for the first time in human history, the number of persons aged 65+ will outnumber children under age 5 [BofA Merrill Lynch, 11/20/19].
- In Asia, Europe, and the Americas, population is basically done growing, moving from 6.4 Billion today to 6.5 Billion in 2100. [Adair Turner, 7/2/19, summarizing the UN's Report on World Population Prospects 2019, as to all of the demographic points below]
- The European average of birthrates [per woman] is 1.6, with no country above 1.85, compared to the required rate to maintain current population of 2.1.
- The US birthrate is about 1.78, but with additional, strong immigration while most other countries do not have immigration and even have residents leaving their countries.
- India's birth rate has dropped to 2.24, and is below replacement levels in most regions with higher education and income. India should still grow from 1.38 Billion today to 1.65 Billion in about thirty years, but will plateau in or around that time.
- China and Japan face significant declines in working-age population, but higher education levels in many Asian countries protects them more from automation of many basic jobs.
- Economic growth is primarily driven by the size of the working age population in a country, and globally, but automation may render that causation relationship less meaningful.
- In a future world of manufacturing that can be highly automated, countries with high population growth but lower education face a major concern. Automation has turned conventional economic wisdom on its head; there is greater prosperity in fewer numbers.

The total population of the least developed countries is growing at a rate that is 2.5 times faster than the growth rate of the total population of the rest of the world...



Data source: United Nations, Department of Economic and Social Affairs, Population Division (2019). World Population Prospects 2019.

## Trends/Developments Insights

### FOURTH INDUSTRIAL REVOLUTION

- We're at the very beginning of ...the fourth industrial revolution. The first used water and steam power to mechanize production. The second used electric power to create mass production. The third used electronics and information technology to automate production. And the fourth will be the digital revolution that leads to long-term gains and efficiencies and productivity and impacts almost every person and every industry. [CEO of Major Wireless Tower Company, 10/17/19]
- The fourth industrial revolution is closely tied to the deployment of 5G, which will allow for billions of devices to be connected and communicating in real-time. This level of connectivity is unprecedented. [same source]

### BIG DATA

- We are at a key inflection point with the exponential growth of data creating massive demand for semiconductors. Cloud workloads are diversifying, networks are transforming and more computing performance is moving to the edge. [Major Semiconductor Company, Q3 2019 Conference Call]
- The U.S. will need 10 times more in greater reliability and speed to meet data growth. [Major Wireless Tower Company, Q4 2018 Conference Call]

## INVESTMENT GRADE DEBT ISSUANCE

- A large public European software company issued 3 year and 5 year maturity Euro bonds with a 0% interest rate; issued a 7 year maturity bond at .19%, and issued a 10 year maturity bond at .44%, for an average interest rate of .16% for an average 7 year maturity. [9/19/19]
- A large public equipment manufacturing company sold 30 year bonds at an initial yield of 2.877%, breaking the previous record low of 3.197% that Disney set when it sold 30 year bonds in July 2016. [Wall Street Journal, 9/3/19] In 2012, this equipment company sold 30 year bonds at an initial yield of 3.94%. By comparison, this same company currently has bonds issued and outstanding, maturing in 10 years, with coupons of 7.125% and 8.10%.

## HIGH YIELD DEBT ISSUANCE

- The average new-issue yield across all ratings of high yield [below investment grade] for the first 15 U.S. deals printed in September 2019 was 4.91%, down from 7.33% a year ago. [S&P Global Market Intelligence]
- A U.S. telecom company issued high yield 10 year bonds at a coupon rate of 4.625% to pay off bonds maturing in 2021 and 2022 that had coupon rates of 6.125% and 5.75% respectively. [9/25/19]

## MONEY FLOWS

- Assets in money market funds have grown by \$1 Trillion over the last three years to nearly \$3.4 Trillion, their highest level in around a decade, according to Lipper data. [Wall Street Journal, 11/6/19]
- Year to date in 2019, investors have added nearly \$400 Billion to developed market bonds and withdrawn nearly \$200 Billion from developed market equities. [EPFR Global, Wall Street Journal, 11/6/19]

# Industry Insights

## SEMICONDUCTORS

- Looking beyond the cycle at the broader context for the electronics industry, it's important to recognize that we are in a period of transition as major new growth drivers emerge in the form of IoT [Internet of Things], Big Data, and artificial intelligence [AI]. Over the next decade, we expect hundreds of billions of edge devices to be deployed, and explosion of data generation and new approaches to computing to sustainably process and create value from all the data that's available. [Major Semiconductor Equipment Supplier, Q4 2019 Conference Call]
- AI and Big Data have the potential to transform every area of the economy and our lives. These inflections will also have a profound impact on the semiconductor industry. As we move from the age of general purpose computing to domain-specific approaches, new system architectures and new types of semiconductor devices are needed in the data center and at the edge. A major factor in the adoption rate of AI will be how quickly we can realize improvements in the power, performance, area and cost or PPAC of the foundational semiconductor technologies. [same source]

## AIR TRAVEL/AEROSPACE

- Passenger traffic grew 6.6% in 2018, the ninth year in a row of above trend growth. [Major Aerospace Company, Q4 2018 Conference Call]
- The forecast is for 43,000 new airplanes needed over next 20 years; doubling the global fleet size. [same source]

## HOME BUYING/BUILDING/SUPPLIES

- U.S. home equity has doubled since 2011. [Major U.S. Hardware Retailer Q4 2018 Conference Call]
- 52% of U.S. homes are over 40 years old. Spending is 30% greater on homes over 40 years old vs. under 10 years old. [same source]

## Update on Miller Capital

- Registered investment advisor firms are increasingly merging into or being acquired by larger banks, brokerage firms, or investment firm consolidators. Miller Capital remains independently owned and operated, serving only the best interests of our clients [known as the fiduciary standard].
- Our focus is investment management and consulting.
- We do not provide accounting services, prepare taxes, or offer legal advice. Our clients tend to prefer a separation of their professionals' roles to avoid conflicts of interest and provide checks and balances.
- Miller Capital is compensated only by our clients. We do not accept commissions or third party compensation.
- As disclosed our regulatory filings, no litigation or regulatory action has ever been taken against our firm.
- Miller Capital is able to provide investment advice to clients while allowing clients to control the decision of the custodian or brokerage firm where their accounts are held.
- Each client is provided a written investment strategy. Periodic investment reports and portfolio update letters are also provided, as agreed upon by the client and Miller Capital.

### 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/companies, and private trusts [serving individual and corporate trustees].

### CAUTIONARY DISCLOSURE

Investment Advisor is written and published by Miller Capital for educational purposes only and is not intended to be relied upon for investment decisions, tax or legal advice. We only provide investment advice to our clients. Any specific securities, companies, industries, and concepts mentioned, or examples provided, are: illustrative for educational purposes only; should not be considered, in any manner, as recommendations of Miller Capital; are not a forecast of future events or returns.