Miller CAPITAL

Investment Advisor

CONVERSATIONS ON INVESTMENT MANAGEMENT

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CONTENTS

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

"BEFORE WE BEGIN INVESTING, WE NEED TO ASSESS YOUR PAIN THRESHOLD..."

One of my favorite investors was an engineer by trade until their family company was sold to a public company in the early 1970s. This engineer, "Tad", then began supervising their large family fortune until his passing a few years ago.

In time spent with Tad and discussing their family investment approach, he viewed price changes [volatility] of investments as being of little importance unless they had a real consequence. In his view, the real investment consequence or risk "is the probability of not having sufficient cash with which to buy something important." Sufficient cash meant after taxes and inflation. Tad's view is one worth considering in times of significant market volatility.

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

Personal Reflections

According to Ben Franklin nothing is certain in life "except death and taxes". Let me add another one; markets will always go up and down.

I've been involved in the investment markets since 1986. I passed my stockbroker's exam [called a Series 7 Exam] in college. I recall the bull market heating up during the summer leading up to the stock market crash on October 19, 1987. I vividly remember the day of the crash, Black Monday, when the Dow Jones Industrials Average [Dow Jones] declined by 22.6%. By the end of the year, however, the Dow Jones had recovered substantially, generating a positive return of 2.26% for the year.

Beyond specific days, there have been many difficult time periods in the investment markets. Yet, despite some challenging time periods, including this year, there are encouraging lessons I've learned, along with a few warnings that are helpful to remember.

- In the last twenty-five years, I've yet to see one day, week, month, or even a few years do serious, permanent damage to a sensible portfolio that had a longer-term time horizon. One warning would be that there can be longer time periods of low or negative returns in the markets that must be planned for and managed around, like the "lost decade" of 2000 to 2009, when the return for the S&P 500 Index was -.95% per year [12/31/1999 to 12/31/2009]. During that same "lost decade" the return for Berkshire Hathaway common stock [led by Warren Buffett] was 5.90% per year, for comparison.
- It is important to be aware and mindful of the risks being discussed in the media, and acknowledging that unexpected events can occur. However, the biggest risk is not having adequate cash for a client's future needs [after taxes and inflation]; especially for the long-term.
- Hysterical thinking and emotional actions are destructive to preserving and creating wealth. Large market swings and intense media attention typically reflect an immense focus on the short-term at the expense of longer-term potential.
- There is a world of difference between a permanent loss of capital and a temporary decline. Permanent losses can be reduced by minimizing speculative investments, not selling quality investments at low prices, and not being forced to sell due to excessive leverage [borrowing] or spending.

When it comes to financial and investment decisions, it is important to control emotions through clear thinking while also having an open-mind. Assuming a sound investment strategy is in place [critical to controlling emotional decisions], discipline and fortitude [strength of mind to bear adversity with courage] are key attributes. In my experience, investment market downturns should be viewed as opportunities; to upgrade the quality of portfolio holdings and take advantage of higher, future return opportunities presented by the market [or Mr. Market, as discussed in a separate article], within the framework of a written Investment Strategy tailored to each unique investor.

Best regards,
Mark

Investment Insights

We organize our investment research into four categories:

1. Macro - Big picture economic, demographic, geopolitical, and financial issues.
2. Trends & Developments - Across a broad range of topics that impact investment decisions.
3. Industries - Changes that could affect equity, fixed income and alternative investment selections.
4. Micro - Company or product/services insights that inform investment selections at the security level, or provide insights affecting the broader categories above.

Here are just a few of the many topics we monitor in some of these research categories.

MACRO [BIG PICTURE]

- In the last 75 years, **every time** there were two quarters of negative real GDP, a recession was confirmed. Two times there was only one negative GDP quarter when a recession occurred, in 1960 and 2001. *[Source: Economic Cycle Research Institute, News Release July 28, 2022]*
- **The U.S. Purchasing Manager Index** [PMI] **declined from 52.3 to 47.5**, which indicates the economy is in contraction mode. The Eurozone and Global PMI Index releases also show contraction. *[Source: S&P Global, News Release July 22, 2022]*
- In July 2022, the **S&P 500 Index** had a return of 9.22%, but the year to date return is -12.58% through July 31, 2022. This index had a return of **12.05% annually over the last ten years,** and **10.01% annually over the last twenty years,** through July 31, 2022. *[Source: S&P Dow Jones Indices, July 29, 2022]*
- In July 2022, the **Bloomberg U.S. Aggregate Index** had a return of 2.44%, but the year to date return is -8.16% through July 31, 2022. This index had a return of **1.68% annually over the last ten years,** and **3.65% annually over the last twenty years,** through July 31, 2022. *[Source: S&P Dow Jones Indices, July 31, 2022]*
- In 2022, the yield on the 10 Year U.S. Treasury Bond started at 1.63% on January 1, 2022, increased to a high of **3.49% on June 14, 2022,** and decreased to **2.67% as of July 31, 2022.** *[Source: U.S. Dept of Treasury, 7/31/2022]*
- Analysis of past inflationary periods leads us to one period as most relevant; **the inflationary period following World War II.** Both then and now, pent-up demand supported by high savings rates collided with a disrupted, poorly functioning supply system. **Inflation reached nearly 20% in 1947 before collapsing** to more normal levels. Although energy prices now seem less likely to decline materially and sustainably given past under-investment and growing long-term demand, and labor supply being low given the aging, slower growth labor force, the spike in inflation could rollover [perhaps to a lesser degree] as in post-World War II. Such a decline, even if more gradual, has our attention. *[See "Why 7% Inflation Today Is Far Different Than in 1982", Greg Ip, Wall Street Journal, January 12, 2022]*

Following up on the World War II comparison above, **Federal Reserve Chairman Powell indicated that inflation could melt away quite quickly,** just as it accelerated quickly in 2021 and 2022. Powell stated that the recent spike in prices and inflation [as very strong demand for goods met a supply level that was flat or even declined due to labor and supply chain constraints], **in principle "could work in reverse".** As a result, as demand comes down, goods inflation could come down more quickly than one would expect from a more normal situation of an overheating economy with entrenched inflation. *[Source: Jerome Powell Comments at the ECB Forum on Central Banking, June 29, 2022]* This "melt away" of inflation is not something we are predicting, but we are keeping an eye on it as inflation expectations impact interest rates. Interest rates then have a dramatic impact on the valuations of equities, fixed income, real estate and many alternative investments.

TRENDS & DEVELOPMENTS

Dividend increases for U.S. public companies continue to be strong, overall. Data from S&P shows that the indicated dividend payouts for the S&P 500 companies were **$300 Billion in March 2013.** The dividend payouts had increased to **$550 Billion as of July 22, 2022.** *[Source: Howard Silverblatt, S&P Dow Jones Indices Senior Index Analyst]*

Given Europe's large percentage of natural gas coming from Russia, there will be a push to increase energy supply from North America. Global demand for LNG is forecast to reach nearly 78 billion cubic feet a day by 2030, according to S&P Global Commodity Insights, a nearly 60% increase from 2021. **Demand for U.S. LNG is expected to more than double by the end of the decade.** *[Source: World's Growing Thirst for American Gas Tests U.S. Ability to Meet Demand, Wall Street Journal, July 22, 2022]*

"Although internal combustion engine vehicle sales were nearly flat in 2021, **EVs [electric vehicles] grew by 94% and are expected to grow at a CAGR of 22% to 45% of total light vehicle units in the next five years."** *[Source: Hassane El-Khoury, Onsemi Earnings Conference Call, August 1, 2022]*

INDUSTRIES

Semiconductor Manufacturing and Equipment

- "Longer term, if we look at the secular drivers, the global megatrends driving our industry are still in place. The expanding application space for semiconductors and secular trends are driving long-term structural demand." *[Source: ASML Holding, Earnings Conference Call July 20, 2022]*
- "Overall, semiconductor demand remains robust, but with some macro-driven pockets of weakness, particularly in consumer-focused markets. In the longer term, we expect industry growth to be driven by the increasingly vital role semiconductors play in the global economy." *[Source: Lam Research Earnings Conference Call July 27, 2022]*

European Chemical Industry [Focus on Nitrogen Fertilizer]

- With European natural gas costs much higher than in the U.S. due to recent supply reductions from Russia, the impact on European chemical manufacturers is dramatic. Germany's BASF, the world's largest chemical company, is cutting ammonia production further due to soaring natural gas prices, with potential ramifications from farming to fizzy drinks. Ammonia plays a key role in the manufacturing of fertilizer, engineering plastics and diesel exhaust fluid. Its production also yields high-purity carbon dioxide (CO2) as a byproduct, which is needed by the meat and fizzy drinks industries. Ammonia is a primary component of nitrogen fertilizer, used every year for corn production, among other grains. Chemical companies are the biggest industrial natural gas users in Germany and ammonia is the single most gas-intensive product within that industry. *[Source: BASF Readies More Ammonia Production Cuts in Gas Supply Crunch, Ludwig Burger, Reuters July 27, 2022]* The high cost of natural gas is having a major impact in the global chemical industry.
- From interactions by a key fertilizer trade industry participant with EU nitrogen producers, approximately two-thirds of urea production [a commonly used dry fertilizer] in the EU region has been shut down due to high natural gas and other input costs. *[Source: B of A Global Research, July 19, 2022]* This contributes to high fertilizer prices caused by reduced production in Ukraine and sanctions against Russia fertilizer producers.

MICRO

Micro level research usually involves individual companies. Because we do not provide investment advice to non-clients, we are not including company insights in this public newsletter. Any companies mentioned in our newsletter is not meant to indicate we recommend such a company or its securities, but is merely referenced for educational purposes. Please see our Cautionary Disclosure at the end of our newsletter.

Mr. Market

Time is a friend of the intelligent longer-term investor, allowing the intelligent investor to take advantage of market conditions created by impatient or hysterical investors [perhaps better labeled "speculators or gamblers"]. The book *"The Intelligent Investor"*, written by Ben Graham [often known as the father of "value investing" and mentor to Warren Buffett] has an entire chapter devoted to the disconnect that often exists between the underlying economic value of an investment ["intrinsic value"] and the price at which that investment is bought or sold. With investments that trade each millisecond, prices can be quite volatile.

Near-Instant Liquidity Provides Benefits and Risks. Having markets that offer a near-instant ability to buy or sell is a tremendous benefit for publicly traded securities, but it also provides for disconnects between offered prices, available at the push of a button, and underlying economic or intrinsic value based on longer-term outlooks. Imagine having the ability to sell your home every second at the push of a button, with virtually no costs. There will be times when selling at high prices makes a lot of sense, and times where the prices offered are so low it would be silly to sell. As a result, the prices offered second by second can present opportunity, unless one gives in and sells at illogical low prices, or buys at illogical high prices.

Taking Advantage of the Market; Not the Other Way Around. The important lesson from Ben Graham is to not let the prices quoted each second to overly influence your analysis of underlying value. The quotes offered by Mr. Market may be the result of overwhelming media coverage that depresses investors, so that Mr. Market offers very low quotes. Or investors may become exuberant and greedy, so that Mr. Market offers very high quotes. In other words, based on sound analysis of underlying value, take advantage of Mr. Market to the extent possible. But don't be a victim to Mr. Market and let the quotes overly influence the analysis of underlying economic or intrinsic value , or the actual buy/sell decisions.

Discipline and Fortitude During Adversity. Mr. Market is alive and well every second of every day. As mentioned in the Personal Reflections section, when it comes to financial and investment decisions, it is important to control emotions through clear thinking while also having an open-mind. Assuming a sound investment strategy is in place [critical to controlling emotional decisions], discipline and fortitude [strength of mind to bear adversity with courage] are key attributes.

As mentioned on the cover page, volatility in prices does not necessarily represent risk. Remember what Tad had to say.