Investment Advisor

CONVERSATIONS ON INVESTMENT MANAGEMENT

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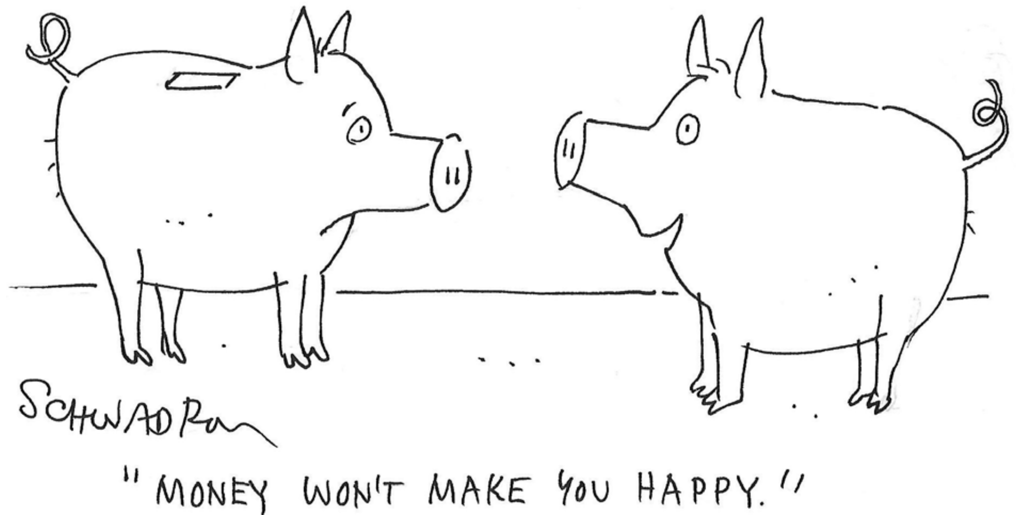
Mark A. Miller, JD, CFA
President

Miller Capital is a Registered Investment Advisor [RIA] serving individuals, families, business entities and trusts.

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



A key issue for any investor is whether their investment plan is appropriate. The last three years have been a very good test. Starting with the Covid-19 global shutdown and recovery, the Russian war against Ukraine followed, along with a global inflation spike, and then one of the most aggressive increases in interest rates from the Federal Reserve. During this time, the equity markets plunged in early 2020, followed by a strong recovery, and then the year 2022 was one of the worst in history when combining broad U.S. stock and bond market returns.

We believe written investment plans are important to the process of achieving investment goals. These plans should assume unforeseen events will occur, as evidenced by the last three years. But another important part of investing is having a proper "investment mindset", if possible, both before and after investment plans are developed.

The cartoon above is true; "money won't make you happy". But investing can create anxieties that can be devastating in real life, to investors and their families. It is worth giving more thought to the concept of "investment mindset", as discussed later in this edition of *Investment Advisor.*

Personal Reflections: The Investment Mindset

TAKING ADVANTAGE OF OR DISREGARDING MR. MARKET. In our last edition of *Investment Advisor* [Second Quarter 2022], we discussed the concept of "Mr. Market", from the book, *The Intelligent Investor*, by Ben Graham. Mr. Market is the hypothetical person you can buy an asset from, or sell an asset to, at any given time, whether it is a farm, a home, or a publicly traded security. In today's public securities markets, Mr. Market allows you to sell your securities in less than a second, often with large price swings from time to time. As Graham discussed, Mr. Market is not always rational with the prices at which it will buy or sell. Graham posits that an intelligent investor, properly prepared and disciplined, can take advantage of Mr. Market and sell at prices that are materially higher than the intelligent investor's estimate of underlying value, or buy at prices that are materially lower than underlying value. Taking advantage of Mr. Market requires the right "investment mindset", as does disregarding Mr. Market's price offers and persuasions when they are not fair.

SUCCESSFUL INVESTMENT MINDSETS. Ben Graham was a professor and mentor to Warren Buffett, CEO of Berkshire Hathaway and one of the greatest investors of the last sixty years. Buffett focuses much more on the proper "investment mindset" and other principles of investing rather than predicting shorter-term stock or market movements. Buffett tends to have a minimum three to five year investment view, and is usually looking out ten to twenty years for his major investment decisions; a time frame not all investors have the ability to adopt. Buffett's approach certainly does not fit the minute by minute, short-term trading approach so prevalent today among the financial media and many investors.

PUT THE PLAN IN WRITING. So much of the anxiety investors experience with their investments comes from not having a proper "investment mindset" or emotional foundation for their investment plan. In our experience, moving to a proper "investment mindset" requires having a clear, written expression of their investment goals while questioning/testing those goals, including having outside opinions and input. Once a proper plan is in place, it requires discipline to stick to the plan, while also having an open mind for necessary adjustments along the way.

BUFFETT'S INVESTMENT MINDSET. One example of how mindsets can be different involves declining asset prices. Buffett is excited when prices decline for certain stocks because he has the opportunity to buy more at lower prices, and then presumably have a higher return potential in the future. Many investors view lower equity prices with alarm, not opportunity. Buffett's investment mindset allows him to avoid anxiety and actually enjoy the process of finding better investments as prices come down. Key to his mindset is his longer-term time horizon and adequate reserves of cash to provide for short to medium term cash flow needs; two key factors.

QUESTION YOUR INVESTMENT MINDSET. What is your investment mindset, whether for yourself or as a trustee of a trust? What is the proper investment mindset given your goals and your investment plan? Are you able to adopt the property mindset; is it in you? Does your investment strategy make sense while limiting the anxiety that can lead to harmful, emotional investment decisions?

COMBINING MINDSET WITH STRATEGY. We advocate that having the right "investment mindset" along with a properly tailored "investment strategy" is critically important. Buffett has combined the two very well, tailored to his duty as CEO of Berkshire Hathaway. In our work, effectively combining "mindset" and "strategy" is a foundational process along with carefully considered risk limits and returns goals.

INVESTMENT ANXIETY CAN BE DEVASTATING. The investment anxiety caused by an investment strategy that is not properly matched with the investment mindset can be devastating and life altering in many ways. That is why the emotional side of investing is critically important to explore when establishing investment plans.

Best regards,

Investment Insights

We organize our investment research into four categories:

1. MACRO: Big picture economic, demographic, geopolitical, and financial issues.
2. TRENDS & DEVELOPMENTS: A broad range of topics that impact investment decisions.
3. INDUSTRIES: Insights within certain industries.
4. MICRO: Insights from companies or at the security level.

Here are just a few topics of note in the first two of these research categories:

MACRO [BIG PICTURE]

INFLATION UPDATE. The Federal Reserve looks closely at both **inflation expectations** and **trailing inflation** in guiding their decisions. As to **inflation expectations,** 5 Year and 10 Year inflation expectations are currently 2.16% and 2.18% respectively compared to the Federal Reserve's 2% inflation target. *[Source: FRED Economic Data, St. Louis Federal Reserve, 1/16/2023]* The Federal Reserve focuses on a concept called PCE Inflation more so than the better known CPI Inflation. Adjusting to a PCE methodology, 10 Year **inflation expectations** [PCE adjusted] are currently 1.95%, below the 2% target. *[Source: GaveKal Research, 1/13/2023]* **Trailing inflation** [PCE adjusted], is below 2% on a month to month basis over the last 1 month, 3 months and 6 months. Using the same adjusted PCE methodology, **trailing core inflation** [excluding food and energy] is just above 3% on a month to month basis over the last 1 month and 3 months, moving substantially lower in recent months. *[Source: GaveKal Research 1/13/2023]*

With both inflation expectations and trailing inflation [PCE adjusted on a month to month basis] arguably meeting Federal Reserve targets, the key question is how long the Federal Reserve will require consecutive months of proof. Real estate [shelter] inflation that factors into reported inflation [nearly 40% of CPI] is likely to reverse course and head lower.

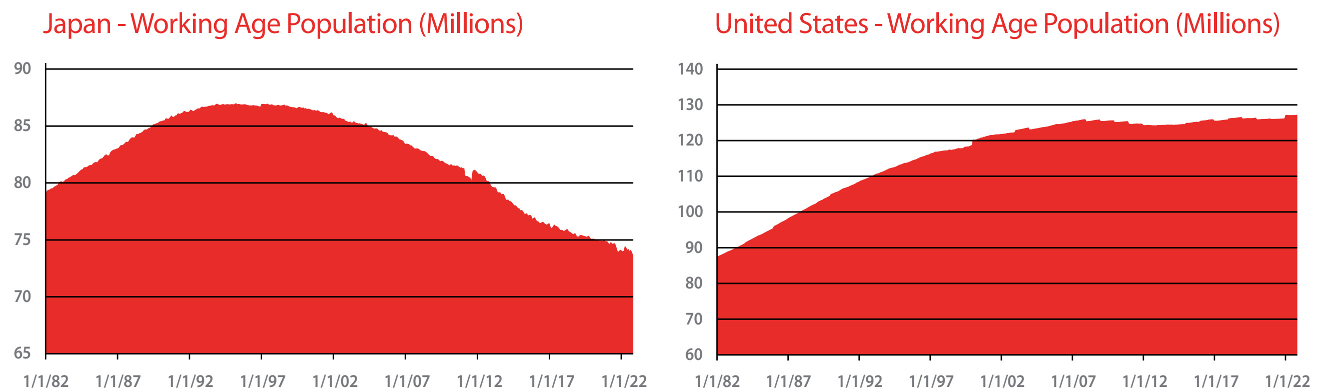
Bottom Line: While this is all very technical, the bottom line is inflation is getting much better and the Federal Reserve should begin to calm down their interest rate increases and possibly take a break. Past interest rate increases have severely impacted housing/commercial real estate and are just starting to have a real impact on the rest of the economy.

FEDERAL RESERVE IMPACT FROM QUANTITATIVE TIGHTENING. According to a study from the Federal Reserve Bank of San Francisco, *[Source, FRBSF Economic Letter 11/7/2022 and 12/2/2022]*, reductions to the Federal Reserve balance sheet ["quantitative tightening"] add about 2% to the Federal Funds Rate, which was 4% at the time of their November 2022 study. The result is an effective Federal Funds Rate ["proxy rate"] of just over 6%. Top economist Ed Hyman has cited this proxy rate as evidence of how restrictive the Federal Reserve interest rate policies are on the economy [source below].

Lagged Impact from Higher Interest Rates. According to economist Ed Hyman [ISI Evercore], Wall Street's number one ranked economist for an unrivaled forty-two years [not to suggest his forecasts should be relied upon, but only that he often provides helpful insights]:

- Money supply changes have a lagged impact on the economy of just over a year.
- Consumer net worth changes have a lagged impact on the economy of about two quarters.
- Money supply is contracting for the first time in seven decades. *[Source: Ed Hyman, WealthTrack 12/9/2022]*.

DEMOGRAPHIC UPDATE. Our view for many years has been that an aging population and reduced birth rates are resulting in a slower growing labor force, and actual declines in many aging countries. Japan's labor force has been contracting for many years, from 87 Million in 1992 to 73 Million today. Western European countries, like Italy and Germany, are following Japan. Not only is China's labor force declining rapidly, but its total population started declining in 2022 for the first time in six decades; an anticipated but still stunning turning point. [Source: Bloomberg News, 1/16/2023]. Countries such as Japan have had very low inflation bordering on disinflation for decades despite having very low unemployment, as they have trouble finding enough workers and have national policies that discourage immigration.



Sources for Charts Above: Organization for Economic Co-operation and Development [fred.stlouisfed.org]

The U.S. also has a slower growing labor force, but it is growing much faster than nearly every other country in the developed world. Despite declining birth rates and less immigration in recent years, the U.S. is aging much less rapidly than the rest of the developed world and should have a growing population into the future. Slower growth in the labor force leads to slower economic growth and lower inflation and interest rates, in our view. Prior to Covid-19, economic growth, inflation and interest rates were very low. The Covid-19 crisis has resulted in large, temporary distortions in long-term trends, but as we recover from the Covid-19 crisis, it will be interesting to watch whether global economies return to lower growth and lower inflation and interest rates. Interest rates drive so much of the returns in assets that this is a critical issue we watch in allocating assets to various categories and specific investments.

QUESTION: Why worry about economic issues when they are ultimately difficult to predict with reliability?

ANSWER: Clients often have great concerns about economic issues. They ask us about economic issues and expect us to have thoughts on those issues. Failure to discuss these issues can increase anxiety which can lead to emotional decisions. So we are always prepared to provide our views on economic issues to provide context and address concerns we feel may be of low risk, or which should be considered in relation to their longer-term goals and their written Investment Strategy. Simply saying "we have no view on economic issues or questions" is not helpful to clients seeking our input.

TRENDS & DEVELOPMENTS

PREDICTING RECESSIONS AND STOCK MARKET MOVEMENTS VS. BUFFETT'S MINDSET. Several investment strategists at large investment firms are calling for a significant decline in U.S. equities due to a coming recession. Some of these strategists did warn of large U.S. equity declines in 2022, and are often the most sought after and interviewed guests by the financial media. But many of these strategists have also been quite wrong in prior years, a fact which shouldn't be surprising. Predictions are a dime a dozen and some come true while others prove to be quite wrong; no different than sports predictions, political predictions and weather predictions. If it were so simple, these investment strategists would not be employees but would be hugely wealthy, like Warren Buffett. Buffett did not become a multi-billionaire by timing or predicting the markets in the short-term, but by finding investments with good value and longer-term return potential. Buffett finds attempts at market timing "silly".

Consider the following comments from Buffett at the Berkshire Hathaway annual meeting in May 2022:

> *"The interesting thing is, you know, obviously we haven't the faintest idea what the stock market is going to do when it opens on Monday. We never have had - I don't think in all the time we've worked together [referring to Charlie Munger, his long-time business partner].... we've ever made a decision where either one of us has either said or been thinking, "we should buy or sell based on what the market's going to do or for that matter, on what the economy's going to do. We don't know.*
>
> *And the interesting thing is, sometimes I get some credit some place for the fact that, you know, how wonderful it was that we were optimistic in 2008 when everybody was down on stocks and all that sort of thing. You know, we spent a big percentage of our net worth at a very dumb time. We spent about $15 or $16 Billion Dollars — which was a lot bigger to us then than it is now — over a period of three or four weeks ...at a terrible time, as it turned out. I mean, I didn't know whether it was going to be a good time or a bad time, but it was a really dumb time.*
>
> *Well, if I'd had any sense of timing and waited six months until — I think the low was in March [2009] — and in fact I think I was on CNBC maybe that day, or something. But I totally missed that opportunity. I totally missed, you know, in March of 2020 [Covid-19 low in the U.S. stock market].*
>
> *We have not been good at timing. We've been reasonably good at figuring out when we were getting enough for our money. And we had no idea when we bought anything — well, we always hoped it would go down for a while so we could buy more, and we hoped even after we were done buying and ran out of money that if it was cheap the company would keep buying [stock buybacks], in effect, taking our [ownership] interest up.*
>
> *We haven't ever timed anything. We've never figured out insights into the economy. But, you know, it's one decision... that it's a good thing to own American business."*

RECESSION PREDICTIONS VS. MARKET RETURNS. Recession start and end dates are difficult to determine, and equity market returns are difficult to time in relation to recessions. Even if you can predict recession starts and end dates to the very day, translating that predictive ability into profitable investment decisions is hit or miss. Their timing patterns are different and unpredictable. Buffett's mindset is not to predict recessions but to take advantage of them by being properly prepared financially and emotionally. Buffett's most important timing decision would seem to be buying only when an investment is a "good value", not before.

Bottom Line: Market timing of asset purchases and sales always seems to be a popular trend. The only thing that changes is the asset being "timed". In our experience, real wealth creation comes from longer-term investing.

Being "In the Know" and Confident [About Wealth]

THE BREADTH OF OUR WORK. We are investment managers and consultants to a variety of clients, from wealthy individuals to multi-generational families, also including private companies and trustees and trust beneficiaries that retain us for trust investment advisory services. We also work with third-party investment managers, a variety of custodians, banks, brokers, trust companies and a large number of law firms and CPA firms that are trusted by our mutual clients. All this to say, we see many unique client situations, investment concepts and an extensive amount of research on a variety of topics.

CLEAR GUIDANCE SUPPORTED BY THOROUGH RESEARCH AND SOUND LOGIC. One advantage to working with an independent advisor, such as Miller Capital, is the access to a wide range of opinions and research that we organize, evaluate and summarize, in addition to our own views. To be confident, clients need to be informed, but not overwhelmed. Clients deserve clear, concise guidance backed by thorough research and sound logic.

OUR CALLING. Clients need to be "in the know" about their investments and the related opportunities and risks. Being "in the know" is often the difference between confidence and anxiety. Confidence allows clients to be more bold in their decision making, whether for themselves or for the benefit of others, including causes that move them. That's our calling – treating clients as true partners, so they can be "in the know" and confident [about their wealth].

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].

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