Investment Advisor

CONVERSATIONS ON INVESTMENT MANAGEMENT

"Investment is most intelligent when it is most businesslike."
The Intelligent Investor, Professor Benjamin Graham

SECOND QUARTER 2025

CONTENTS

" WE'VE BEEN KEEPING HIM ALIVE BY TELLING HIM THE MARKET IS UP."

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UNDUE INVESTMENT INFLUENCE

We are all vulnerable to thinking in ways that do not serve us well—especially during periods of stress and uncertainty. Guarding against undue influence from specific people, events, the media, or our own emotions is critical, especially in such times. I'm sure you know of people [including yourself] that have achieved success - driven by an ability to maintain focus, think clearly, and act with resolve.

The same concept applies to investing. Undue investment influence must be guarded against to avoid irrational decisions. The tariff turmoil of April 2025 is just one example in a long history of market events that tests investor mindsets.

We hope you find this issue of *Investment Advisor* of value. The article on ***Portfolio Design*** **discusses concepts especially important in our work for clients.**

If you would like more information about our investment services, please feel welcome to contact us.

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

PORTFOLIO DESIGN: SOLVING FOR ASSET ALLOCATION

In determining a proper asset allocation target [or ranges] for a portfolio, solving for the proper level of liquidity reserve is a key part of the process.

Calculating the Liquidity Reserve

Hopefully, portfolio owners, including trustees of a trust, have given thorough thought to calculating the liquidity reserve as part of setting a proper asset allocation target [or ranges]. What assets should be part of the liquidity reserve is also a key question; cash, treasury bills, short-term fixed income and/or certificates of deposit, intermediate term bonds? These liquidity reserve calculation approaches often include:

- A simple percentage of the total portfolio.
- A dollar amount based on reasonably expected future distributions [possibly inflation adjusted].
- Other formulas customized to the portfolio owner's needs and preferences, factoring in other assets outside of the portfolio, or cash flows, if relevant to the analysis.

We have seen a variety of approaches to solving for a portfolio's liquidity reserve, including for example:

- Determining the impact of past recessions and market declines [which are separate issues] on portfolio values relative to the expected distributions required over that time period. Every recession and market decline is different, but generally this approach would look at the larger and more extended declines, such as the Global Financial Crisis [2008-2009] and longer time periods with negative equity returns [including those ending in 1982 and 2009]. This approach solves for the following question:

  "How much liquidity reserve is required **until the portfolio value might be expected to recover to full value**, so that necessary distributions can continue and certain assets need not be sold at prices well below their true, longer-term value?"

- Determining the impact of past recessions and market declines on not just portfolio values, but also on reduced portfolio income from declining interest rates and reduced/eliminated dividends. During the Global Financial Crisis, many equity dividends were materially reduced or eliminated, especially in the real estate, consumer discretionary, and financial sectors. Some portfolios still set distribution levels based on portfolio income rather than a set dollar or percentage payout, making the dividend and portfolio income issue more relevant. This approach solves for the following question:

  "How much liquidity reserve is required **until the portfolio value might be expected to recover full value**, **and until portfolio income recovers**, so that necessary distributions can continue and certain assets need not be sold at prices well below their true, longer-term value?".

This calculation of the liquidity reserve is not a "one and done" issue. As markets change, and distribution levels change, both the liquidity reserve methodology and calculations should be revisited. A liquidity reserve analysis from a high interest rate and inflation era merited a revisit as interest rates declined dramatically over the next several decades. The same is true of a liquidity reserve study done during lower interest rate periods.

Family offices and trustees of long-term trusts should actively review these issues because it has a dramatic impact on the amount of portfolio assets that can be invested for higher returns. For example, one family office [serving primarily over family trust assets] commissioned a study on their liquidity reserves:

- Their study examined the amount of liquidity reserves needed to preserve payouts based not only on prior market declines, but also on dividend reductions during periods of high economic distress, including 1930 to 1947.
- Based on their study, it was determined **their long-term trusts had an excessive liquidity reserve**.
- As a result, **the trustees approved investing more trust assets for higher returns**, creating more trust value and income in future years for beneficiaries. It was a key decision in the family's financial history.

Bottom Line:

- Just as every business has unique aspects that impact the determination of the proper amount and characteristics of their liquidity reserve, the same is true for individual and private trusts.
- The key in our view is to solve for a portfolio owner's unique situation, rechecking as appropriate, to determine the reasonableness of the overall asset allocation and the liquidity reserve.
- Once the above determination is made, return goals can be better evaluated.
- In our experience, when clients know their liquidity reserve is well reasoned, it generates greater confidence in many other aspects of portfolio design and management.

Adjusting for the Impact of Less Liquid Assets

Over the last few decades, less liquid assets have become more integrated into many portfolios, particularly large institutional funds [pensions, foundations and endowments], family office investments, and larger private trusts. These assets and/or funds are now making their way to smaller investors and range from traditional hedge funds and private equity funds, to private credit, private real estate, and other alternatives.

When solving for the proper asset allocation and liquidity reserve, one should consider that many investment vehicles are not liquid for certain time periods, or may be limited in times of distress. Consider the following:

- During the Global Financial Crisis [2008-2009], many hedge funds restricted owner redemptions for quarters and even years, as permitted under the hedge fund governing documents but not anticipated.
- Many private equity funds, credit funds, real estate funds, and alternative investment funds clearly state that withdrawals are not allowed for several years, or they have limited time periods for withdrawal, all of which can be deferred even longer under many such governing documents.
- In addition to uncertain withdrawal periods, private funds often have capital call provision that can force owners to contribute funds rather than withdraw funds when needed. This is the opposite of liquidity and should factor into the overall asset allocation and liquidity reserve determination.

To the extent certain illiquid investments cause the need for greater liquidity elsewhere in the portfolio, the returns on those potentially "illiquid investments" should compensate for this added risk. For trustees of private trusts especially, avoiding "uncompensated risk" is a prudent concept.

Bottom Line: Adjusting for the impact of non-liquid assets is important. What may seem like an exciting, new investment alternative may come with restrictions on liquidity buried in complex legal documents. As a result, consider whether that "additional risk" to liquidity is worth it and can be expected to compensate for the risk.

At Miller Capital, we solve for the asset allocation target [or ranges] and the liquidity reserve based on each client's situation and document the results in a written Investment Strategy. Whether our client is an individual, the trustee of a private trust [subject to the Prudent Investor Rule or overriding trust terms], or an owner/manager of a private company, investment management begins with tailor-made portfolio design.

PORTFOLIO MANAGEMENT: MINDSET MATTERS DURING TURMOIL

At the top of the cover page is a quote from Ben Graham, mentor to the great investor Warren Buffett.

"Investment is most intelligent when it is most businesslike." [*Source: The Intelligent Investor*]

Events that Create Disconnects Between Market Prices and Underlying Value

Both Graham and Buffett approached investing using business principles; long-term in nature, deeply researched, using discipline and shunning emotional decisions. The "tariff turmoil" that started this spring is just one of many events that have caused investors to be shaken from a business-like approach to investing. In fact, events like the "tariff turmoil" often create a disconnect between the underlying economic value of an investment ["intrinsic value"] and the price at which that investment is bought or sold.

Opportunities Created by an Emotional "Mr. Market"

The important lesson from Ben Graham is to not let the prices quoted each second to overly influence an analysis of underlying value. The quotes offered in the market [coined "Mr. Market" by Graham] 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. Based on sound analysis of underlying value, Graham suggests taking advantage of Mr. Market to the extent possible, not being unduly influenced by 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 fearful investors.

Bottom Line: During significant market declines, a prudent investor should be prepared to take advantage of opportunities. However, it is important to keep an open mind in investing. Sometimes, a major event does in fact require a change in strategy. We shouldn't always assume it is best to "stay the course", no matter what.

At Miller Capital, we evaluate investment opportunities using our internal models, determining fair value for investments, and future return estimates. These data sets, based on our research, allow us to make decisions for client portfolios during significant market declines, considering not only the tax impact of changes but also the positive impact on portfolio income and future return estimates. Proper positioning prior to a significant market decline may result in not making changes, but evaluating possible changes is prudent and responsible.

INVESTMENT INSIGHTS: RESEARCH

We organize our investment research into four categories:

1. Trends & Developments: A broad range of topics that impact investment decisions.
2. Industries: Insights within certain industries.
3. Macro: Big picture economic, demographic, geopolitical, and financial issues.
4. Micro: Insights from companies that impact their own securities, or other research categories.

Here are a few insights on the first three of these research categories:

Trends & Developments

Corporate Buyback Restriction Windows and the Tariff Correction

On April 2, 2025, President Trump announced broad and significant tariffs against other countries. The U.S. stock market declined rapidly and significantly, to a degree rarely seen in the equity markets. Shown below are the percentage declines through the April 7, 2025 low price for the S&P 500 Index and Nasdaq Index.

% Decline to Low	# of Trading Days	S&P 500 Index	Nasdaq Index
From 4/2/25 to 4/7/25 Low	3 Trading Days	-14.7%	-16.0%
From 3/25/25 to 4/7/25 Low	8 Trading Days	-16.5%	-19.1%

In addition to large amounts of selling, one underappreciated factor is **less corporate stock buybacks during "black-out periods"**. Since 2008, companies buying back their own stock has become the largest source of buying, by far. But companies can only buy back their own stock during certain time periods. When those companies are restricted from buying back their own stock [**often called a "black-out period"**], it takes away significant buying support. Most public companies have black-out periods beginning near the end of their financial reporting quarter and extending through their reported earnings date. This black-out period is designed to restrict buying stock on inside information and for other reasons. In addition, there are many other events that can prevent most corporate buyback activity [such as potential corporate transactions], but the earnings black-out window is the most consistent restriction against open ended stock buybacks.

Merrill Lynch [BofA Securities] publishes research on the amount of equity buying from four key client categories: hedge funds, institutions, retail clients, and corporations [mainly stock buybacks]. Since the Global Financial Crisis in 2008/2009:

- The first three categories have been net sellers of equities, in fairly large amounts, nearly every year.
- The one large buyer of equities has been corporations buying back their own stock.
- The largest year of buybacks was 2023 at $92.6 Billion, until last year.
- In 2024, corporate buybacks were $184.9 Billion, nearly double the previous year record.
- By comparison, from 2009 to 2019 the annual average was about $45 Billion per year.
- In 2025 [through May 31], corporate buybacks are $70.4 Billion, slightly below the 2024 rate. [Source: BofA Securities Equity Flow Trends 6/2/2025].

Bottom Line:

- Heavy tax loss selling can often cause weakness in a stock during the month of October [most mutual funds and many other funds have tax years that ends October 31] and the month of December [the tax year ends December 31 for most other taxpayers]. Buyback black-outs overlap with these time periods.
- Heavy selling from an unforeseen event that overlaps with significant buyback black-out restrictions, such as during the tariff announcement on April 2, 2025, can be met with little buying support from buybacks.
- When there is large tax-loss selling or other selling and limited corporation stock buy-backs during black-out periods, with no major change to the outlook, we pay attention for possible opportunities.

Industries

The Semiconductor Industry is Going 3D with Advanced Chips

As semiconductor chips get smaller and more dense with complex interconnections, these chips are becoming more 3D or taller in nature. Just like skyscrapers in New York City or any dense city center, building higher and even underneath the surface is a necessity for advanced chips. Key developments in this 3D process include:

- This 3D trend is expanding beyond just the previous subset of memory chips into a more advanced, broader set of memory chips and leading edge logic chips [used in ai systems, mostly sold by Nvidia].
- The amount of money being spent to build out this 3D capability is on the cusp of a rapid expansion.
- Suppliers must work with chip designers and manufacturers years in advance to integrate 3D offerings.
- While barriers to entry into this 3D world are high, there is also an enormous opportunity for focused companies to use their technology leadership to gain new 3D business, taking more market share.
- The winners in the 3D roll-out are becoming clear today, as the required R&D spending occurred up to five years ago in close collaboration with key industry partners. That R&D has led to design wins and products that are now shipping and generating revenue, and should continue for many years to come.

Bottom Line:

- Regardless of which company sells the most chips, the suppliers to the chip industry are also a key component and have strong growth opportunities as ai and automation/robotics advance.
- Using Professor Michael Porter's "Five Forces of Competitive Strategy" model, we find certain suppliers to the chip industry having notable competitive strengths and positioning. [*Source: Competitive Strategy*, Michael E. Porter]
- In a rapidly changing world, finding companies with sustainable competitive advantages is important.

The Valuable but Aging Home

Unlike many countries, the population in the U.S. is expected to grow nicely through 2050, assisted by above average birth rates [although below population replacement levels] and immigration [putting aside the recent immigration gyrations]. That means the need for more housing and maintenance. Home Depot recently noted:

- For most people, their home is their biggest asset, and home prices continue to rise.
- This has led to record levels of home equity, giving our customers confidence to invest in their homes.
- U.S. houses are aging with 55% of homes over 40 years old, requiring more maintenance and updates.
- We're now at a net cumulative shortfall of about $50 Billion of home improvement spend on housing. So we're very much looking forward to it as much as you are, when people tap their equity, gain the stronger macro confidence, and engage in those bigger projects.
  [*Source*: *Home Depot Earnings Conference Call*, 5/20/2025]

Bottom Line:

- High interest rates on new purchase mortgages and home equity loans are depressing the level of spending on home maintenance and improvement relative to normalized levels.
- If interest rates decline from their current high and restrictive economic levels [using the view of "restrictive" as admitted to by many Federal Reserve officials], future spending on home maintenance and improvement could increase substantially, assuming no major recession occurs.
- Periods of under-investment can go on for longer than expected, but eventually a return to normalcy should occur. It's likely just a matter of timing, but we remain observant to this industry dynamic.

Macro

Demographics: Low U.S. Unemployment Rates the New Norm?

The U.S. labor force growth rate is set to slow noticeably.

- Declining U.S. birth rates over the last few decades mean the number of persons turning age 18 is set to slow dramatically starting this year.
- Births peaked in 2008 at nearly 4.2 Million and now 18 years later are down to 3.6 Million in 2024, a decline of nearly 600,000.
- The cumulative annual decline is meaningful, although offset by immigration.
- The U.S. birth rate in 2024 was 1.62 births per woman vs. the population replacement rate of 2.1. [*Source: Vital Statistics Rapid Release, U.S. CDC,* April 2025]

The population growth and labor force growth trends in the U.S. are far better than nearly every other country around the world, both developed and emerging. However, given the new reality that U.S. birth rates are much lower, immigration rates are now much lower, and retirement rates are growing with the aging population, the number of new jobs needed to support new entrants into the U.S. workforce is much lower.

- Last decade, the U.S. economy needed to create somewhere between 125,000 to 150,000 jobs per month for the unemployment rate to remain steady.
- Today, we believe that the job creation rate is 100,000 per month, or less.

For the U.S., it would be logical that even if our economy slows, unemployment rates can also remain low, assuming there is not a significant recession. In fact, it does not surprise us that defined benefit pensions plans are actually returning to some industries and companies. It is vitally important to retain workers, despite the near-term trend to streamline the workforce following the post-Covid hiring wave. The long-term trend is to retain workers, as they become more scarce.

Bottom Line:

- The U.S. economy has a much stronger population growth and labor force growth rate than nearly every other country [some of which are actually depopulating], but those growth rates are slowing.
- The U.S. economy can grow more slowly but still generate a low unemployment rate.
- Historically, lower labor force growth resulted in lower economic growth and inflation rates. [*Source: The Great Wave: Price Revolutions and the Rhythm of History,* David Hacket Fisher, 1996]
- Future headlines that may show low job creation should not be interpreted to mean unemployment rates will move substantially higher. However, economic cycles still exist and a recession can push unemployment materially higher despite a favorable long-term employment trend.
- We have never had such a growing number of countries facing actual population and labor force declines. The U.S. is a powerful exception as its rates of growth are declining, but the absolute number is not actually declining.
- As highlighted later in the **Industry Insights: Research** section, automation and robotics will be a key focus to offset labor force scarcity.

Lagging Housing Inflation and the Impact on Current "Reported" Inflation

The Federal Reserve has a goal for inflation to be at or near 2% annually, as measured by several methods, be it the CPI Index or PCE Index or other variations. Currently, these reported inflation rates are between 2% and 3% depending on the index. The Federal Reserve admits the interest rates it controls are higher than normal or restrictive due to these reported inflation numbers being above 2%.

As admitted by the Bureau of Labor Statistics [which produces the CPI Report], housing or shelter inflation has been contributing one-half to three-quarters of all inflation. Yet, shelter inflation is produced by surveys using lagging data. Using real-time shelter data, reported inflation is actually well below 2%. The Federal Reserve knows this, but prefers to rely on lagging shelter data.

Bottom Line:

- If tariff-related inflation is not material, declining shelter inflation should help lower inflation over the next year, which the Federal Reserve could use to justify lowering its interest rates.
- While we don't assume interest rates will move lower, they would be positive for asset valuations.
- In the meantime, with interest rates at current levels, there are significant opportunities to lock-in portfolio income for the next several years through a variety of strategies and methods.

At Miller Capital, **we believe in the value of research**. We have a duty to help our clients meet their reasonable and risk appropriate return objectives. To us, that means searching for available investment opportunities, beyond just relying on index funds or outside managers. While we utilize index funds and outside managers, our dedication to research better informs us of opportunities, risks, and how to best design, implement and manage tailor-made client portfolios. To many investment firms, this level of research, including on individual companies, is viewed as unnecessary. To us, we'd rather be more informed than less informed, so long as it helps us help our clients. **We believe it does**.

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, private trusts [serving individual and corporate trustees], businesses and investment partnerships/companies.