BARRACK YARD ADVISORS

Current Anchors

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"Because something is happening here, but you don't know what it is,
Do you, Mr. Jones?" --Bob Dylan

Sweeping change is upon us in our culture and in our world. Consensus views are shifting and therefore, assumptions must be challenged. Global institutions, created and nurtured by the US for the past 70 years, instead of being acknowledged as blessings, are increasingly derided within the bounds of mainstream thought.

Policies that served American businesses in pursuit of ever expanding markets are now viewed with suspicion. The zenith of globalization, of Pax Americana, may well be behind us. All because America may choose to look inward, putting "America First."

Only time will tell if we are amid radical change, or, if it just seems that way. Changes in the style of governing may simply reflect a wider culture. In terms of substance, it's not certain the new populism will take hold. If it does, however, those of us born within 20 years of the last mid-century could be as ill-equipped to understand the new Era as Victorian babies were in understanding the Jazz Age—Flappers and all!

The litmus test will be on trade. Presently, it is difficult to imagine the rest of the world seeing the president's "fair trade" agenda as anything other than an opening gambit in a trade war. At the very least, investors must recognize that trade skirmishes are a distinct probability. This matters because it will make our capital markets more volatile in the near term and less attractive over time.

A trade war would have unhappy implications for multinational companies. There is also the adage that trade wars lead to real wars. Recent bullishness in stocks implies that investors see this as a low probability event. I am skeptical that trade is *the one area* wherein the president will not insist on matching reality with rhetoric.

"Fair trade" has the potential to create significant disruptions and risks unknown in our lifetime.

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The stock market is not the economy. The economy is the economy!

As investors, it is critical to make a distinction between our economy and the financial markets. Even if new policies overcome the headwinds of too much debt and unfavorable demographics, and we experience Boom-Times-On-Main-Street, the financial markets will not necessarily act in concert.

Here is an illustration. Assume GDP accelerates. That means workers are making more money which is a good thing. From a base of 4.7% unemployment, this would likely create higher inflation, a rise in interest rates and lower bond prices. In the stock market, PE multiples would decrease because a dollar of earnings would be worth less due to higher interest rates. CFOs would likely participate in the boom by increasing investments, causing profit margins to decline. Returning cash to shareholders, important in a low growth economy, will no longer be the mantra. Dividend growth will slow and stocks therefore would look less attractive. Main Street will have its revenge on Wall Street. This is not a prediction. Only an example of how the markets can be counter-intuitive.

Weather is short-term, climate is long-term.

Value investors know the stock market has a split personality. Like the weather, in the short run, stock prices provide no meaning and no insight. For the sake of this discussion, let's personify "stock prices" as Mr. Market. Now, this is one activity-prone dude. He loves a good story and, most of all, enjoys deceiving and confusing us. Mr. Market can party hard and be a lot of fun to hang with until, of course, his revelry is spent and he needs to crash. Like a politician, Mr. Market loves attention and seeks it daily. Nearly everyone accommodates his narcissism.

In the long run, stock prices are controlled by Mr. Value. This fellow is involved in the work that allows wealth to compound over time. Staid and serious, Mr. Value is concerned with serving customers, being a good steward of assets, inventing and making stuff, reinvesting profits for satisfactory returns, and the like. Mr. Value gets little attention because what he does is measured in years, if not decades. Though he toils in near obscurity, Mr. Value can be counted on to get up and go to work every day. Like the climate, he is predictable.

Think of the Market/Value dichotomy this way. A few weeks ago, in mid-January, temperatures hit the high 60s here in DC. Mr. Market would immediately conclude, "Yeah! Mothball your coats. It's t-shirts & shorts weather." By contrast, Mr. Value would say, "Not so fast! A couple of warm days in January proves nothing—weather is fickle—the climate here in January remains cold. Weather is not climate."

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The stock-market-split-personality insight was first written about by Benjamin Graham. It is useful because it forces a focus on what matters—taking the long view. Owning a good business, bought at an attractive price and held for a very long time is the only way to benefit from compounding cash flows. This way of investing has the bonus of being tax efficient. All in all, this is Mr. Value's path to a successful investing life.

So, what to do?

To mitigate risk, we headed into January with a higher than normal cash position of roughly 20% for most accounts. This was primarily due to valuations being so high and therefore expected long-run returns being so low: 0% after inflation for bonds and 2-4% for US stocks.

Adding in factors such as the potential for trade skirmishes, a high level of bullish sentiment and the stark reality that in any given year, the market drops by 10% at some point, my inclination is to sell or hedge if prices head even higher. On an individual company basis, if I can buy high quality businesses that meet our free-cash-flow yield hurdle, I will continue to do so.

American companies in the portfolio that receive most, if not all, of their revenues domestically include CVS Health, Icahn Enterprises, Liberty Braves Baseball Club and, in taxable accounts, Master Limited Partnerships such as Boardwalk Pipeline Partners.

There are also attractive investments internationally. Despite US rejection last week of an opportunity to deepen economic ties with 11 mostly Asian nations, all evidence points to continued growth of the Asian middle class.

An attractive way to participate in Asian growth is through Jardine Matheson Holdings, a Singapore-based conglomerate. The company has been in business since the 1830s and is controlled by the Keswick family, descendants of the founders. Jardine's stake in five publicly traded companies is worth more than its current stock price. They have positioned their business to be closely aligned to the increasingly prosperous consumers in the Asian region.

Jardines is a big company. They employ 440,000 people and are involved in selling and assembling cars, property investment and development, food retailing, home furnishings, engineering and construction, transportation services, insurance, restaurants, financial services, mining and agribusiness.

Their property assets include prime office and luxury retail properties in key Asian cities as well as the hotel and residence business, Mandarin Oriental. Their pan-Asian retailing operation includes well-known brands, 7-Eleven and IKEA. Partners in their motoring business includes Mercedes-Benz, Toyota, Honda and Mazda.

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Jardines is consistently profitable, with return on invested capital (ROIC) of roughly 15%. They have a nice track reward of rewarding shareholders—dividends per share have nearly tripled in the past decade. It is a quality business with an investment grade debt profile, run by a 'skin-in-the-game' management team.

Jardines give no thought to keeping Mr. Market happy by giving quarterly guidance and other such nonsense. With a focus on Mr. Value, their stock trades for only 11 times earnings.

The Biggest Mistake We Make.

Think about it. Most investors expect to live to a ripe old age—and no one wants to outlive their money! Setting aside funds earmarked for specific objectives, such as emergencies, paying for college, or a vacation home, everything else is money for the long-term. Even if you are 50 or 60, there needs to be money available for decades to come.

The biggest mistake we make is paying lip service to being long-term investors, but it is only in theory. We do not act like long-term investors in practice. An example is worrying about what the market will do in the coming months, or even in the next year or three. Despite having no intention of liquidating our holdings, we act as if current stock quotes mean something to us personally!

That is, our biggest mistake is allowing Mr. Market to convince us that his short-term concerns are relevant to our long-term concerns. We are nearly 8 years into a bull market. At some point, there will be a bear market. It might be useful to remember the "the biggest mistake" when the inevitable discomfort becomes particularly acute.