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INSIDE STORY

Good Things Come to Those Who Wait

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Good Things Come to Those Who Wait

Patience is a virtue. Not one that I possess, but it is a virtue nonetheless. It is one that I continually work on, and I am getting better. My hobbies have helped with that.

Growing up I had an uncle who lived in Maryland and owned a small sailboat, which he kept on Chesapeake Bay. I have very fond memories of overnight trips with my uncle and my father. We would sail during the day, then find a place to anchor for the night. My uncle would grill something on the small charcoal grill, which somehow tasted better than the same thing on land. When bedtime came, he would tell me that there is no better sleep than sleeping on a boat at anchor. The gentle movement would rock you to sleep like a baby being rocked in a cradle. In the morning my uncle made pancakes, which he referred to as sinkers.

Fast forward thirty plus years and I am at the beach with my family. We went to dinner at a restaurant in a marina and afterward walked down the dock to see the boats. I was reminiscing about those childhood trips and looked at my wife and said, “I am going to learn how to sail.” She thought I was joking. I found a sailing school on Lake Lanier, just north of Atlanta. I had no idea how challenging it would be to learn to sail on a lake surrounded by heavily treed hills.

The wind tended to be light, which is a challenge in and of itself, but it also tended to swirl among the trees and hills. We would be cruising along nicely one minute and then the wind would just stop. The first few times this happened I went into “do something” mode. I would mess with the sails trying to get us going again, or God forbid, turn on the engine. As soon as I did all that work the wind would return, and we would have to undo all I just did and get things back the way they were. Finally, I learned to just wait. The wind always comes back, I just needed some patience.

I have been reminded of that lesson over the last year. Patience is a key ingredient to long-term investing success. This past year we have been recovering from the 2022 bear market, and it has been a frustratingly slow process. Things started off looking better, yet it was only seven stocks that were going up while everything else went nowhere or even down. Then finally the wind came back around and we ended 2023 with a strong rally. I am happy to say that we were well-positioned for that rally and delivered very good results for our clients, but that is not the point of this lesson.

The point is that in our fast-paced world in which we are constantly on and constantly connected, we need to constantly remind ourselves to be patient. To put it in market terms: there are trends, and there is a lot of noise. The art of investing, and frankly life in general, is to be able to filter out the noise.

This is easier said than done as sometimes the wind does actually shift. One cannot just go out in a boat point it in the direction you want to go, raise the sails, and wait. That isn’t how it works. We cannot control the wind; one must work with the wind as it is. If we simply do nothing we could get blown onto the rocks. So, we need to know the difference between a momentary change that we just wait out, or a permanent shift, which must be addressed.

Patience is a key ingredient to long-term investing success.

So how do we know? Experience certainly helps, but there are fundamentals that can help too. Investments of all kinds spend most of their time actually going nowhere; they will trade in a range. Oil is a perfect example. For some time now, oil has been valued at $70 to $90. It just keeps going back and forth. Sometimes it may drop to the high-$60 range and it may break $90 for some short period, but in reality, it is stuck in this range.

As I write this oil is priced at $71, which puts it on the low end of its range. There are no guarantees in life, but the odds are strong that oil will go back up to $90 before coming back down. At some point in time there will be an event that will break this cycle, but until that happens we are in this range, and that matters if one is invested in energy companies.

When the price of oil goes down, the stock price of energy companies will usually go down with it. Then when the price of oil goes up, the stock price of energy companies tends to rise. Every time we approach the bottom of oil's range, the media starts talking about oil prices "collapsing," and when we approach the oil highs, there is talk of spiking and inflation. If one panics when oil is on the lower end of its range and/or gets greedy when it is on the high end, then he will end up selling low and buying high – the opposite of what an investor wants.

We own Marathon Petroleum Corporation in portfolios where we believe it is appropriate. (Please note: I use this as an example for educational purposes only, this is not a recommendation as this may not be an appropriate investment for you.) Marathons stock was up 30.61 percent in 2023. That is a very good return and better than the S&P 500. However, the stock ranges in price from $104 to $162, and as I write this it is $153. That is a range of 55 percent. There were a lot of ups and downs in what ended up being a 30 percent return for the year.

It is tempting to believe one can trade into and out of a stock that moved up and down in a 55 percent range, but that is a fool's errand. History has taught us that timing does not work. If one is going to get a good long-term return, then patience is a requirement. Good things come to those who wait. Of course, doing the same thing over and over again while expecting a different result is the definition of insanity, according to Einstein. Cliches can only take us so far.

There is a difference between patience and stubbornness; being patient is not the same thing as sticking one's head in the sand and ignoring what is happening. As with sailing, how do we know when we just need to wait, versus when we need to make a change? I can certainly tell you that I am much better at this today then I was 30 years ago when I was still young in my career. Part of this is the art of investing, but our investment philosophy helps.

Prudent investing is done from the bottom-up. This means we make investment decisions based on each individual investment. It is much easier to analyze a particular company and assess its future than it is to guess where the entire market is going. This is obvious to anyone who thinks about it for a second, yet the standard question we get is, "Where is the market going?"

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REVIEW *of* ECONOMY

The 3rd quarter 2023 GDP growth came in up 4.9 percent. So much for all that recession talk. It is hard to remember a year when so many got it so wrong. That isn't sustainable but GDPNow shows 2.2 percent growth in the 4th quarter, which is still solid growth.

The official unemployment rate was 3.7 percent through December. The labor market remains tight, and participation is growing. This is occurring while inflation is coming down, and the market is finally recognizing that good news is good news.

Inflation is 3.1 percent based on the latest consumer price index report. Down from 3.7 last quarter. The producer price index, which tracks wholesale prices, is up only 0.9 percent over the last 12 months. +

REVIEW *of* MARKET

The market had a broad rally. For the quarter the S&P 500 finished up 11.69 percent, and small company stocks represented by the Russell 2000 index were up 14.03 percent. Growth and value both did well with the Russell 1000 Growth index up 14.16 percent while the value index was up 9.50 percent. For small companies value did better with the growth index up 12.75 percent, and the value index was up 15.26 percent.

Bonds had their best quarter in years. The Barclays U.S. Aggregate Bond index ended up 6.82 percent. High yield bonds rose 7.06 percent. Bond yields remain attractive.

International stocks also rallied. The EAFE index finished up 10.47 percent and the MSCI Emerging Markets index ended the quarter up 7.93 percent. +

MARKET *forecast*

Patience paid off and the gloom seems to be lifting from the market. We have come a long way very rapidly, so a pause is in order. However, the long-term outlook still looks bright.

Growth stocks are all the way back from the 2022 bear market, but value stocks and small company stocks still have room to rise. International stocks remain more attractive than domestic. Diversification worked last quarter and should continue to do so.

Bonds still look worthwhile and are behaving like bonds should. Yields are in the middle of their range and should settle down, after a volatile last six months. +

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That is what the media focuses on, so that is what people think about.

Back to our example of Marathon Petroleum. It is relatively easy to understand that this is one of the best-run refiners in the world and the stock is selling for less than six times earnings, which means we are investing in a solid business at a very attractive price. It is much harder to guess where the price of oil is going; those prices will move a lot, while the dynamics of Marathon's business do not change nearly as rapidly. As long as the business is solid and the price of the stock is cheap relative to the company's earnings, then Marathon remains a good investment.

Does this mean we just ignore the short-term movements of the market? Not exactly. One of the biggest differences between the professional investor and the lay investor is that the professional thinks in terms of weightings while the lay investor thinks in terms of absolutes. In other words, the lay investor will think in terms of either buying Marathon's stock or selling it, while the professional thinks in terms of how much we want to own.

For example, in our core equity strategy we tend to own stocks in a range from 2 percent of the total portfolio to 7 percent of the total portfolio. We don't buy stock above 5 percent, but we will allow winners to run as high as 7 percent. This is just an example. A more aggressive investor may be more concentrated and therefore have larger position sizes, and a more conservative investor may want more diversification which would mean smaller sizes.

In this example we may buy a stock at a 4 percent position. To make this easy let's just assume a portfolio of $1M. We do the math and 4 percent of $1M is $40k, so we would buy $40k worth of that stock. For our example we will say the stock price is $100, so that would be 400 shares of this hypothetical stock. If the price of that stock goes up $50 to $150 and to keep it simple the portfolio as a whole has not changed, the total investment would be worth $60k or 6 percent.

At this point the lay investor is thinking, "Should I sell it all and take the profit?" On the other hand, the professional thinks, "This company should still be a 4 percent holding." We don't sell it all, we trim 133 shares or $20 thousand worth of the stock to get back to the 4 percent. If the opposite were to happen and the stock price goes down, but nothing has changed at the actual company, then we would add and get it back to 4 percent. In other words, we rebalance. Lay investors are familiar with that concept because they may do this in their 401(k) with their asset allocation among the various funds, but I believe the reason behind this becomes clearer when looking at individual stocks.

We purchased our hypothetical stock for $100. If the price goes up to $150, then we sell some of it at a high price. If it goes down to $80, we buy more at a low price. This discipline forces us to buy low and sell high, which is exactly what investors want. It also helps us to focus on the actual company, and by doing that helps us to be patient.

The market will do silly things, but as long as we focus on the fundamentals of the actual investments we own, then we can be patient and even allow the market silliness to create opportunities. If we focus from the bottom-up and pay attention to only what matters, we can position our portfolio prudently. Then good things will come to those who wait. Patience is a virtue.

Warm regards,

Chuck Osborne

Chuck Osborne, CFA *Managing Director*