The Margin of Safety[1] Quarterly
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April 2023

In lieu of our normal quarterly letter we decided to send this PowerPoint for your update of our thinking as the "Mr. Market" investment environment is changing quickly, but good fundamentals of companies change at a much different pace (thankfully).

1 "Confronted with a challenge to distill the secret of sound investment into three words, we venture the motto, MARGIN OF SAFETY." - Ben Graham, *The Intelligent Investor, Chapter 20. We still think it best to keep on the top of our mind in all we do at SAA.*

In the short run, the market is a voting machine. In the long run it is a weighing machine. BG

Inflation hurts ALL investments but hurts long bonds the most!

The less prudence (rational) with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs. WEB

Traits of the Ideal Investor (WEB)

- *Independent Thinker*
- *Emotional Stability*
- *Keen understanding of both human and institutional behavior*
- *Uncommon, common sense (BL)*

"*When the facts change, I change my mind.*"
And they are changing very fast!!!

Q1 Summary – Investors rush to Safety…

- S&P rose 7% during the quarter
  - Nasdq rose 17%
  - Short interest rates rose, while longer rates declined (page 11)

- Big winners were Tech stocks and Money market accounts
  - Flight to cash rich, cash generating big cap technology
- Turmoil in the banking sector sparked flight from smaller to larger banks. Then to Money Market accounts.
  - Money Market accounts now average ~4.5%, very attractive after years of no returns.
- We are happy with the quarter's results but remain concerned about the future. As always, we look to our "North Star" of valuation to help navigate these markets.

To prepare we focus on two fundamentals consider whether to be aggressive or defensive (we don't try to predict the future).

I. Valuation of Stocks (the Market) – Our North Star

- Valuations are better relative to beginning of the year, but still not cheap. (Page 16-22)
  - Forward PE of S&P 500 17.3x (3/24/23) (Page 12)
  - Forward PE of S&P excluding Mega Cap 8 Stocks 15.4x (Page 13)
    - Forward PE of Mega 8 Stocks is 26.8x (Page 13)
    - Mega 8 stocks make up 26.8% of S&P 500 (3/24/23) (Page 14)
- Risks: Bank Scare/Crisis fallout, Future fed action, Deficits, Inflation, Recession, Profit Margins, Earning multiple declines
- Recent Flight to safety: i.e. T-Bills & Cash rich businesses: Apple, Microsoft, Berkshire, Consumer staples (such as KO or P&G)
- Future Inflation and Interest effect on valuation multiples still a concern

II. Psychology of the Markets (Attitude toward risks)

- Consumer sentiment is currently very low
- Unknown Fallout Effect of SVB, Signature Bank, Credit Suisse, etc
- More Fear than Greed? Degree? Blame Game?
- “Fed Put” effect as confidence; “Like having religion without the existence of hell” (CM)
- Present facts can (and do) change quickly and cause volatility, so must remain flexible in thoughts and allocations -
- High geopolitical uncertainty i.e. Russia, China, etc. Future Bank regulations, Bank Blame Game; increase recession odds
- Plus “Unknown, unknowns”
- Stock market is a voting machine in the short term! (BG)

Powell and Yellen - Can we count on them?

- Lack of confidence in Yellen and / or Powell (ongoing – 3/27/23)
  - Is the "Fed Put" dead?
  - Blame Game
  - Mismanagement at SVB? Regulators asleep?

- Yellen says government has "implicit guarantee" of all bank deposits
  - > $250,000
  - Then "back tracks" in her speech – Yellen contradicts Powell?
  - Does she have power to do this or not? How much does this matter?
  - Both stress that "Banks are strong." in order to reassure us.

- Powell somewhat contradicts Yellen on guarantee (?)

Men and Nations behave wisely when they have exhausted all other resources.

Abba Eban

- Confidence gap – confusion between Powell and Yellen
  - Blame game on cause of banking scare – Regulators, rapid increase in rates by Fed
  - Accounting rules related to AFS and HTM securities.

- This time, the crisis is a "timing factor" – Hold to Maturity (HTM) - (miss match of assets (long) and liabilities (short)) not a credit issue as it was in 2008.
  - Losses in HTM Bond portfolio – the speed and significance of changing interest rates, created losses in portfolios (mark to market) not seen before.
  - Venture Cap big depositors withdrew capital from banks / Bank Run / Apps do quickly
  - Runs on banks can cause liquidations of HTM bonds – realization of losses previously unrealized
  - In today's banking environment, a bank run could cause a liquidity issue at almost any bank.

Important Questions Now / We will be watching going forward

1. Will “Little Financial Scare” (LFS) effect future bank lending? Slow economy and push us into recession?

2. Is there another “shoe to drop? Office & Commercial RE? Private Equity?

3. Will Fed back off on further rate increases? If so, what will be the effect on inflation?

4. What will be the terminal interest rate be? Valuation effect, reinvestment risk of short T-bills? When is right time to ladder fixed income our longer?

5. How much will future interest rates move? How long will the Fed keep higher rates? See current and past yield curve on page 13.

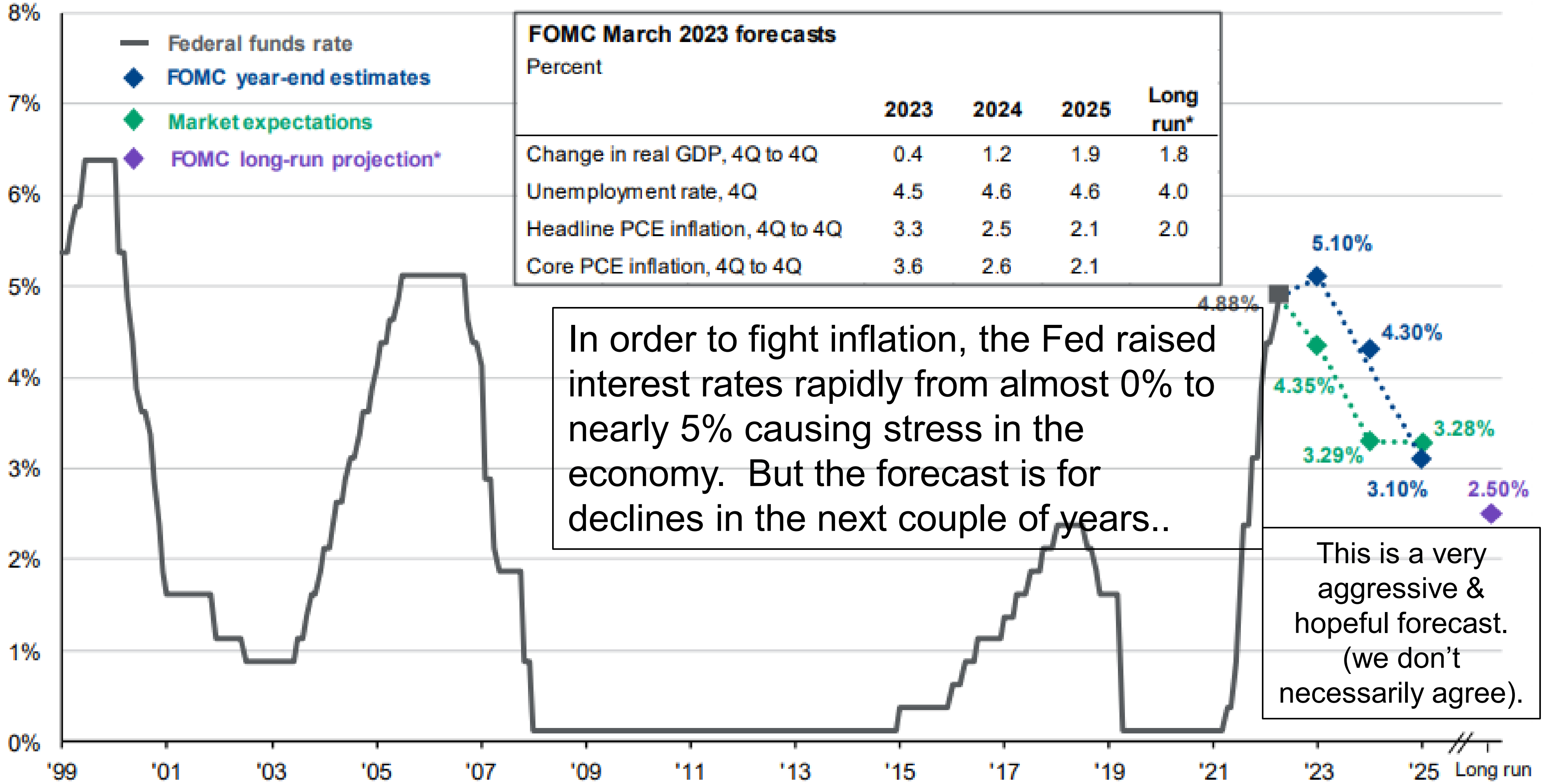
6. When will it make sense to ladder bonds maturities longer, rather than buying 1–1.5-year short bonds that yield 4 - 5% with no risk and can HTM?

   Or hold in higher yielding treasury money market that yields 4.3 – 4.4%

The Fed and Interest Rates

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



FOMC March 2023 forecasts

Percent

	2023	2024	2025	Long run*
Change in real GDP, 4Q to 4Q	0.4	1.2	1.9	1.8
Unemployment rate, 4Q	4.5	4.6	4.6	4.0
Headline PCE inflation, 4Q to 4Q	3.3	2.5	2.1	2.0
Core PCE inflation, 4Q to 4Q	3.6	2.6	2.1	

In order to fight inflation, the Fed raised interest rates rapidly from almost 0% to nearly 5% causing stress in the economy. But the forecast is for declines in the next couple of years..

This is a very aggressive & hopeful forecast. (we don't necessarily agree).

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Market expectations are based off of the respective Federal Funds Futures contracts for December expiry. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.
Guide to the Markets – U.S. Data are as of March 31, 2023.

Where do we go from here? How do we position portfolios?

So, what do we do now? Where do we go from here?

- Stay rationally defensive but proceed with caution
  - TIAA – “There Is An Alternative” TINA is out.
  - Short treasury bonds provide decent return now, but with some minimal reinvestment risk.

- Valuation: Markets metrics appear at “fair value” but not cheap. Doesn’t yet reflect potential risk of lower earnings, lower multiples and potential unknown shocks.
  - If inflation (and interest rates) stay high, the current valuation may be expensive (i.e. earnings decline).

- Investor psychology has moved from Euphoria (2021 & prior) to at least somewhat more skepticism – some pessimist (which is usually a “buy” signal)

- With higher interest rates, investors do have an option to equities. (TIAA)
  - Short term bonds (3 month – 1.5 years) are paying 4.5 – 5% and this may increase
  - Reinvestment opportunity – or risk?

- Generally, we believe investors should be at <u>or slightly below</u> their long-term target equity allocations, depending on their time horizon, cash needs and tolerance for volatility.

  - If new money comes in, be slow to put to work, it’s o.k. to be below your allocations now as can earn reasonable return on short term money markets or treasury bills
  - If interest rates increase, it may be time to revisit long term target allocations as bonds may soon offer a reasonable return i.e., ladder strategy (at some point)
  - Staying below allocation with “dry powder” that can be put invested when opportunities present themselves seems prudent at this time. Short T-Bills in interim

Selected Charts / Graphs for the Discussion

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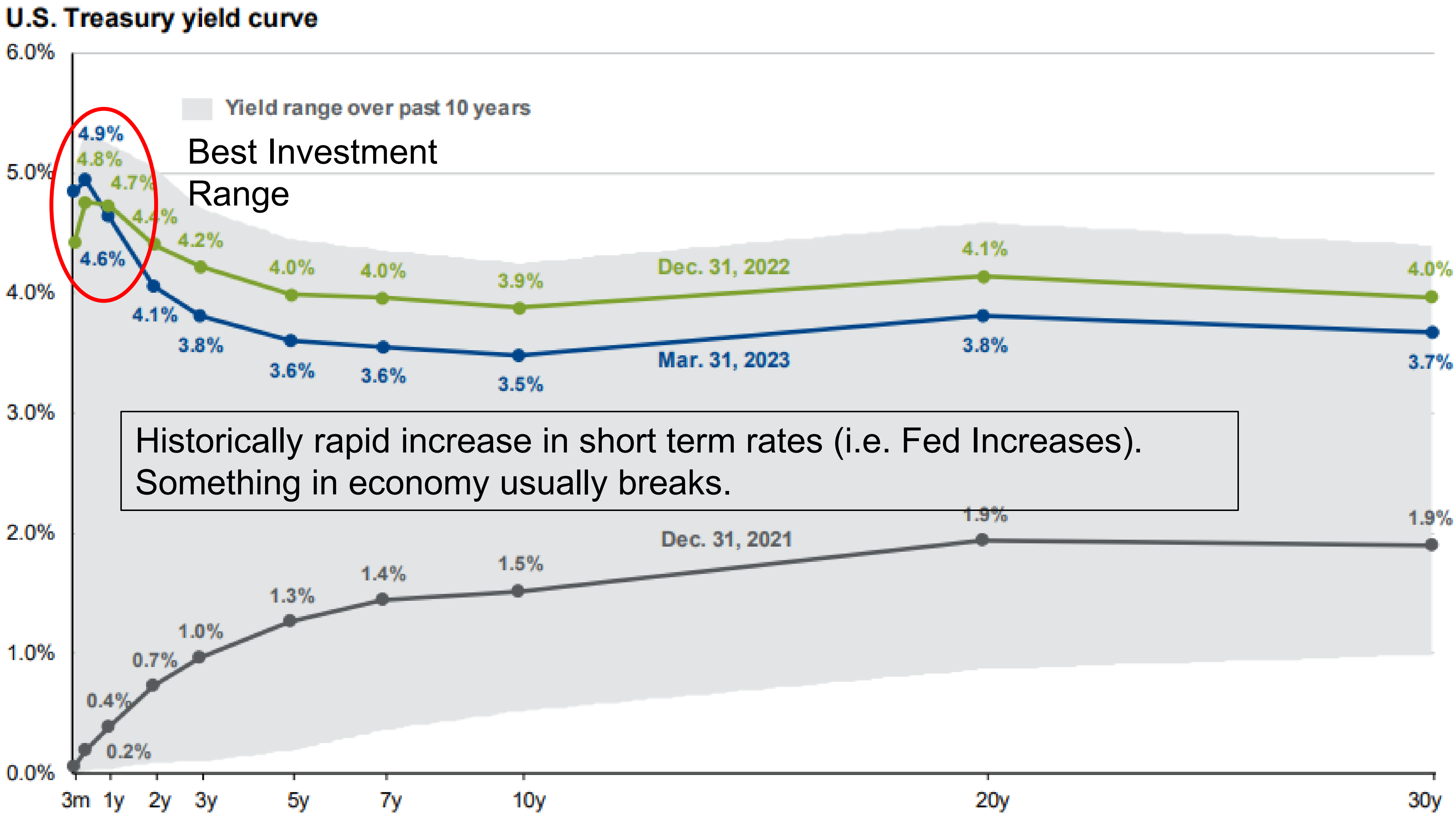
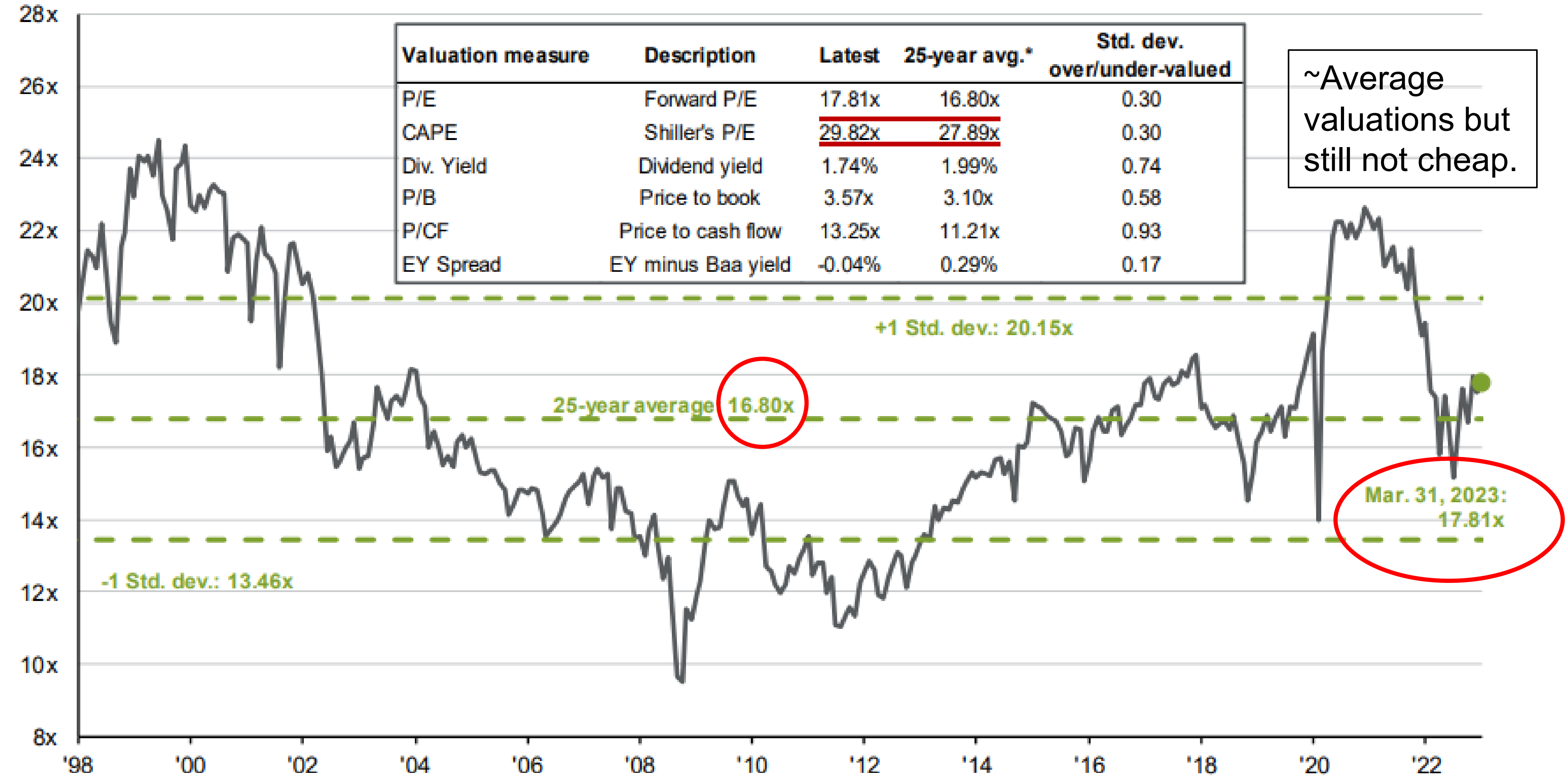
Yield Curve



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2023.

S&P Valuation Measures

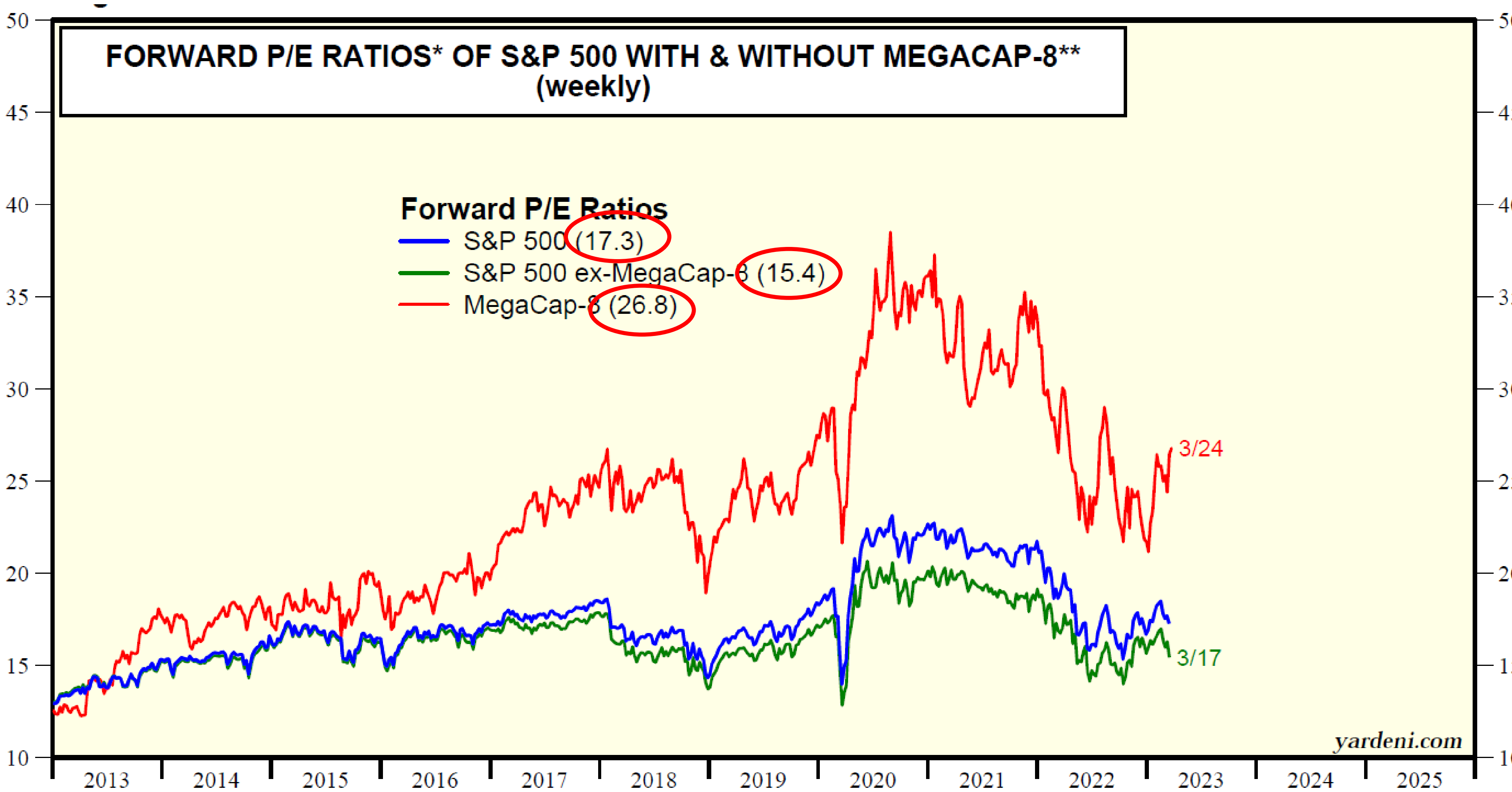
S&P 500 Index: Forward P/E ratio



Valuation measure	Description	Latest	25-year avg.*	Std. dev. over/under-valued
P/E	Forward P/E	17.81x	16.80x	0.30
CAPE	Shiller's P/E	29.82x	27.89x	0.30
Div. Yield	Dividend yield	1.74%	1.99%	0.74
P/B	Price to book	3.57x	3.10x	0.58
P/CF	Price to cash flow	13.25x	11.21x	0.93
EY Spread	EY minus Baa yield	-0.04%	0.29%	0.17

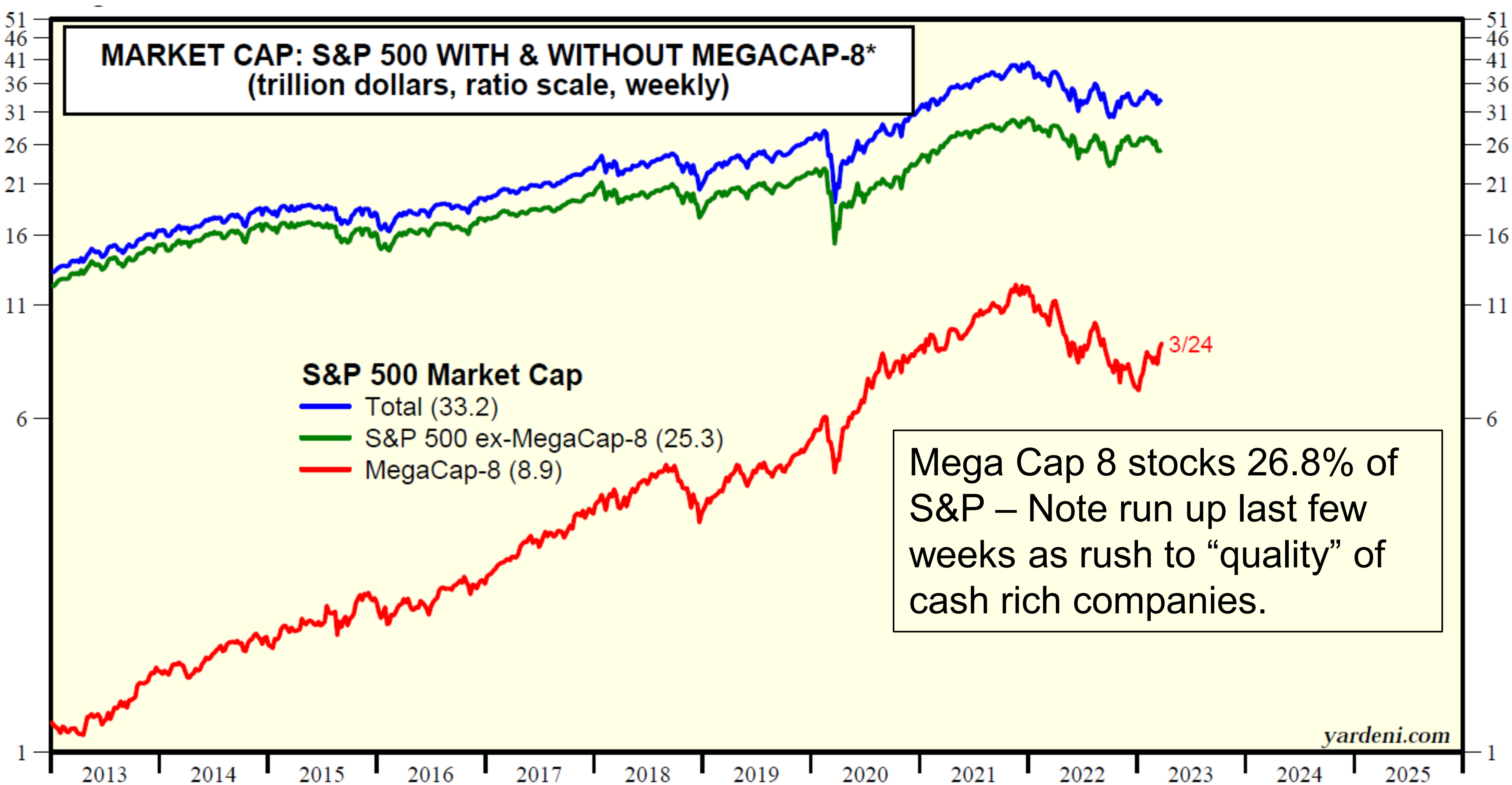
Source: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since March 1998 and by FactSet since January 2022. Current next 12-months consensus earnings estimates are $228. Average P/E and standard deviations are calculated using 25 years of history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Price-to-book ratio is the price divided by book value per share. Price-to-cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure. *P/CF is a 20-year average due to cash flow availability.
Guide to the Markets – U.S. Data are as of March 31, 2023.

Valuations – S&P 500 vs S&P 500 ex Mega cap 8



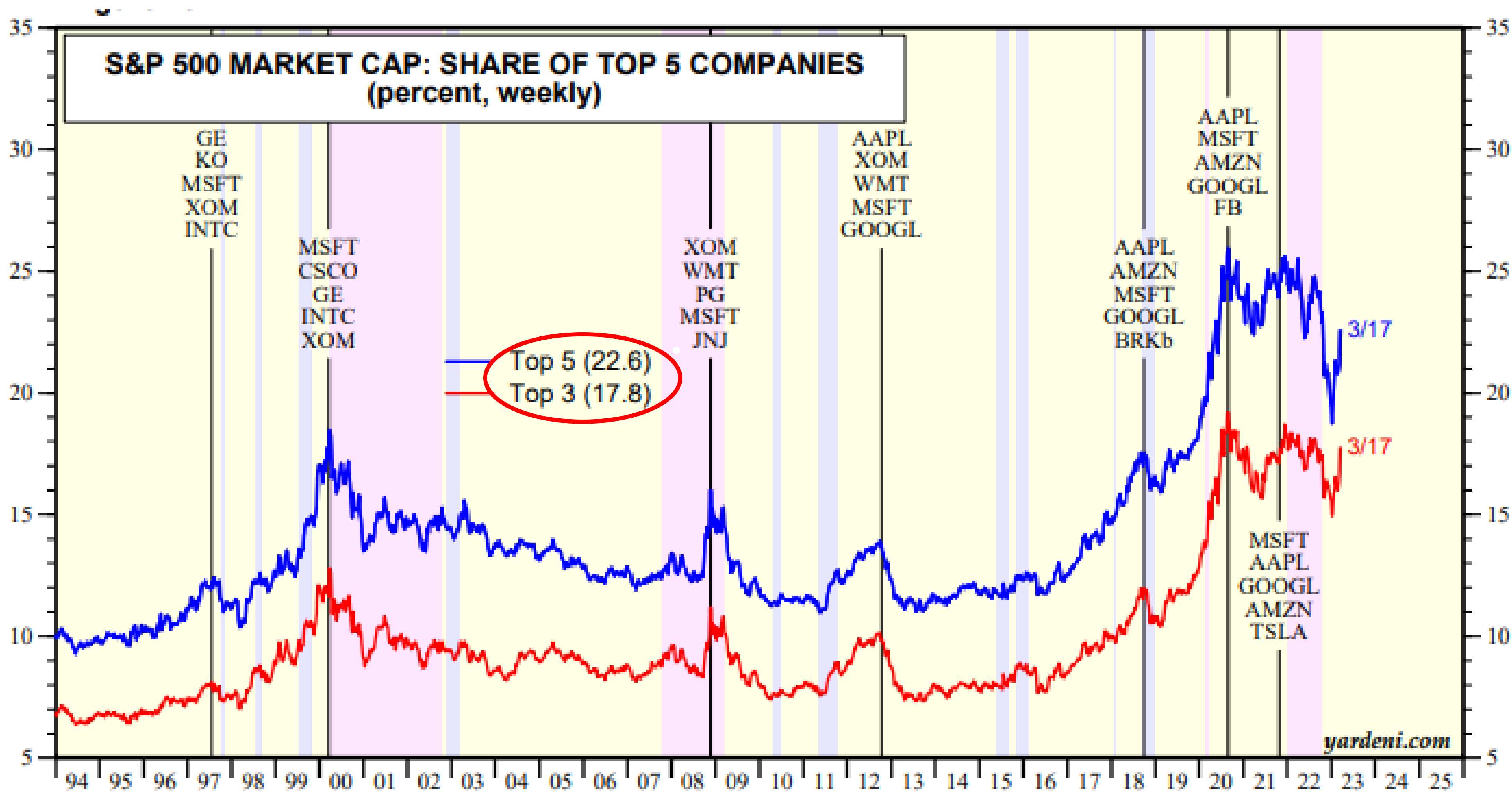
* Price divided by consensus forward earnings forecast.
** MegaCap-8 stocks include Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, NVIDIA, and Tesla. Both classes of Alphabet are included.
Source: I/B/E/S data by Refinitiv.

S&P 500 – Concentration of Mega cap 8



* MegaCap-8 stocks include Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, NVIDIA, and Tesla. Both classes of Alphabet are included.
Source: Standard & Poor's and Yardeni Research Inc.

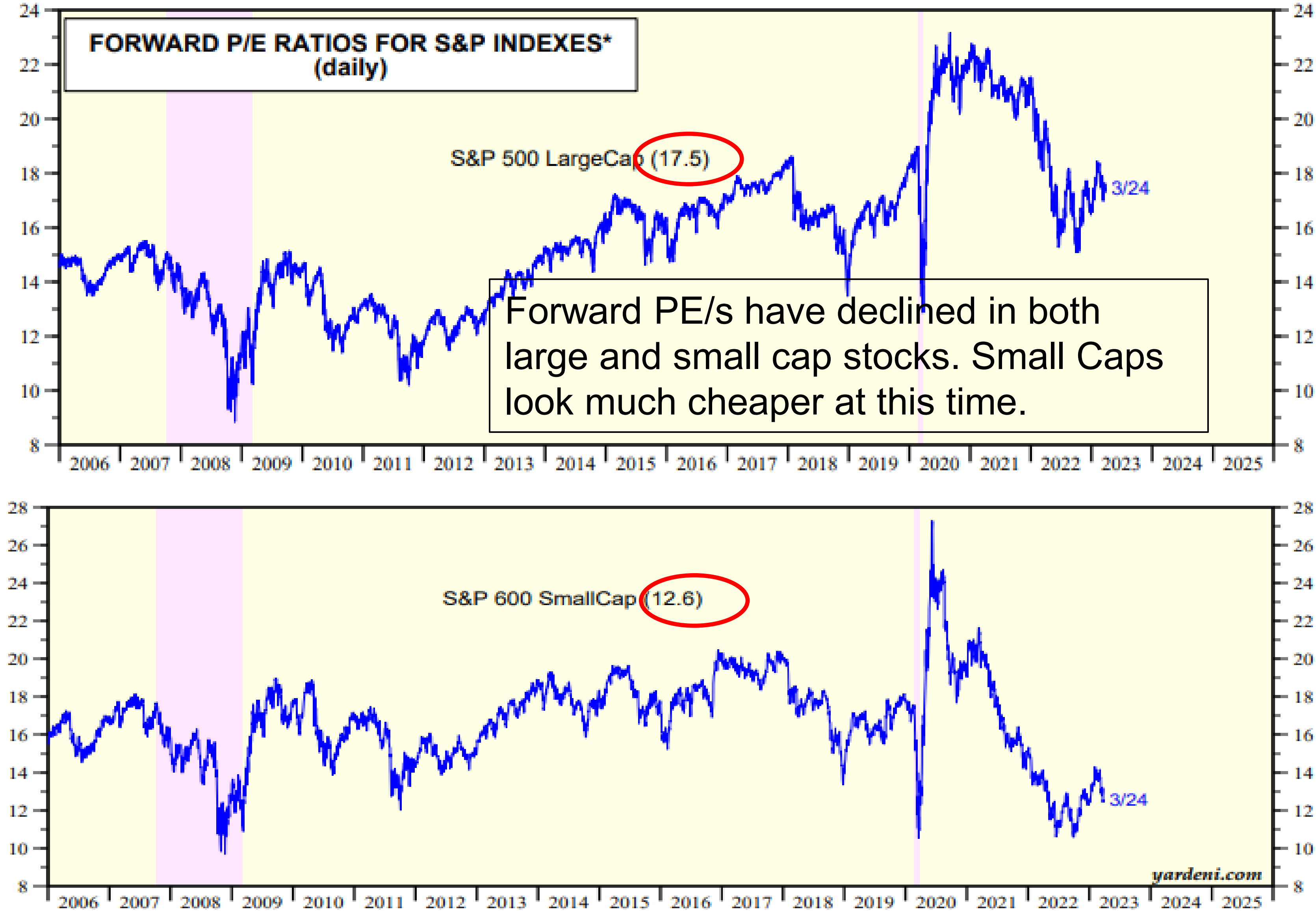
S&P 500 – Concentration of Top 5 Holdings Over time



Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Blue shaded areas are correction declines of 10% to less than 20%.
Yellow areas are bull markets.
Source: Yardeni Research using Standard & Poor's and I/B/E/S data by Refinitiv.

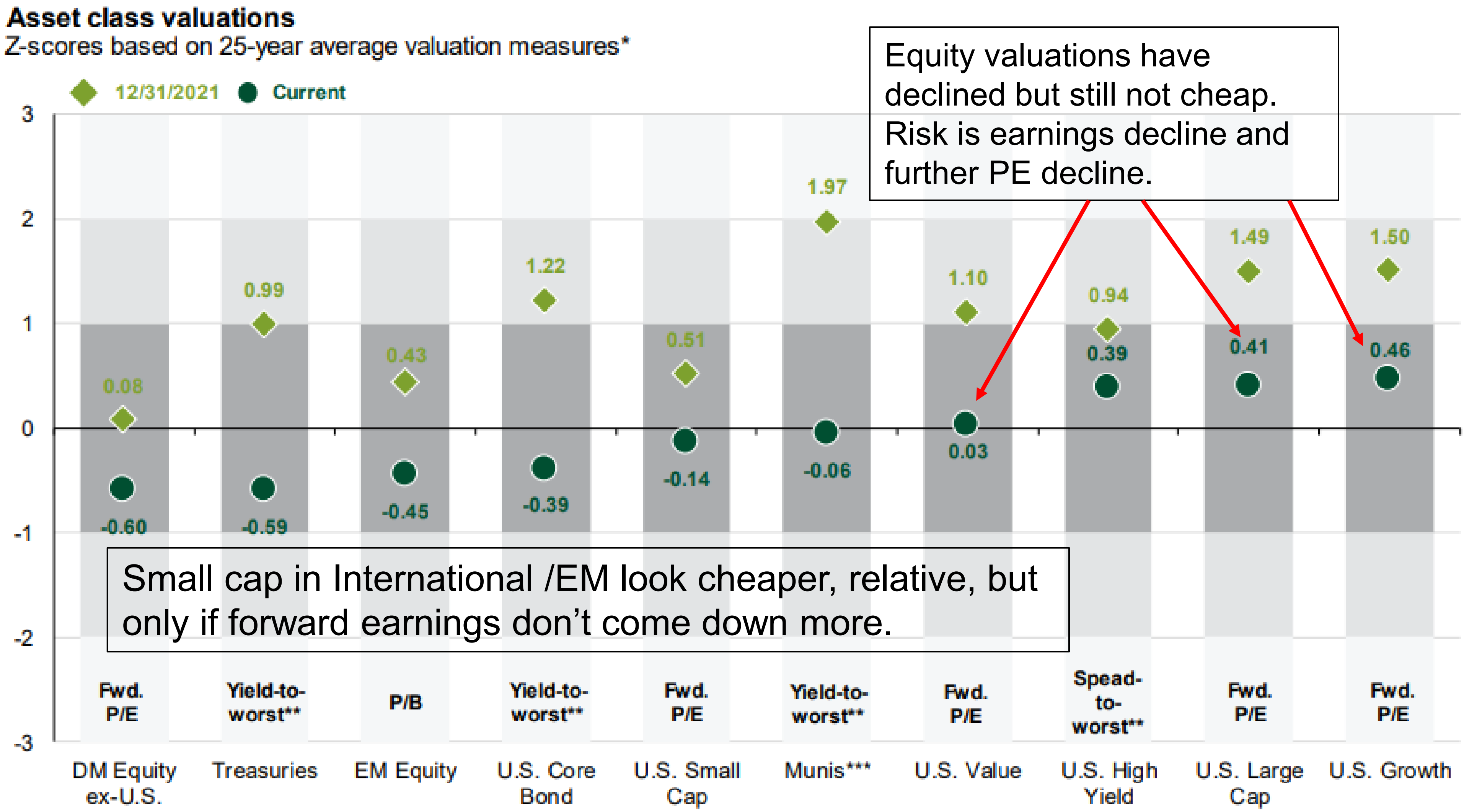
Historical Forward P/E ratio S&P 500 & S&P 600 small cap

Figure 12.



* Price divided by 52-week forward consensus expected operating earnings per share.
Source: I/B/E/S data by Refinitiv and Standard & Poor's.

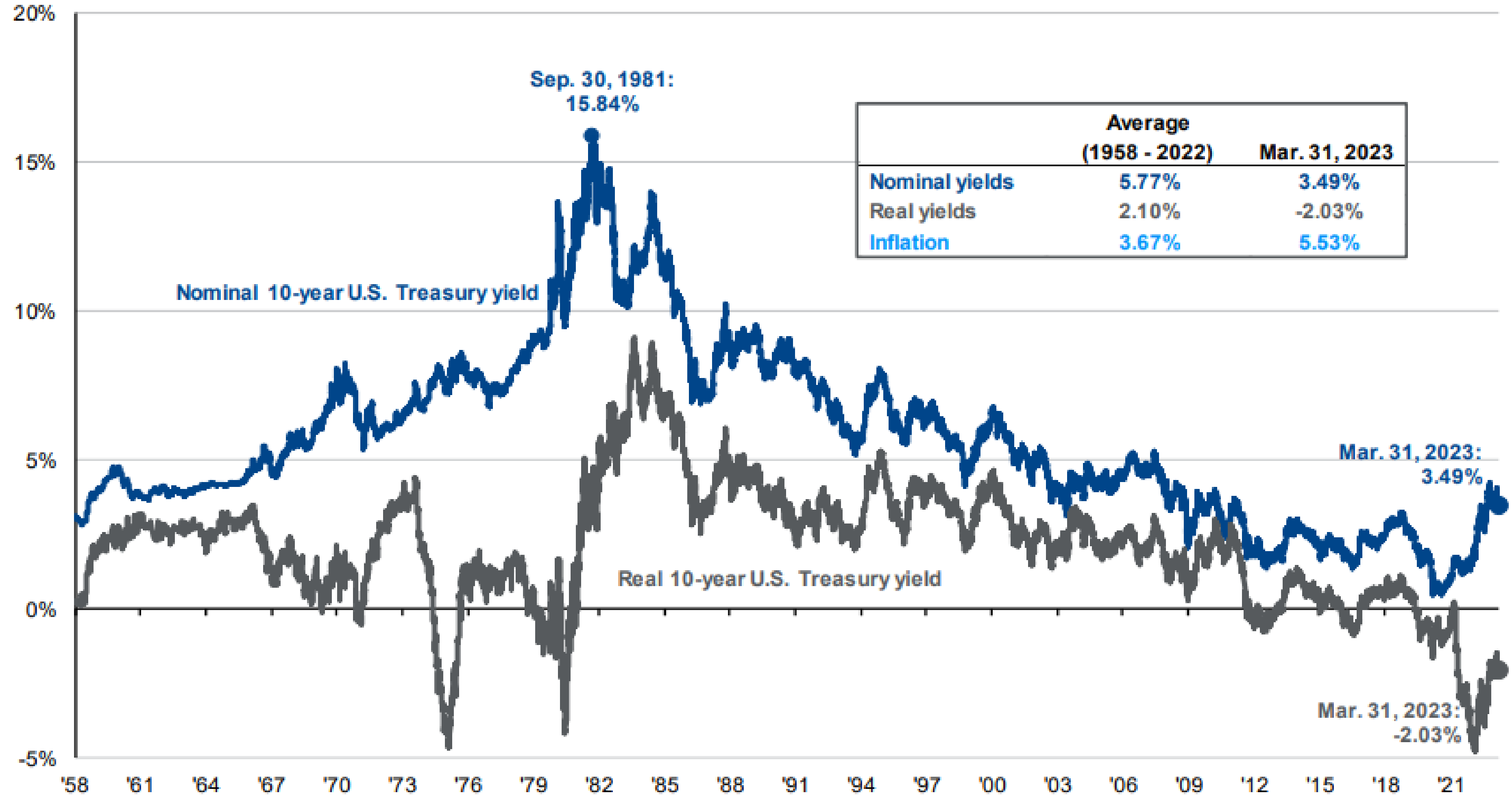
Valuations Monitor – different measure, but same story



Source: Bloomberg, BLS, CME, FactSet, MSCI, Russell, Standard & Poor's, J.P. Morgan Asset Management.
U.S. Large Cap: S&P 500, U.S. Small Cap: Russell 2000, U.S. Mid Cap: Russell Midcap; EM Equity: MSCI EME, DM Equity: MSCI EAFE, U.S. Value: Russell 1000 Value, U.S. Growth: Russell 1000 Growth, U.S. High Yield: J.P. Morgan Domestic High Yield Index, U.S. Core Bond: Bloomberg US Aggregate, Treasuries: Bloomberg U.S. Aggregate Government – Treasury, Munis: Bloomberg Municipal Bond. *Yield-to-worst and spread-to-worst are inversely related to fixed income prices. **Munis yield-to-worst is based on the tax-equivalent yield-to-worst assuming a top-income tax bracket rate of 37% plus a Medicare tax rate of 3.8%.
Guide to the Markets – U.S. Data are as of March 22, 2023.

Interest Rates and Inflation

Nominal and real U.S. 10-year Treasury yields



Source: BLS, FactSet, Federal Reserve, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month. For the current month, we use the prior month's core CPI figures until the latest data is available.
Guide to the Markets – U.S. Data are as of March 31, 2023.