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Southeast Asset Advisors, LLC

Investment Management & Consulting

Thomasville – Atlanta – Tallahassee – Mobile – Charleston

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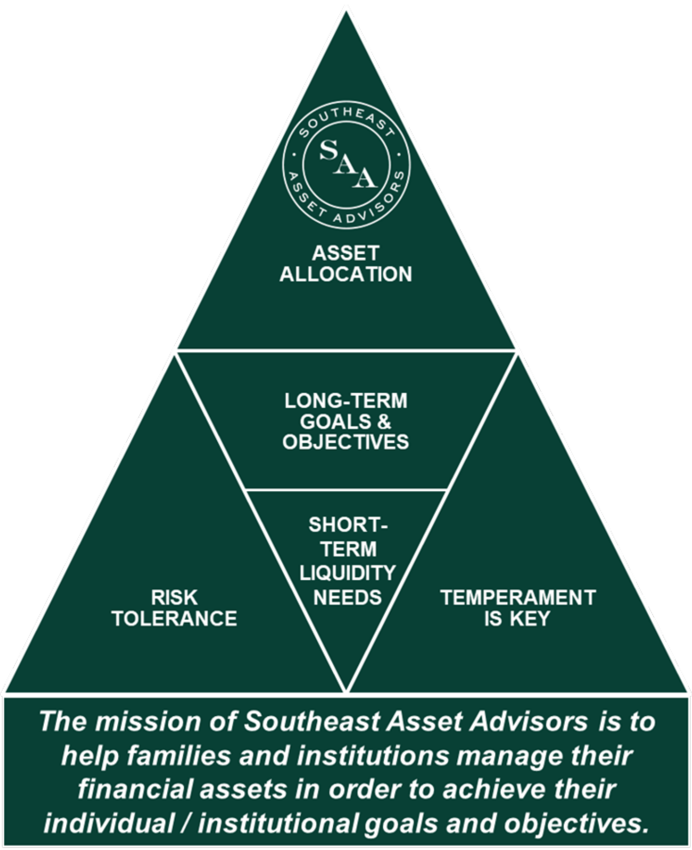
The Margin of Safety Quarterly [1]

1st Quarter 2024



SOUTHEAST ASSET ADVISORS

WE STRIVE TO PROTECT AND GROW OUR CLIENTS' CAPITAL OVER THE LONG TERM BY:

1) Focusing on individual client goals and objectives.
2) Having the proper asset allocation to reflect each client's tolerance for volatility (i.e., temperament).
3) Stress testing short-term liquidity needs.
4) Investing with a value orientation and utilizing managers who understand the intrinsic value of a business and margin of safety along with passive strategies as appropriate.
5) Rebalancing portfolio holdings/managers when appropriate to take advantage of underpriced and to avoid overpriced assets based on the client's profile of asset allocation ranges.

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[1] Margin of Safety (MOS): Many investing greats have said these are the most important three words in investing. We agree and call our quarterly letter accordingly. MOS is key in determining anything with variables occurring in the future, i.e., price to future value, all future outcomes, etc. Its magic is that the higher your MOS, the smaller your edge needs to be to have a favorable outcome.

TO: Clients and Friends
FROM: SAA Managing Directors
RE: 1st Quarter 2024 Commentary
DATE: April 2024

1st Quarter

Some of the "mag 7" stocks are beginning to fizzle, but the stock market still headed higher, as the S&P 500 returned 10.6% in the first quarter of 2024. An exceptional start after a strong 2023 performance, even though two of the biggest stocks in the S&P 500 suffered double-digit declines. Apple shares fell ~11%, and Tesla dropped almost 30% in the first three months of the year. Alphabet shares sputtered for much of the quarter before making a run at the end of the quarter to end up ~8%. The remainder of the "mag 7", Nvidia, Meta, Microsoft, and Amazon, continued their run. They are now even called the "fab four" by some. It is a positive sign to see the market gains without Apple and Tesla, as it means other groups are participating. However, the "fab four" account for nearly half of S&P gain in the first quarter.

The 10-year treasury rate ended the quarter at ~4.2%, slightly higher than the ~4.0% year end rate. We continue to roll short-term treasury bonds to increase/maintain cash yields for many clients. The 3-month treasury currently yields ~5.4% and the one-year yields ~5.1%. We don't know how long we'll be able to continue earning over ~5% on this short-term paper, but we are happy to have a great yield in fixed income that fits the asset allocation of some clients.

The bond yield is mostly determined by actual and expected inflation, and how the Fed responds by raising or lowering interest rates. Over the past couple of years, excessive stimulative fiscal policies have helped to avert a recession while increasing the supply of treasuries.

Where Do We Stand?

It appears that the economy is not going to have a recession as some had feared a short time ago. The Fed may cut interest rates later in the year, even if not at the pace some had previously predicted. The recent labor/jobs report was another reason many asked, "why cut rates and risk inflation increases in this Goldilocks economy where the wealth effect seems to be lifting all boats?" The second half of 2024 will be interesting to watch particularly the Fed's action, given the November election. The Presidential candidates have radically different views on taxes, immigration, etc. and at least talk a very different game, which makes for an interesting November as well as the next four years.

<u>Be Skeptical of all Predictions/Forecast and Plan for Different Outcomes</u>

We need to constantly remind ourselves that all predictions/forecasts are a guess, and at best, an educated guess. We must all be skeptical of believing what we read or hear – anywhere or anytime, especially any predictions/forecasts!

Of course, investing involves assessing and having an opinion on the future. We always want a "margin of safety" (MOS) in any forecast and prepare for different outcomes. Many predictions/forecasts will surely end up being too optimistic or pessimistic. We should be wary of predictions/forecasts that became consensus because they may not be right; and in the short term, Mr. Market is a voting machine where psychology can be more important (maybe) than any other factor.

Two of our favorite quotes about predictions that are so true are:

- *You cannot predict (correctly) but must try to prepare for different outcomes.*
- *We learn more about forecasters than we learn from their forecasts.*

Everyone's forecast (both short and long-term) is influenced by their personal bias.

Different opinions by knowledgeable people may indeed help us think appropriately about different outcomes. Especially, as we continually try to disprove our current thinking.

As always, pundits freely give their predictions about the future and their crystal ball. The late Charlie Munger said that he never gave his opinion unless he knew the other side of the argument better than anyone. However, unfortunately, very few people have followed this criterion for giving out their opinions.

It is important to know the capabilities of the forecaster, as well as their risk attitude and their biases. We generally have the most respect for investors who consider the downside risk before projecting the possible upside reward of any forecast.

Speaking of different opinions, Jamie Dimon, J.P. Morgan's chief executive, recently warned that U.S. interest rates could soar in the looming years due to record high deficit spending, etc. He worries that geopolitical stress will complicate the fight against inflation. He went on to say, "huge fiscal spending, the trillions needed each year for the green economy, the remilitarization of the world, and the restructuring of global trade — all are inflationary."

Dimon, head of the nation's largest bank, acknowledged that despite skepticism by forecasters (himself included), the U.S. economy has remained resilient. The reasons may be due to massive government spending, and that a lot of debt was fixed by many at low interest rates and this fixed debt did not increase as the Fed increased rates.

However, once again on a cautious note, Dimon questioned the optimism in the financial markets. Dimon further explained that the risk of extreme volatility has not subsided for him. He noted that his bank is preparing for a wide range of outcomes where interest rates could drop as low as 2% or head to "8% or even higher," based on where the economy is headed. He reportedly said that under these many different scenarios, his bank should perform at least okay. Jamie Dimon's forecast and preparation for radically different outcomes is a prime example of what we must all try to do as we find ourselves in a very uncertain world and economy over the next few years.

We encourage you to read Jamie Dimon's sixty-page letter to J.P. Morgan shareholders as it has a lot of wisdom and insight. Bottom line, he worries and prepares his bank accordingly for very different outcomes in the future in areas of interest rates, quantitative easing, government spending, and deficits, etc.

<u>Temperament – FOMO</u>

As we have said many times, the temperament of an investor is so important. Fear or greed caused by changes in the economy or markets can change our temperament quickly. Prudent asset allocation, along with some uncorrelated asset holdings therein, can possibly help abate some of this inherit volatility.

Fear of missing out (FOMO) is perhaps the emotion of the moment, as the Goldilocks economy and market continue upward. "AI" has the potential to increase productivity and could be a game changer. Certain stock prices have exploded to the upside based on AI expectations, exacerbating FOMO in many investors. Key questions remain to us on AI such as (1) who and when will we see the returns and payback on the huge AI investments by many companies? and (2) will AI benefit a few first movers or the entire economy via productivity? Time will tell!

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As the late investor Charlie Munger said, "*The highest form that civilization can reach is a seamless web of deserved trust. And that seamless web of deserved trust can only happen with one fulfilled promise at a time.*"

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Thank you for your trust in us. We will do our best not to disappoint you. Please reach out to any of us at SAA if you need anything.

Have a great spring!

Your SAA Team

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"Curiosity is a form of humility — acknowledging that you don't know everything. Responding to curiosity allows other people to speak freely. Facts and details matter and inform a deeper and deeper analysis that allows you to continually revise and update your plans. This, of course, also means that you are constantly admitting prior mistakes."

- Jamie Dimon

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"Guessing at the future rate of interest is, in my opinion, one of the most puzzling problems in the world."

- John Maynard Keynes

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"A thoughtful investment process contemplates both probability and payoffs and carefully considers where the consensus – as revealed by price – may be wrong."

- Michael J. Mauboussin

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"People will always be driven by greed and fear and extremes up and down."

- Li Lu