

# The Conservative Strategist

JANUARY 2022



A QUARTERLY  
INVESTMENT  
NEWSLETTER  
PUBLISHED  
EXCLUSIVELY  
FOR CLIENTS  
OF SEASONAL  
STRATEGY

## 2022: Valuation is destiny

It's difficult to find a better word for 2021's markets than *irrational*.

### Nonsense reigns

Among other craziness, it saw a boom in NFTs, so-called non-fungible tokens, essentially a unique digital identifier of ownership of a digital asset (photo/video/audio), verified by the blockchain. An example: Steph Curry, on breaking the NBA 3-point shot record, sold 2,974 digital sneakers (2,974 was his new career 3-point record) for \$333 apiece (3-pointers, get it?). That's more than \$990,000 for a digital asset simply conjured up by a marketer, and good for nothing but trading to a greater fool at a higher price.

Equally head-scratching, real estate is now selling for millions in the so-called *metaverse*. This isn't real estate you can live in or work in, but digital real estate that exists only online and in virtual reality.

Add *DogeCoin*, Tesla stock at 20 times revenue, "sculptures" of literally nothing, and a host of other nonsense, and you can only conclude that ultra-low interest rates, combined with trillions in government payments piled up in bank accounts have resulted in *too much money chasing too few good ideas*.

### Bursting bubbles

Some bubbles are already appearing to burst. So-called *innovation stocks*, all the rage in 2020, topped out in February. Since then the ARK Innovation ETF

### US value stocks have rarely been this cheap, relative to US growth stocks

Relative valuation of cheapest 50% of US stock market on composite value less average



In the past 40 years, value stocks have only been cheaper relative to growth stocks during the 2000 bubble. They could rise 50 percentage points more than growth stocks in the coming years, and they will still be below their mean relative value. Source: GMO.com, 9/30/2021

fell as much as 45% to its recent low. Special Purpose Acquisition Companies, or SPACs (where we invest in a limited-risk arbitrage strategy) saw huge interest in Q1, fizzled in Q2, and have traded sideways since.

### Lopsided markets

Markets have grown quite lopsided in 2020 and 2021, as we've seen record runs of growth stocks vs. value stocks, big stocks vs. small stocks, US stocks vs. foreign stocks, and financial assets vs. real assets. The imbalances among these pairs are also at or near record

levels — in most cases two standard deviations away from the norm, a condition that generally occurs only about 2.5% of the time.

### Mean-reversion coming

Over long periods of time, all of these relationships have been mean-reverting. Years in one direction have led to years-long shifts in the opposite direction. Is there a catalyst out there that will reverse these trends? We think it may be ***inflation and higher interest rates***. Value stocks, for instance, tend to outperform their growth stock

(Continued on page 2)

The Markets	December 31, 2021	Price/Yield	Gain, Qtr	Gain, 2021
<b>US Stocks</b> (S&P 500/Vanguard Index)		4766.18	10.99%	28.54%
<b>International Stocks</b> (Vanguard Index)		20.45	2.09%	8.61%
<b>Emerging Markets Stocks</b> (Vanguard Index)		31.24	-0.45%	0.73%
<b>Real Estate Stocks</b> (Vanguard REIT Index)		38.52	14.86%	40.19%
<b>Bonds</b> (30 year US Treasury/Vanguard Index)		1.90%	2.56%	-4.81%
<b>Dollar</b> (US Dollar Index)		95.63	1.49%	6.34%
<b>Gold</b> (London Afternoon Fix)		\$1805.85	3.62%	-4.33%
<b>Money Market Funds</b> (Vanguard Cash Reserves Fed)		0.01%	0.01%	0.01%*

\*change in yield



# Effective altruism: How to give

The giving impulse is in most of us. But it's not easy to figure how to give effectively. I submit that there are two main obstacles to overcome here. The first step is understanding how to leverage your giving tax-effectively. And the second step, discussed on Page 4, is learning to maximize the impact of your giving by directing it to charities that will do the most good per dollar given.

## STEP 1

### Give the max by maxing your tax benefit

Some may be sheepish about sully the altruistic impulse with thoughts of tax savings. But let's reframe that: The government wants to amplify your giving by offering a tax incentive to give. It only makes sense to take them up on it. Such incentives are designed to induce you to give more. And if you'd like, you can always take note of the tax savings and give that too, this year or next.

There are three key ways most can amp up philanthropy with tax benefits:

1. Bunch it
2. Time it
3. Appreciate it

### Bunch it

Roughly 90% of taxpayers, rather than itemize their deductions, opt for the standard deduction for non-itemizers. In 2022, that deduction will be \$12,950 for single filers and \$25,900 for married filing jointly. The habit of giving a modest amount to charity each year may fall short for them, failing to get them to a level of total deductions where it pays to itemize.

But what if they forego charitable donations in, say, four years out of five, and then, in a single tax year, make five years' worth of charitable contributions? Such *bunching* can send their overall deductions well over the standard deduction and make it pay to itemize. Result: A net tax savings over that of the regular yearly givers.

### Time it

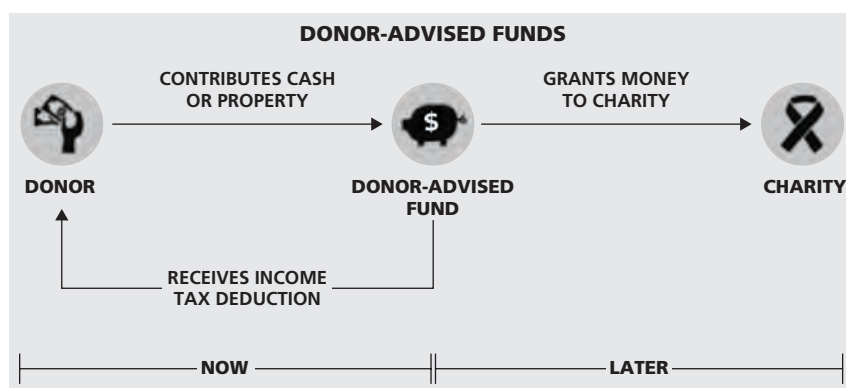
Even itemizers can benefit from such a strategy if the bunching comes in an especially high income year, when they may be in a higher bracket than in previous years. Every dollar of charitable contributions, then, results in greater tax savings.

### Appreciate it

One way to turbo-charge the tax benefits of charitable giving is to donate qualified *appreciated assets*. In such circumstances, the donor can not only take a tax deduction for the total amount of the gift, but can also wipe out the capital gains — and the capital gains tax — that would have accompanied the sale of such an asset.

For some high-bracket taxpayers in high tax states, executing the above strategies in concert can mean tax savings that exceed two-thirds of the value of the donation. It's like getting the government to donate two of every three dollars alongside you. ■

## Separate deductions and giving with a Donor-Advised Fund



If it makes sense for you to take a sizable deduction in the current year, but you don't yet have the charities lined up, you can open a Donor-Advised Fund (DAF), and contribute cash, appreciated securities, or both. You get the current year deduction but then you can take your sweet time to make your donations. In the meantime, you can invest the funds within the DAF and they grow tax-free. One drawback: DAFs charge asset management fees.

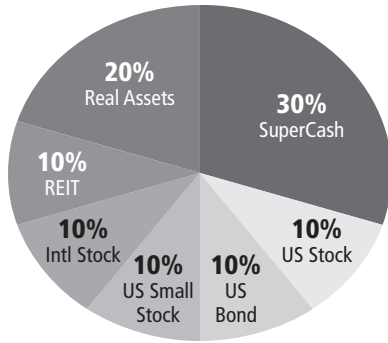
Image courtesy of meritwealth.com

## Valuation is destiny

(Continued from page 1)

counterparts when inflation and interest rates are climbing. Emerging markets, largely resource-heavier than their developed market counterparts, prosper when inflation is on the rise, as do real assets (real estate, infra-structure, farmland, timberland, industrial commodities, and precious metals) vs. financial assets.

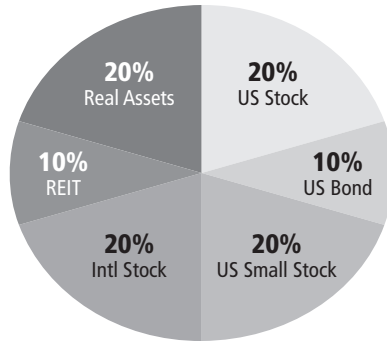
2022 should witness a shift from the fully-valued regimes of growth stocks, US stocks, and financial assets in general to more grounded assets, including value stocks, foreign stocks (particularly emerging markets) and real assets. ■

SuperDiversified  
Portfolios (SDPs)Brightman on  
inflationSDP1 *Conservative*

4th Quarter 2021  
**3.44%** **15.49%**

"For the Fed to fix the inflation problem, it's going to require real interest rate increases. And I think they're really constrained from doing so because of our massive debt. And it really puts the equity market at risk."

"You know, we explain the very, very high PE multiples that we see by the extraordi-

SDP2 *Moderate*

4th Quarter 2021  
**5.04%** **20.86%**

narily low interest rates. But you take away the extraordinarily low interest rates and there's no kind of reason for the very high prices we see in equity markets."

— Chris Brightman,  
Chief Investment Officer,  
Research Affiliates

The above model portfolios are not intended to indicate the performance of any real account, but reflect the composite performance, before fees, of the percentage allocations in the asset classes and funds listed in the table below. Seasonal Strategy's actual allocations vary from these models, and among portfolios.

How the Sectors  
PerformedBiggs continue to  
trounce smalls

Asset Class	Mutual Fund	Performance 4th Quarter '21	Performance 2021	
SuperCash	PIMCO Instl Low Duration	-0.86%	0.02%	Best
	Merger	0.15%	-0.34%	Worst
	Calamos Market Neutral	1.57%	3.08%	
US Stock	Vanguard Index Trust 500	10.99%	28.54%	
US Bond	Vanguard Long-Treasury	2.56%	-4.81%	
US Small Stock	Vanguard Small-Cap Index	3.84%	17.59%	
Intl Stock	Vanguard Intl Index	2.09%	8.61%	
REIT	Vanguard REIT Index	14.86%	40.19%	
Real Assets	PIMCO Commodity Real Return	-0.41%	32.80%	

Last quarter in this space, we reported that in Q3, we saw the widest outperformance of large-cap stocks versus small-caps (in a positive quarter) since 4Q2015, about 300 basis points. Yet that was nothing compared to the quarter just ended: Large US stocks beat their small counterparts by nearly 700 basis points.

That's a 10-percentage point beat in just six months. This kind of disparity doesn't occur except in extreme markets. Investors are deserting the mass of stocks but piling into the largest of the large, perceiving them as less risky. Call it a kind of lifeboat strategy. But the lifeboats are getting awfully crowded.

## Berkshire &amp; Apple

Most investors get more conservative as they age. But at 91, Warren Buffett is making one of the biggest bets of his career. And it's not so much what he's doing but what he's not doing.

Apple has been the largest holding for Buffett's company, *Berkshire Hathaway*, for a long time, and Buffett has more than a five-bagger on his cost basis. The stock's meteoric (and somewhat baffling) rise this year has sent the 905 million shares Berkshire owns to a value of more than \$158 billion as of late December.

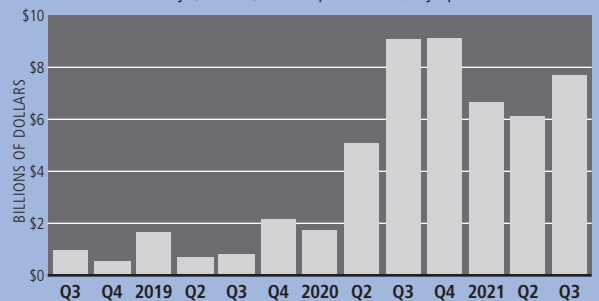
This \$158 billion is more than three times the size of Buffett's second-largest holding (*Bank of America*) and constitutes more than 45% of *Berkshire's* public stock portfolio. The average percentage allocation to his other holdings? Less than 2%.

Buffett clearly thinks he can take the risk. To his credit, he holds roughly \$150 billion in cash, nearly equal to the *Apple* stake. And of course, he holds roughly 35% of *Berkshire's* overall value in an assortment of private companies.

The *Apple* stake scares us and we hope Buffett will trim here aggressively. But the rise in *Apple's* value combined with a solid but restrained performance by *Berkshire*, has sent *Berkshire's* book value down to about 1.25, roughly where Buffett says the stock is a compelling buy, and where he himself has bought back his own stock most aggressively.

One of the world's greatest investors likes...  
his own company and little more.

Berkshire Hathaway (BRK-B) share purchases, by quarter



Since the pandemic began, Berkshire has stepped up buybacks of its own stock. Meanwhile, during the same time, Buffett has been a net seller of other stocks in the Berkshire portfolio.

Source: [empirefinancialresearch.com](https://empirefinancialresearch.com)



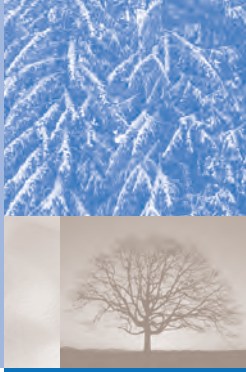


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## Effective altruism: Where to give

**O**K, so giving optimally sounds like a numbers game. Not exactly. That may cover the what, when, and how, but there remains the elusive *where*.

### STEP 2

#### Maximize the impact of your giving

Which charities use our given dollars most effectively? Until recently, the answers had been elusive. But thanks to organizations such as *CharityWatch*, *Charity Navigator*, *Guidestar*, *Great Non-Profits* and *GiveWell*, you now have a number of organizations that do serious research to narrow your own search to the most deserving charities.

Each has its own methods, and you can go online and even find comparisons of them. *Great Non-Profits* is interesting as the only one that is crowd-sourced rather than top-down. It includes in-person stories from many thousands of volunteers, participants, clients and

donors, to give you a personal view of a charity's effectiveness.

#### GiveWell

Conversely, *GiveWell* narrows its sophisticated, empirical, top-down research effort to a specific question: "*How can we get the biggest charitable bang for the buck in the cause of saving human lives and alleviating human suffering?*" It spends thousands of hours rigorously researching and monitoring to produce a select list of highest impact charities. Its quantitative cost-effectiveness criteria allows it to produce a figure for how many dollars it takes to save a human life (less is more here, of course).

*GiveWell's* mandate leads it predominately to organizations involved in global health on the African continent. It has found the most lives can be saved per dollar with medicine and cheap mosquito nets to lower the incidence of malaria, especially among children. It also recommends charities that prevent Vitamin A deficiency,

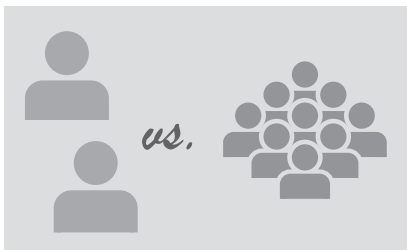
vaccinate children, and treat them for parasitic worm infections.

You can give directly to any of these charities. Or *GiveWell* offers a *Maximum Impact Fund* that will spread your donation among its top charities and deduct zero fees. But clearly its specific mandate is not for everyone. You may have a favorite charitable cause like the environment or animal welfare that is not represented among its charities. Or you may want to give closer to home than Africa. Sue and I, for instance, donate regularly to the *Alameda Food Bank*, because we know it first-hand, having volunteered there.

But there remains online a dearth of valuable analysis of charitable effectiveness, and it's easy to fall for scams like those listed in the margin to our left. So it's a welcome development that there are investigative firms which will not only help us optimize our giving, but also provide metrics for how effective that giving may be. ■

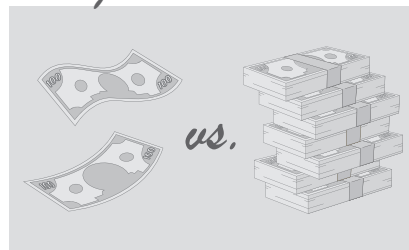
### Three key dimensions of effective altruism

#### 1. Scale



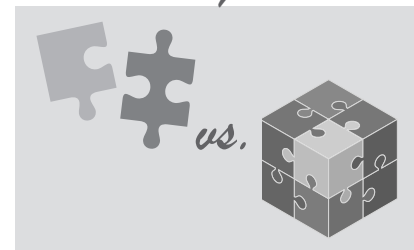
**Scale** — How many people are affected and how are their lives impacted?

#### 2. Neglectedness



**Neglectedness** — How many resources are currently devoted to the cause?

#### 3. Solvability



**Solvability** — How feasible are evidence-based solutions?