The Conservative Strategist

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Warren Buffett – 94 and full of energy

There's a lot going on at *Berkshire Hathaway* this season. Buffett and his minions have been quite active, and those actions from the world's greatest investor may tell us something about where value is — and isn't — in today's markets.

Buffett is selling

Buffett is deeply pruning his portfolio this past quarter, with huge sells in his top two positions, *Apple* and *Bank of America*. The Apple stake has been reduced by 56% since 4Q2023, with 510 million shares sold, reducing Apple's weight in the public stock portion of Berkshire's portfolio down from an outrageous 50% to about 25%. Still the largest individual stock position by far, more than twice second place's *American Express*.

Of course, the sale triggered billions in long-term capital gains taxes, but Buffett deemed the rebalancing more than worth it. With *BofA* and several other large positions chopped, Buffett's hoard of cash, T-Bills and notes has now reached $277 billion, the highest ever. Some speculate that he is raising liquidity for estate planning purposes. Others say that he is gathering a war chest for his two investing lieutenants, Ted Wechsler and Todd Combs, who are the future of the firm's investment wing. And still others say that Buffett, turned off by high public stock valuations, is instead planning another major acquisition or three to supplement *Berkshire*'s collection of *private* companies.

Bullish on energy

Energy stocks have been the laggards this year, and *Berkshire* loves laggards, as that is often where the value lies. Berkshire owns a major stake in publicly-held BYD, a Chinese company that specializes in electric vehicles and renewable technologies. And he has taken a majority stake in *Occidental Petroleum;* there is some speculation that some of his cash hoard may go to buying the rest of the company. Through subsidiary *Berkshire Hathaway Energy,* Buffett also owns private stakes in various traditional energy firms and utilities, including *PacifiCorp, NV Energy* (here in Nevada, and well-run, I can tell you first-hand), and *MidAmerican Energy Company.*

"Things aren't attractive"

Warren Buffett in May, 2024, describing why he's raising cash.

The S&P is up another six percent in the four months since.

Is Berkshire finally expensive?

The *Berkshire* B shares are up 100 points this year as of mid-September, or about 28%. That's well ahead of the S&P, and now puts *Berkshire* at 1.63 times book value. For the past five years, *Berkshire* has spent roughly 95% of the time between 1.25 and 1.65 times book value, so the current valuation is quite pricey. Investors seem to be betting that Buffett will once again outperform when the inevitable downturn hits, but one of the ways Buffett outperformed in the last major debacle, 2008, and again in 2020's scare, was to swoop in with his cash hoard and purchase private companies, sometimes swallowing them whole. He has considerable competition now: In 2008, private equity firms had about $800 billion in dry powder, while today the number is closer to $2.6 trillion. ■

The Markets September 30, 2024	Price/Yield	Gain, Qtr	Gain, YTD
US Stocks (S&P 500/Vanguard Index)	5762.48	5.85%	21.95%
International Stocks (Vanguard Index)	20.81	8.04%	13.55%
Emerging Markets Stocks (Vanguard Index)	30.33	9.29%	17.20%
Real Estate Stocks (Vanguard REIT Index)	32.38	17.12%	13.47%
Bonds (30 year US Treasury/Vanguard Index)	4.14%	7.40%	2.22%
Dollar (US Dollar Index)	100.75	-4.82%	-0.57%
Gold (London Afternoon Fix)	$2661.85	14.20%	28.07%
Money Market Funds (Vanguard Federal - VMRXX)	4.88%	-0.42%	-0.45%*

*change in yield

Portfolio Planning

How catastrophe can make your portfolio safer

I don't know about you, but I've heard enough nonsense about cats this season. First, there was Republican VP candidate JD Vance claiming that outsized societal influence has been exerted by *childless cat ladies.* Then, in the midst of the September 10 Presidential debate came Donald Trump's exhortation about immigrants in a midwestern town: *"They're eating the dogs! They're eating the cats!"*

Practical cats

I think it's time to talk with common sense about cats. For your portfolio. **Enter cat bonds – short for catastrophe bonds.** Cat bonds are income-bearing financial instruments that transfer the risk of natural disasters (hurricanes and tornadoes, floods, earthquakes, even hailstorms, among others) from insurance companies to investors. Because premiums on disaster insurance are so high, investors get an above-normal yield (lately in the low-teens). But insurance claims can reduce that yield and even impact principal. Overall, returns to cat bonds in general have been surprisingly steady, with only one mild down year in the past two decades (see graph).

Cat bonds simply make sense as diversifiers for a multi-asset portfolio like those of *Seasonal Strategy's* clients. The main factors that affect their return and risk – the frequency and intensity of natural disasters and thus the level of resulting claims – have little or nothing to do with the factors that affect the return and risk of mainstream assets. No surprise, then, that cat bonds are non-correlated with every other asset class (and actually negatively correlated to stocks in a certain sub-industry group that we profile on the reverse). They go in our Bond allocation, but are SuperCash-like in their return, risk, and correlation.

A clowder of cats is better than one

However, you'd be imprudent to buy an individual cat bond. One mega-disaster (the biggest cat, if you will) could wipe out all of your principal, in much the same way that an individual corporate bankruptcy could wipe out the bonds of that corporation. Instead, it's wise to diversify across geographies and disaster types.

Cat bonds are out of the bag

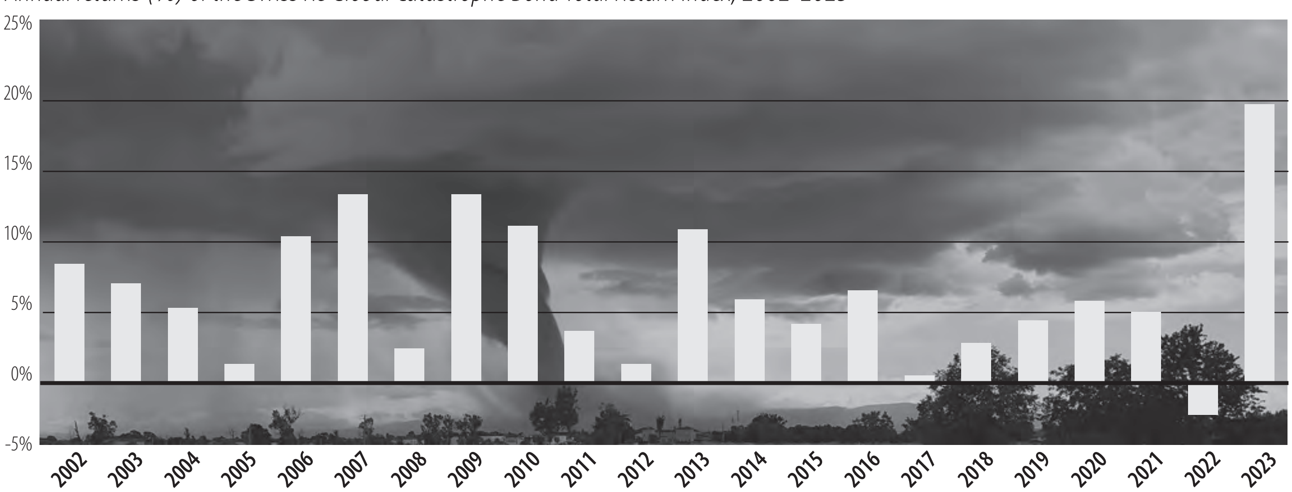
For a long time, cat bonds have been investable only by big institutions and family offices representing some of the world's wealthiest individuals. Warren Buffett's firm *Berkshire Hathaway,* was an early investor in cat bonds and remains with an allocation to the asset class.

But as with the democratization of so many asset classes in recent years (think hedge fund strategies, private real estate, private equity, venture capital and private credit), cat bond access has filtered down to smaller investors through mutual funds from *Pioneer* and *Stone Ridge,* among others.

This season, another leap forward in the democratization of this asset class: The first cat bond exchange-traded fund (ETF). It's *Brookmont Catastrophe Bond,* and its symbol, ROAR, describes the sound a tornado is reported to make. More on ROAR in an upcoming issue. ■

Cat bonds are pretty tame

Annual returns (%) of the Swiss Re Global Catastrophe Bond Total Return Index, 2002-2023



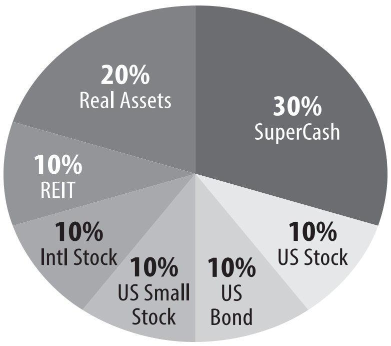
Cat bonds have averaged 6.7% per year over the past 22 years, or about 5.4 points per year above Treasury Bills. The standard deviation of returns was just 5%. This puts cat bonds' risk-adjusted return, or Sharpe Ratio, at more than twice that of the S&P 500. The main cat bond index has shown a positive return in 21 of the past 22 years, with only a mild downer in 2022 (-2.2%) in the wake of Hurricane Ian. Notice that was followed by the strongest year on the whole chart (2023; 19.7%). As with most major disasters, Ian led to higher premiums, larger deductibles, and tighter underwriting standards, which tend to lead to higher cat bond returns in subsequent periods.

Sources: Morningstar, Swiss Re

SuperDiversified Portfolios (SDPs)

SDPs up all three quarters, with rally broadening

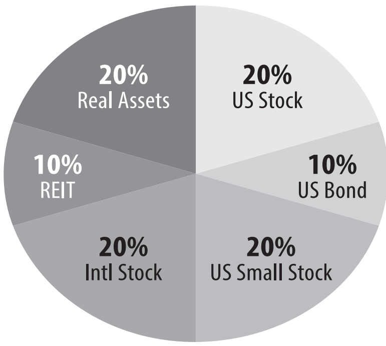
SDP1 ***Conservative***



3rd Quarter	*Year-to-Date*
5.60%	***8.24%***

A solid advance for the SDPs this quarter, with all asset classes except Real Assets moving higher. And in Real Assets, we outperformed with a stake in gold and gold stocks, up 13.05% and 17.36% respectively in Q3.

SDP2 ***Moderate***



3rd Quarter	*Year-to-Date*
4.91%	***6.96%***

With inflation now quieting down to 2.5% annualized, SDP1 is running at an annualized real return (return above inflation) well above 8%, exceeding our Investment Policy targets, and doing so with much less risk than mainstream assets alone.

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 Performed

Commodities looking like bargains

Asset Class	Mutual Fund	Performance 3rd Quarter '24	Performance Year-to-Date
SuperCash	PIMCO Instl Low Duration	2.72%	4.39%
	Merger	1.68%	2.28%
	Calamos Market Neutral	2.45%	5.79%
US Stock	Vanguard Index Trust 500	5.85%	21.95%
US Bond	Vanguard Long-Treasury	7.40%	2.22%
US Small Stock	Vanguard Small-Cap Index	8.99%	12.26%
Intl Stock	Vanguard Intl Index	8.04%	13.55%
REIT	Vanguard REIT Index	17.12%	13.47%
Real Assets	PIMCO Commodity Real Return	1.74%	6.36%

Best
Worst

As measured by the ratio of the S&P 500 to the Producer Price Index, deflationary cycles exhibit average lengths of 18 years, with most of them falling between 10 and 21 years. The current cycle can be traced to the 2008/9 breaking of the prior inflation bubble, and thus is 15-16 years old.

We think that at the coming bottom of this cycle, commodities will be a generational buy. Once again this quarter, they lagged while financial assets, steeply overvalued by any proven valuation metric, continued their advance. We think time approaches to overweight commodities and underweight equities.

Pioneer Cat Bond

Along with an offering from alternatives provider *Stone Ridge,* and until the anticipated Q4 release of the *Brookmont Catastrophe Bond ETF,* the *Pioneer Cat Bond Fund* (CBYYX) is the only way for smaller investors to participate in an obscure but worthwhile asset class that has until recently been the playground of institutions (like *Berkshire Hathaway)* and family offices representing ultra-wealthy individuals.

The fund inception was 1/27/2023, and its total return for the nearly twenty months up until 9/18/2024 is 24.89%. That's fine on an absolute basis but substantially lags its benchmark, the *Swiss Re Cat Bond Total Return Index.* We expect that's in part because the fund had to get invested over a number of months and therefore trailed a very strong period for the asset class.

The fund is available to our clients with no transaction fee on the *Schwab* platform. The expense ratio is a not unreasonable 1.51% thanks to a fee waiver that is likely to be renewed in mid-2025. Coming to a portfolio near you.

Global Cat Bonds have outperformed investment-grade bonds over two decades

Performance of two indices, 1/1/2002 to 6/30/2024

	US Aggregate Investment Grade Bond	Swiss Re Global Cat Bond
Annualized Return	3.41%	7.09%
Standard deviation of monthly returns	1.20%	1.02%
Sharpe Ratio (risk-adjusted return)	0.44	1.58

Global cat bonds have doubled the returns of traditional high-grade corporates over the past 22 years, while exhibiting lower volatility. The result is a risk-adjusted return more than triple that of mainstream bonds. All the while, they provide meaningful portfolio diversification. Don't let the catastrophe label fool you.

Sources: Bloomberg, Swiss Re

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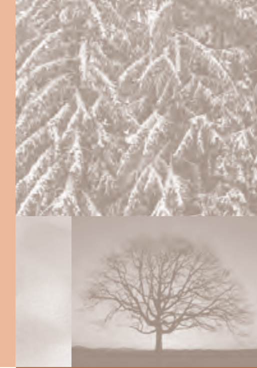


Cat bonds: A paired-investment idea

The main risk of catastrophe bonds is that of *above-normal frequency and intensity of disasters.* Such incidence will trigger above-normal claims against insurers, which will in turn impact the total return of the bonds.

Is there a way to hedge that risk? Well, wouldn't it work if there was a fund that invested in a collection of companies that **benefited** from *above-normal frequency and intensity of disasters?*

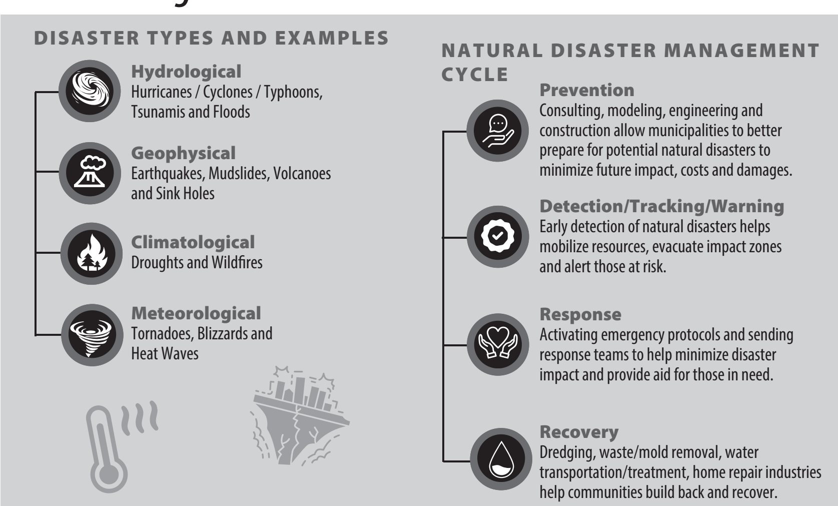
Enter *The Procure Disaster Recovery Strategy* ETF (symbol: FIXT). FIXT tracks a portfolio of approximately 42 global companies that are engaged in recovering from natural disasters. These include hurricanes, tornadoes, floods, droughts, earthquakes, wildfires, volcanoes, and other disasters. Its companies are involved in disaster response, prevention, recovery, mitigation, resilience, and reconstruction.

Heads we win, Tails we don't lose

With the volatility of climate change, it's entirely possible we see a multi-year period of above-normal natural disasters. We seem to be in a period when the proverbial 100-year hurricane occurs at least once per decade, thereby redefining the whole calculus of disaster. We think such a period could cause a spate of below-normal cat bond returns (although again, as we point out on page 1, the rising incidence of disasters will lead to higher premiums and deductibles, and thus higher yields on the bonds).

But such a period will also be a boon for companies engaged in recovering from natural disasters, thus increasing their earnings above expectations and likely boosting their stock prices. In short, FIXT is likely to rise sharply in a climate-unfriendly decade.

FIXT: Running toward trouble



While FIXT will be a very small allocation to our client portfolios, make no mistake that with its theme of climate rescue, it is a growth fund with a strong ESG component. Source: ProcureETFs.com

On the other hand, in a climate-friendly environment, FIXT's companies may not see as much business as desired, earnings may climb only slowly or stagnate, and stock prices meander. But in such a scenario, ROAR will suffer from lower-than-expected loan losses for claims, and thus its returns are likely to be robust.

A good start for FIXT

FIXT has less than the three years of history that we'd like to see before investing. But so far so good for the strategy — since its 6/1/2022 inception, and as of mid-September, it is up 20.21% annualized, 3.64% per year ahead of the S&P 500. That's not without volatility, however. In its first three months and change of life, FIXT suffered a drawdown of 18.51%, well beyond the S&P's 10.64% loss in the same period. We think this may be a rarity, however; FIXT's members, with their natural disaster businesses, are more recession-resistant than most industrial firms.

The ideal mix

A blend of cat bond ETF ROAR and recovery ETF FIXT is likely to be a smoother ride than either fund alone. However, because ROAR will be far less volatile than FIXT, a 50/50 mix is not recommended. Instead, we recommend a 75 ROAR/25 FIXT mix. Aggressive accounts can go 70/30, conservative accounts closer to 80/20. An overall portfolio allocation in the 6% range would add meaningfully to our SuperDiversification. ■