# The Conservative Strategist

JANUARY 2024

A QUARTERLY INVESTMENT NEWSLETTER PUBLISHED EXCLUSIVELY FOR CLIENTS OF SEASONAL STRATEGY


## RIP Charlie Munger

The investment world lost a giant this season when Charlie Munger — right-hand-man of Warren Buffett, master investor in his own right, self-made billionaire, summa cum laude graduate of Harvard Law, real estate attorney, writer, social critic, philanthropist, and decades-long font of wisdom — died in November, 34 days shy of his 100th birthday.

Munger's extreme success was a blend of luck, good timing, vision, and hard work. The luck and timing? Munger grew up in Omaha, Nebraska, Warren Buffett's hometown, and as a teenager, worked at *Buffett & Son,* a grocery store owned by Buffett's grandfather, Ernest P. Buffett. He first met Buffett, 6 years his junior, at a dinner party in 1959 (the year I was born). Munger was 35 and a successful attorney at the time. Buffett was 29 and an up-and-coming investment manager. According to Buffett: "About five minutes into it, Charlie was sort of rolling on the floor laughing at his own jokes, which is exactly the same thing I did. I thought, 'I'm not going to find another guy like this.' And we just hit it off."

Buffett convinced Munger to quit the law and focus on investments. It was a good call. From 1962 to 1975, Munger's own partnership earned 19.8% per year compounded. Meanwhile, Buffett had started *Berkshire Hathaway* in 1965 as a better mousetrap for managing and growing wealth, and convinced Munger to join him as vice-chairman in 1978. They have been joined at the hip ever since.

Before Munger, Buffett focused on what he called 'cigar-butt companies' — scooping up low-priced stocks of struggling companies that Buffett had researched thoroughly. Munger persuaded Buffett that as *Berkshire Hathaway* grew, this was not an effective way to manage large sums. Instead, Munger suggested that it was better to, in Buffett's words, "buy a wonderful company at a fair price than to buy a fair company at a wonderful price," because wonderful companies stayed wonderful for much longer than fair companies stayed fair. Hence the wonderful-company style of investing could leverage the compounding effect.

In recent decades, Munger has evolved into something of a curmudgeonly elder statesman, even more quotable than Buffett at Berkshire's annual meetings. He was often nuanced and insightful: "By and large the people who [observe the Golden Rule] win in life, and they don't win just money [or] just honors and emolument. They win the respect, the deserved trust, of the people they deal with, and there is huge pleasure in life to be obtained from getting deserved trust." And he was occasionally quite outspoken, and funny, on subjects for which he had high conviction — witness his Bitcoin remarks. He will be missed. ■

### *Munger on Bitcoin: Tell us how you really feel*

*"Rat poison" … "Stupid" … "Evil" … "Disgusting" … "Worthless artificial gold" … "Crypto-crapple" … "Crypto-sh*t" … "It's like somebody else trading turds and you decide I can't be left out." … "Suppose you could make a lot of money trading freshly harvested baby brains." … You wouldn't trade them, would you?" … "I don't welcome a currency that's useful to kidnappers, extortionists, and so forth."*

| **The Markets** December 31, 2023 | Price/Yield | Gain, Qtr | Gain, 2023 |
|---|---|---|---|
| **US Stocks** (S&P 500/Vanguard Index) | 4769.83 | 11.65% | 26.11% |
| **International Stocks** (Vanguard Index) | 18.58 | 9.75% | 15.19% |
| **Emerging Markets Stocks** (Vanguard Index) | 25.96 | 6.14% | 8.66% |
| **Real Estate Stocks** (Vanguard REIT Index) | 29.71 | 19.55% | 13.00% |
| **Bonds** (30 year US Treasury/Vanguard Index) | 4.03% | 12.31% | 3.01% |
| **Dollar** (US Dollar Index) | 101.33 | -4.60% | -2.12% |
| **Gold** (London Afternoon Fix) | $2078.40 | 11.11% | 14.59% |
| **Money Market Funds** (Vanguard Federal - VMRXX) | 5.32% | -0.11% | 1.08%* |

*change in yield

Portfolio Planning

# 2024: Crowded trades and contrarian trades

The virtue of the SuperDiversified portfolios we advocate is that we can afford now and again to overweight or underweight some of our forty-something sub-asset classes when opportunity knocks. That opportunity can come in the form of abnormally low (or high) valuations, or wildly unpopular (or popular) trades.

As 2023 comes to a close, we see a few such valuation and sentiment extremes, and it influences our positioning for 2024, at least on the margins. Here are a few such lopsided trades we see for the coming year, and the all-too conventional wisdom behind them.

**"Sure we can easily have a soft landing in the US. But the rest of the world is a worsening mess."**

Ah, American Exceptionalism at work. Somehow the Fed is going to thread the needle between recession and inflation, landing the plane in the Hudson River with all safe aboard. Yet, the rest of the world is in flames and uninvestable. This view is reflected in the record conviction of money managers that bond yields will trend lower in 2024 — see graph below.

It's also seen in the record low percentage of institutional money in foreign stocks versus domestic stocks. US Stocks have touched an unprecedented 60% of world market capitalization. (Mind you, only 10% of the world's companies are here in the US.) It's all about us, it seems. Yet foreign stocks stand at record low valuations relative to the tech-goosed S&P 500. We have seen this over and over: Investors exhibit their greatest fear of an asset class just when it's at its relative cheapest.

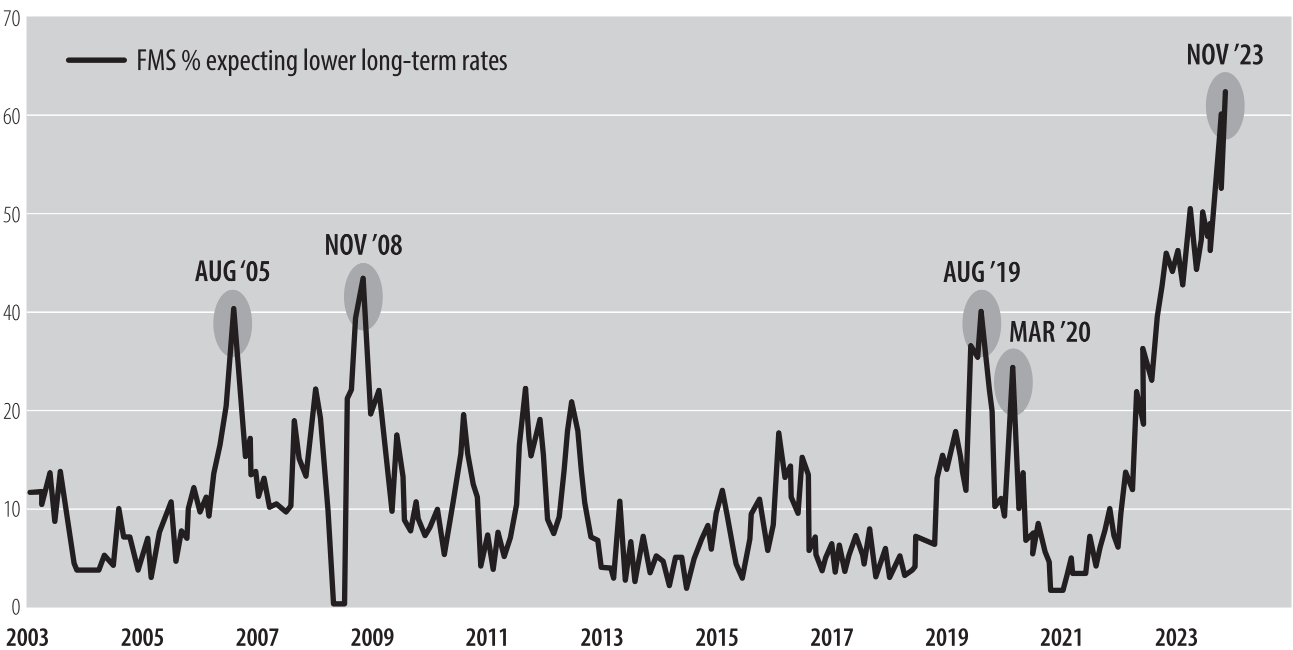
**"You have to own the Magnificent 7, and the S&P 500."**

Just seven stocks in the S&P, most of them AI-related, accounted for the great majority of gains in the index this year. We thought it had gotten extreme two years ago when the S&P's seven most valuable companies constituted 24% of the index. This season that figure has touched 30%, the highest ever. The average price/earnings ratio of the Mag7? 44 as of late November. The Mag7 are up 80% in 2023. The rest of the S&P — the so-called S&P 493? 5%. Twice in the past century, we have seen these kind of lopsided returns. Once was the so-called Nifty Fifty Era in the 1970s, and the other was the tech bubble of 1999-2000. Both ended with not only the bubble stocks bursting, but the overall market suffering a difficult decade.

(Continued on page 4)

***2024's most crowded trade***

*Big conviction bond yields lower in '24*



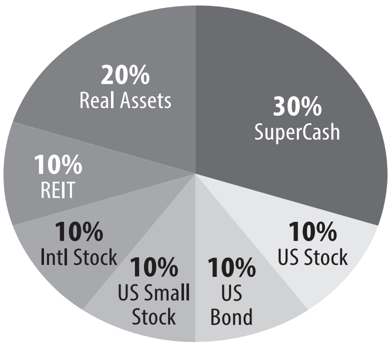

*61% of Fund Managers are predicting that long-term bond yields will be lower in 2024. This expectation surpasses even the peak of the Global Financial Crisis when only 40% of managers expected lower long-term bond yields the following year.*

*Source: BofA Fund Manager Survey*

SuperDiversified Portfolios (SDPs)

# Solid quarter for SDPs though well behind US stocks, bonds

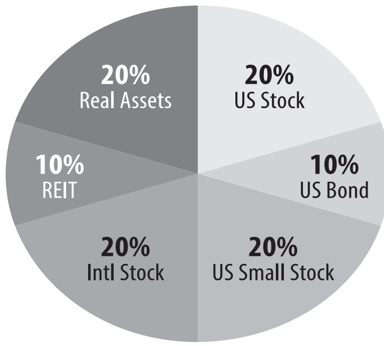
## SDP1 *Conservative*




*4th Quarter* **7.12%** *2023* **8.44%**

Our conservative Superdiversified portfolios nearly always will lag conventional assets when the latter have a stellar quarter or year, as they did in Q4 and 2023. When you're invested in as many as seven asset classes, the performance will inevitably moderate the big ups and downs of US Stocks and Bonds.

## SDP2 *Moderate*




*4th Quarter* **6.46%** *2023* **6.71%**

In 2022, we saw the positive aspect of this performance, as US Stocks dropped 22% and our other assets fared much better. In 2023, we saw the reverse. Now, with US Stocks once again in overvalued territory and our Superdiversifiers much cheaper, we may see that pattern reverse once again in 2024.

*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

# Fed official says bond market may be ahead of itself

| Asset Class | Mutual Fund | Performance 4th Quarter '23 | Performance 2023 | |
|---|---|---|---|---|
| SuperCash | PIMCO Instl Low Duration | 2.57% | 4.93% | Best |
| | Merger | 1.82% | 4.18% | Worst |
| | Calamos Market Neutral | 2.18% | 8.92% | |
| US Stock | Vanguard Index Trust 500 | 11.65% | 26.11% | |
| US Bond | Vanguard Long-Treasury | 12.31% | 3.01% | |
| US Small Stock | Vanguard Small-Cap Index | 14.64% | 19.38% | |
| Intl Stock | Vanguard Intl Index | 9.75% | 15.19% | |
| REIT | Vanguard REIT Index | 19.55% | 13.00% | |
| Real Assets | PIMCO Commodity Real Return | -3.32% | -7.87% | |

*Federal Reserve Bank of Cleveland* President Loretta Mester said financial markets had got "a little bit ahead" of the central bank on when to expect interest rate cuts, the Financial Times reported on Monday, December 18.

"The next phase is not when to reduce rates, even though that's where the markets are at . . . The markets are a little bit ahead. They jumped to the end part, which is 'We're going to normalize quickly', and I don't see that."
*[Reuters, Dec. 18]*

# Private credit: Steady and solid

Our four private credit interval funds, added to portfolios over the past three years, have performed very well since purchase and especially well in 2023. The chart below shows double-digit average returns for the four funds. What it does not show is that none of the four funds have suffered even a single down month during the year. (VFLEX came the closest, up only .09% in March).

The funds yield an average 11% currently, with default rates well below 1%. They are likely to hold up much better in a recession than high-yield bonds or even leveraged loans, because their covenants are stricter and collateral quality is higher. They offer the best reward/risk among our candidate asset classes, and we look to expand carefully there in 2024, with eyes on two new offerings that will further our diversification in the category.

## *Private credit: A sound bet for 2024*

*Annualized returns for 2023 on our four private credit interval funds, as of 12/19/2023*

| Fund name | Symbol | Return |
|---|---|---|
| Cliffwater Corporate Lending | CCLFX | 12.97% |
| Cliffwater Enhanced Lending | CELFX | 12.28% |
| Variant Alternative Income | NICHX | 9.33% |
| First Trust Alternative Opportunity | VFLEX | 9.62% |

*While it should be a challenge for conventional stocks and bonds to rack up 10% returns for 2024, we expect our private credit funds to equal or exceed that mark with far less volatility.*

*Source: Investors FastTrack*

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## 2024: Crowded trades and contrarian trade

*(Continued from page 2)*

### "Commercial real estate is dead money. So are REITs."

Commercial real estate's slump in 2023 has prompted many investors to sell REITs. But in the past 40 years, commercial real estate has never suffered more than two consecutive down years (and four down years total, before 2023 – see graph). So betting that the slump will extend beyond 2024 is betting against history. Further, REITs tend to do well after Fed tightening cycles, returning 20.9% and outperforming even the S&P by 3.6 percentage points in the four quarters after the Fed ends its rate rises. Today REITs trade at a discount to Net Asset Value of more than 10% and have been rallying for a few weeks.

### "Short China and the UK — their economies are imploding."

After two years of slow growth, a debacle in their real estate sector, and a COVID resurgence, China seems to be on everyone's Sell or Avoid list. Sentiment has gotten so extreme that a slew of new emerging markets funds have come out with investment policies that avoid China entirely.

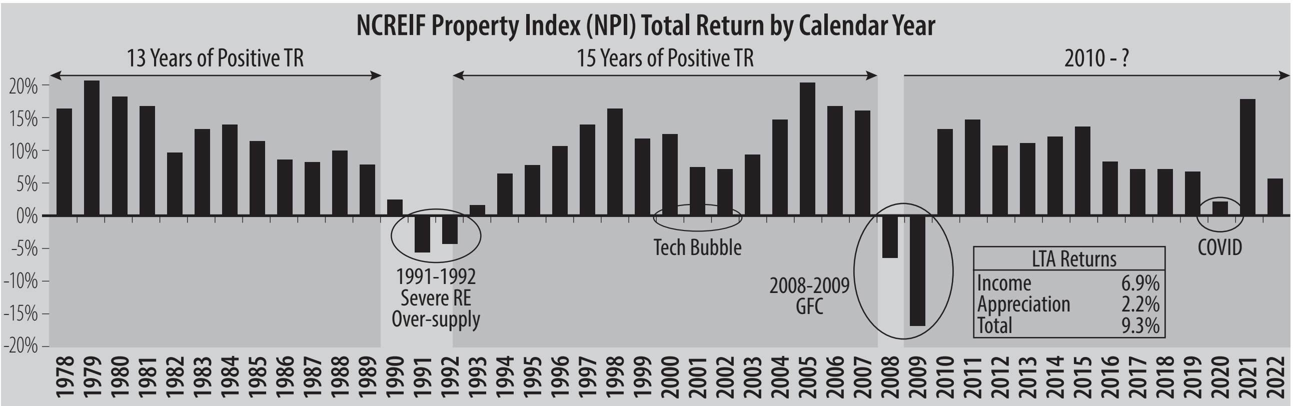
No doubt there are sound arguments for avoiding China for ESG reasons. But China's stock market has been hit hard enough that it now represents fundamental value. Overall price/earnings (P/E) ratio of Shanghai Stock Exchange, as of December 8: 11.85, compared to 24.59 for US stocks. And plenty of Chinese blue-chips yield 4%, 5%, and more.

Meanwhile, post-Brexit, the UK has been an investment pariah and mired in a flat-to-down market, yet now trades at a P/E of 10.8, lower than China's, and very cheap relative to its three-year average P/E of 17.4. Britain's main index, the FTSE 100, now yields a solid 3.88%. Money managers are not prepared for UK outperformance. According to a BofA survey, only 14% are overweight UK stocks.

You seldom get bargains by following the consensus. In fact, that's a common way to buy into a bubble, which we think the US stock market may be experiencing once again as 2023 closes. We prefer *anti-bubbles,* where sentiment is overwhelmingly negative, where prices largely reflect the worst, and where green shoots are either appearing or are just a quarter or two away, as we see today in REITs, and in China and the UK, among other asset subclasses. ■

## *Commercial Real Estate is hard to kill*

*41 years of positive returns in 45-year history*




*It takes a lot to send commercial property lower on the year. In the past 40 years, it has only happened in two separate two-year clusters. The first was triggered by the Savings & Loan Crisis of the 1980s and 1990s; the second occurred amidst the Great Financial Crisis of 2008-2009. Both were followed by multiple consecutive years of solid returns. 2023, not on the graph, was a down year. If the pattern repeats, 2024 may be a struggle, but also a buying opportunity.*

*Source: Clarion Partners, NCREIF*