Q3 2016 Market Commentary

Dog eared and worn, the Webster's New World Dictionary my parents gave me on my way to college sits lovingly on my desk, held together with tape and wishful thinking. I have always enjoyed flipping through its browning pages, sifting for spellings and definitions and the odd synonym. I find it far more comforting in some principled way than using Google, as if I have earned the right to use a word because I have taken the time and energy to find it. For me it is a lost art. Which reminds me of another lost art in today's meta-data, fast paced, "I want it now" world. The lost art of investing.

Investing a lost art? The markets are open every trading day for business with billions of shares trading hands. If anything it could be argued that the markets are larger and more vibrant than they have ever been in history, globalized, always in motion, never sleeping. But I would contend that while the markets, the infrastructure behind investing, are alive and well the idea of being an investor is not so healthy.

This past April I had the honor of accompanying some friends and clients of Northstar to the annual Berkshire Hathaway shareholder meeting in Omaha, Nebraska who graciously asked my 17 year old Nephew and I to join them. As many know, I have been a huge fan of Warren Buffet and Charlie Munger since I first read "Buffet: The Making of an American Capitalist" by Roger Lowenstein, in my late 20's. For me the shareholder meeting was an experience like no other. The Oracle, speaking from his seat of capitalistic power, imparting upon us all his decades of investment experience and taking question after question for six or seven hours, answering openly and honestly in his unpretentious, Midwestern way.

What struck me most were their answers to two specific questions; at one point they were asked;

"How should children look at companies when every day they see in the media IPOs and the business cycle getting shorter and shorter?"

Warren reflected at length on the IPO issue;

You don't really have to worry about what's going on in IPOs. People win lotteries every day. You don't have to be jealous. If they want to do mathematical unsound things, that's nothing to worry about. They put the one winner on television, and the other million that contributed to it – with the big slice taken out for the state – don't get on. All you have to do is figure out what makes sense. When you buy a stock, get yourself in a mental frame of mind that you're buying a business. Don't *get a quote on it for five years. You don't get a quote every day on your farm or apartment house or McDonald's franchise. You want to look at stocks as businesses and think about performance as a business. Think about what you pay as if buying a business. Let the rest of the world go its own way. Don't get into a stupid game just because it's available.*

And followed with;

They really have an easy problem. American businesses as a whole will do fine over time.

The second question was from a German Fixed Income Manager, who wanted to know why the pair didn't try to squeeze more return from their insurance float.

Charlie answered with his typical brevity;

The truth of the matter is we don't pay much attention by trying to get an extra two basis points by being gamey on our short term things. Credit default position is a weird historical accident, and we don't pay much attention to it either. It will go away in due course.

Granted these are two brief moments out of hours of questions and replies, but they sum up the tone and philosophy behind the success of two great investors. First, investing is about buying good companies, so have conviction about what you buy, and second don't get hung up on short term movements because time, not esoteric trading strategies, is what creates return and wealth.

Sounds simple in concept but is very hard to do in practice because many have moved away from the idea of being an investor to being a trader. Let's face it, there is a thrill and excitement to buying a stock, fund or ETF that goes gangbusters. It's exciting, makes one feel very smart, and creates a sense of being really capable. But more often than not, a speculative trade tends to lose money and, when aggregated across all trades, the winners tend to get weighed down by the losers.

The tough part about being an investor is having the conviction to hold what you have when you feel that all those around you are doing better. Many of the mutual funds that we utilize tend to do worse than their peers during highly bullish times. Yes, worse. But we utilize them because they have a philosophy of risk mitigation, and they stick to it even when the market is increasing in a very bullish manner, despite the notion that other funds will look better on a short-term basis. They adhere to their process, and during the down periods these managers greatly outperform their peers, which translates into consistently high rankings over a full market cycle. They do not allow themselves to abandon their strategy when the market is moving away from them because they are investors, not traders, and recognize that deep losses create a demand for higher upside years to counter those losses which only adds greater amounts of risk necessity and more volatility.

It had occurred to me that, when Warren mentioned not getting a quote for five years, in some respect he is being serious. Now without suggesting that anyone own Berkshire Hathaway, or any of the positions they own or have owned, while they of course trade into and out of positions, the overall amount of turnover in their portfolio is exceedingly low which speaks to their investment philosophy. Looking at their top 10 holdings in 2011 and in 2016, according to SEC filings and ValueLine they were as follows:

2011	2016
Coca Cola Co.	Wells Fargo
IBM	Coca Cola Co.
Wells Fargo	IBM
American Express	American Express
Proctor and Gamble	Wal-Mart Stores
Kraft Foods	Charter Communications
Munich Re	US Bancorp
Wal-Mart Stores	Davita
ConocoPhillips	Kraft Heinz
US Bancorp	Moody's

7 of the top 10, five years apart, remain as top holdings. Curious to see longer term periods, I went back 10 years to their 2006 annual report and found 4 of today's top holdings (American Express, Coca Cola, Wells Fargo, and Moody's with US Bancorp coming in 11th). Then looked 20 years out at their 1991 annual report and found 3 of today's top 10 (Coca Cola, American Express and Wells Fargo) with only the top 7 listed in the annual report.

Over two decades, aside from the companies they own directly like GEICO, the fund has in varying degrees retained 30-70 % of the same holdings over various periods. Through all economic conditions, multiple bear markets, the tech bubble and the Financial Crisis they have continued to hold and believe in well run companies involved in the everyday business of America and the world, with good cash flows and long-term earnings growth.

They have been investing instead of trading.

Many times they have underperformed the S+P 500 on an annual basis. Many times pundits have questioned if their strategy or philosophy was outdated – if the pair had lost their mojo. And yet they simply moved forward with their plan, buying companies and stocks that fit their profile. And over long periods, as investors, they outperformed.

As varied as the markets are individuals all have the ability to choose the way they wish to put their capital to work. They can be options traders, day traders, penny stock traders, commodity traders, currency speculators. They can get into shorting stocks or arbitraging. They can try to conquer the markets in a thousand different ways. But it would be our belief that the clients of Northstar are best served by us assisting them in becoming what we view as an investor; long term thinking and straight forward strategies driven by a well-defined plan.

That starts with defining your goals, of course, and your time horizon and your capacity for saving, and all of the things that come together in creating a solid, long-term plan. But more specifically, it involves helping you understand your capacity to tolerate market volatility – both the routine 10% slides as well as the occasional bear market – and constructing a portfolio that matches that tolerance. We help find fund managers that approach market risk in the same way and share in Berkshire Hathaway's philosophy of being an investor, instead of a trader, by buying well run companies and holding them even when they are not favored by the broader market. And most importantly helping you stay patient.

Over the long term that simple strategy has rewarded those that have chosen to be investors, and while many argue that they don't have time to invest for the "long-term" we would reply that most will likely be an investor for the rest of one's life.

Warren and Charlie would agree.

Should you have any questions regarding your planning or your portfolio Julia and I are always available to talk things through with you. We can be reached by email at julia@nstarfinco.com and steve@nstarfinco.com or by phone at 800.220.2161.

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