Bill Miller, CFA
Chief Investment Officer
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Dear Shareholder,

For those who believe in omens, signs, and portents (and who doesn't?), 2018 was the year of the dog according to the Chinese zodiac, and if you were in almost any asset class except cash for the past 12 months, that aptly described your results. From an all-time high reached on January 26, US stocks began a decline just as the Chinese New Year welcomed the dog, culminating in a decline of 6.2% in the S&P 500 before dividends and 4.4% after. That was the worst year in stocks since the 2008 financial crisis. December had its worst return in that month since 1931 when the economy was collapsing into the Great Depression.

What does the Chinese New Year say about 2019? This is the year of the pig. Market participants are likely to immediately recall the old saw that "bulls make money, bears make money, but pigs get slaughtered." That would suggest a very dim view of one's prospects if the pig is an apt metaphor for what we are likely to experience in 2019. I think, though, there is a better analogy than the bromide noted above. In 1992, George Soros and Stan Druckenmiller bet heavily against the British pound, expecting it to fall sharply. George kept telling Stan the position needed to be bigger and Stan dutifully increased it each time. Stan, worried that the position had gotten too big, and when George told him again it needed to be bigger, Stan repeated the point about pigs getting slaughtered. George responded, "It takes courage to be a pig." That courage was rewarded when the pound collapsed on September 5. Soros made a billion dollars and became known as the man who broke the Bank of England.

In this year of the pig, I think courage will be rewarded in the equity market, just as it has for most of the past 10 years. The precipitous December decline led to the same behavior we saw in late 2008 and early 2009 as people fled stocks for the safety of treasuries. Equity mutual fund outflows reached levels only seen around the 2008 lows as investors rushed to reduce risk. One would think that if risk reduction makes sense, it should be concurrent with the year's highs and not the year's lows, but it never is. The 2008-09 financial crisis was a once-in-a-lifetime event, just as was the Great Depression, and both dramatically changed investor behavior for years afterward. The financial crisis made investors risk- and volatility-phobic, and when markets begin to fall, as happened in early 2016 and last quarter, investors rush for the equity exits and into bonds and cash.

The first six weeks of 2016 were the worst start to a year in the history of the S&P, and the 2018 December results were the worst in 87 years. The concerns then and now were macro and remarkably similar: fears the Federal Reserve would overtighten, fears that collapsing oil prices signaled a global economy that was rolling over into a recession, and fears that grim economic news out of China presaged a potentially dire, debt-driven downturn that would prove contagious. None of those came to pass, the fears were just that, and the stock market's decline stopped just above the 200-week moving average of 1790 before beginning a recovery of over 1000 points over the next three years. Those same macro fears, along with a few new ones such as a messy Brexit, tariffs and trade wars, and the uncertainty of the Mueller investigation, have been bedeviling this market. Just as in 2016, the S&P's decline halted (at least for now) at the 200-week moving average of 2350 and has made a sharp recovery in the first days of the New Year, albeit with considerable volatility.

I think it likely that the current, well-advertised macro worries will prove as ephemeral as 2016's. The market clearly welcomed Fed Chairman Powell's recent remarks that emphasized "flexibility, adaptability and open-mindedness" according to The New York Times' Neil Irwin, and he dispelled fears that the Fed was ignoring market-based signals in favor of its academic models, saying the Fed would be "patient" as it considered the economic data. His remarks were followed by an "as good as it gets" employment report showing a remarkable growth of non-farm payrolls of 312,000, growth of average hourly earnings of 3.2%, and a modest uptick in unemployment to 3.9%, driven by an increase in the labor force participation rate. Inflation remained subdued. Stocks soared and bonds fell.

For investors, the sharp selloff from the September high of 2940 to the current 2530 level coupled with the rise in bond prices over the same period has stocks now priced at under 15x 2019's estimated earnings compared to about 37x the annualized, hold-to-maturity return on 10-year treasuries. At 15x, the market is at the lowest point it's been since late 2013. Corporate earnings and dividends should grow about 5% or so long-term, while today's 10-year coupons likely will not. Back in 2008 near the lows, Warren Buffett wrote an op-ed saying he was buying US stocks and urged others to do so. When someone asked him later how he knew it was time to buy, he said he didn't know the time to buy, but he knew when prices were attractive. I also have no idea when it's time to buy, but I do believe US stock prices are the most attractive they have been since the 2016 lows and there appear to be plenty of bargains to be had.

Stan Druckenmiller turned cautious on the market a year ago as the year of the dog approached and went largely to cash. It has been reliably reported that he began buying stocks again in December as he believed the decline was nearing its end and that equities were again attractive. As we enter the year of the pig, I think a slug of porcine pluck is called for.

Bill Miller, CFA

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S&P 500 2,531.94

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