Incrementalism is a Virtue

BY PAUL KLEINSCHMIDT ON *JANUARY 31, 2024*

The end of 2023 brought a welcome respite for investors of nearly all stripes. Conventional wisdom coalesced around the narrative that the Treasury's decision to moderate the size and pace of its debt issuance, along with the decline in the Federal Reserve's favored gauge of inflation (leading to the "Powell Pivot" and the restoration of the "Greenspan Put"). With underlying US economic data points remaining healthy, markets cheered (and began to price in) the elusive, and much hoped for "soft-landing" scenario. Happy Holidays indeed!

This new consensus creates a higher bar for returns in the year ahead as deviation from a benign economic backdrop and a loosening of financial conditions could come with negative consequences for asset prices in my view. Several scenarios come to mind that might derail this narrative: Perhaps the strength of the US economy is not fully appreciated, leading the Fed and Treasury to ease liquidity conditions prematurely, reigniting inflation. Perhaps existing liquidity is in danger of being sucked out at a much faster rate than market participants realize. It is not hard to imagine a scenario where banks, already lending less, are deluged by the implementation of Basel III rules and the looming disaster in the commercial real estate market, precisely while government stimulus expires, and consumer balance sheets weaken. More likely, any number of things that we *cannot* conceive will surely emerge. As I write this, the recent election in Taiwan has increased tensions in Asia, while Houthi rebels, in response to a joint US/UK bombing of their fortifications in Yemen, have issued public statements saying, more or less, "Bring it on!"

For investors, great expectations come with the need for even greater vigilance; all the more so when government debt levels are at historic highs, with little hope in my estimation that either austerity or economic growth can meaningfully alter that fact. This is the moment at which investors currently find themselves.

Thank heavens then, that our investment process and philosophy does not rely solely on deciphering the tea leaves of macro-economic soothsayers!

While risk-oriented investors may lament that their portfolios are not overwhelmingly comprised of the “Magnificent 7” and bitcoin futures (to name two sets of asset classes that rebounded strongly from a dismal 2022), there is good news for fundamental, disciplined investors who remain committed to the “old fashioned” practice of focusing on valuations, returns and cash flows.

The broad equity indexes, in aggregate, may appear expensive historically, but not so when adjusted for the handful of names that represented 90% of last year’s returns. In fact, our research department continues to churn out attractive opportunities in quality companies, with Portfolio Managers at Tocqueville building positions for their clients as well as themselves. Incrementalism, we have found, is a virtue, especially in portfolio management. We have never obsessed over timing markets, or “nailing” a trade, but we do spend a lot of time thinking about how we can avoid significant losses, while participating in the progress of human creativity and endeavor, and the madness of crowds. Incrementalism in temperament as well as in timing can be a great asset.

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