George McAuliffe – First Quarter 2023 Commentary

Dear Clients,

The first quarter of 2023 may have marked a turning point. While continuing the abnormal volatility of these recent "Covid and beyond" years, much of the focus now seemed on interest rate movements rather than Ukraine, or China, or supply chain, or even covid (if one could still find it in the news). The quarter started with a strong rally, saw that fade with interest rates and eventually things breaking (regional banks), and then rebounded again as the market seemingly began looking beyond current Fed policy.

In a period when there is a lot of turmoil, I tend not to make any large moves, unless of course I happen to find a new bargain. But a note on not making big moves... I have always explained that I am a long-term investor with a long-term horizon, and while I watch short-term news closely, I rarely react unless there seems to be material longer-term implications. And there has been a lot of short-term news over the last few years, and always temptations to repositioning the portfolio for specific concerns here, or higher yields there, or whatever the hot topic might have been in any given quarter. So when markets make large swings, one can, for example, look for counter-cyclicals; but if one wants to make this a regular practice, this is by definition a long-term un-winnable game. Similarly, one can look for where yields have been maintained; but yield usually only comes from duration or risk; Silicon Valley Bank has shown us duration mismatch; commercial real estate (and Signature Bank) have shown us risk concentration; and alternative asset classes (like private equity funds), many of which are very slow to mark to market, probably hold their own surprises yet to be revealed. Conversely, when markets make these large swings one can, as I have, stick with good high-quality companies one knows well and has faith in. One might not be rewarded every quarter, but eventually, as in this past quarter, one is. And over time, this strategy has worked out reasonably well.

So are we at a turning point? And what might come next? Several topics are making news and moving markets. First, there is the Fed, and interest rates, and inflation. The feeling seems to be that the Fed is done or nearly done, that we should have a period of wait-and-see, and some mix of potential recession and easing inflation to inform what happens next. For the companies I like, I am content with this scenario. Another topic, of course, is Ukraine and resultant global tensions and energy and commodity costs and other spillover effects. I do not know how this will resolve, but I continue to believe the Russian people are becoming tired of this and that probability is more on the side of some sort of negotiated resolution -- albeit one that will probably please no one, but will be good for global business. Finally, all of a sudden and seemingly (but not) out of nowhere, we have AI. Are all of our jobs obsolete and should we retire? No, it is a lot more subtle and nuanced than that (and would require several more paragraphs). It is more akin to an industrial revolution, and like prior examples throughout history of a new tool and new technology, it will obsolete some fields, while supercharging and creating anew others. And as always, it is up to us investors to try to make sure we do not hold shares of buggy-whip companies.

Two quarters ago, I mentioned believing we are now very near the beginning of a meaningful leap forward, and that despite all the recent travails, I was very excited to be investing. Writing this today, I feel even more so. Yes, I am cautiously optimistic. Always cautious, because over the short term, one can never be sure what might trip one up, or which way overall markets might zig or zag; but also always optimistic, because always, economies evolve, businesses find ways to profit, and high-quality assets will always rise over time. Thank you for your continued confidence, and I am excited to see what comes next for our investments.

As always, I would be happy to discuss further with anyone interested.

Kind regards, and all my best wishes for spring!

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