# ORIGINAL THINKING

FALL
2022

**THE HANSBERGER GROUP**
**at**
Morgan Stanley

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Morgan Stanley Smith Barney LLC Member SIPC

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"Best-In-State Wealth Advisors"

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"Top Advisor Rankings by State"

– Barron's 2022

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"Top 100 Financial Advisors"

– Barron's 2022

Source: Forbes.com (August 2022) 2022 Forbes America's Top Wealth Advisors ranking awarded in 2022. This ranking was determined based on an evaluation process conducted by SHOOK Research LLC (the research company) in partnership with Forbes (the publisher) during the period from 3/31/21 - 3/31/22. Neither Morgan Stanley Smith Barney LLC nor its Financial Advisors or Private Wealth Advisors paid a fee to SHOOK Research LLC to obtain or use the ranking. This ranking is based on in-person and telephone due diligence meetings to evaluate each advisor qualitatively, a major component of a ranking algorithm that includes client retention, industry experience, review of compliance records, firm nominations, and quantitative criteria, including assets under management and revenue generated for their firms. Investment performance is not a criterion. Rankings are based on the opinions of SHOOK Research LLC and this ranking may not be representative of any one client's experience. This ranking is not indicative of the Financial Advisor's future performance. Morgan Stanley Smith Barney LLC is not affiliated with SHOOK Research LLC or Forbes. For more information, see www.SHOOKresearch.com.


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# THE HANSBERGER GROUP

***"While the productive labors of a society, the functioning of its ships and railroads, its mills and factories, give the effect of a beautiful order and discipline of the rhythmic regularity of the days and seasons, its markets, by a strange contrast, seem to be in a continual state of anarchy. Here the same services and commodities, produced every day with perfect routine, go through a mad dance."***

– *The Robber Barons*; Josephson (1934)

This passage from the quintessential biography of the great American capitalists serves as yet another reference to the ups and downs, peaks and valleys, bulls and bears, ebbs and flows, expansions and contractions of financial markets. Since the dawn of the 19th century to the present day, the stock market has endured volatility. The Hansberger Group's discipline states that **a stock typically can only perform as well as the company itself**; hence we endeavor to focus on the best businesses of today and tomorrow.

The year 2022 has been tumultuous and a volatile one in financial markets, somewhat reminiscent of the first quarter of 2020 with the very beginning of the pandemic. In fact, year-to-date, there has been an even more troubling variety in the list of concerns, including a sea change in monetary policy, the Russia-Ukraine conflict, ongoing supply chain issues and a spike in oil prices and inflation, on top of lingering issues with Covid and fear of recession.

Dramatic economic and geopolitical uncertainty and higher commodity costs do result in higher inflation, and higher inflation does result in higher interest rates, which weigh on stock prices. Great businesses are friends of the long-term investor despite and even because of inflation and shifting macroeconomic and political influences. Over the long term, **nothing builds net worth like the ownership of great businesses.**

The purpose for all these years of <u>Original Thinking</u> is to make some sense out of current goings on in the world and in the marketplace– economic, political, social– the myriad of influences that surround capital markets. The reality is that one actually cannot make sense out of *nonsense*, which we often dub as the *noise* commonly in the headlines and the 24/7 coverage of investments and politics versus the very rare *signals* that actually matter. Common sense is far superior to nonsense.

We know there's no magic formula for investing success, but there *are* these principles. The investor should, indeed, focus on these principles and think through their time horizon for the funds invested or to be invested. For shorter time horizons we must be careful and thoughtful and aware of the vulnerabilities of volatility.

Such periods are times for investors to focus on the fact that **behind every stock is a tangible operating business**. No one preaches this dictum more than The Hansberger Group, but on any short-term basis, we know it is a heck of a lot easier said than followed because share prices are priced daily and don't necessarily reflect the value of the business itself. A lot related to share prices is *short term*. Corporate profits, return on equity, profit margins, free cash flow, pricing power and pristine balance sheets are all *long term*; therein lies the incongruency for investors.

**Price is what you pay. Value is what you get. Our goal has always been to pursue maximum long-term capital appreciation, net of taxes and inflation, commensurate with risk and volatility tolerance.** We know investors cannot grow capital net of taxes and inflation by holding excess cash. No risk does indeed equal no return, but even if capital preservation, not growth, were the goal, there's no actual preservation if you're losing purchasing power to taxes and inflation every single year.

All of these market influences come down to what we call the Big Three: inflation, interest rates and corporate profitability. We've said many times **the economy and the stock market are cousins, but they're not twins.**

In both bull and bear markets, when investors are comfortable and successful, or when investors are fearful and seeing portfolio values decline, principles still apply. They do not go in and out of fashion like the stock market, and company values do not change as rapidly as their share prices do. Investors cannot reap significant long term capital appreciation and an increase in net worth without enduring periods of meaningful declines.

The Hansberger Group believes that when something is not sustainable, we typically recognize it. We attempt to look ahead to the endgame with Russia, to the endgame with the current pace of inflation, to political concerns, all the while not claiming to know the timetable. It is the concept of looking through to what's on the other side of this because certain worries may already be discounted in current market prices, but markets can and will do anything in the short term.

Markets double about every ten years[1] and there are only four asset classes anyone can invest in: Equities, public and private, fixed income, hard assets like real estate, and cash. Two of those asset classes have created a dilemma in the last decade because certain fixed income and cash have actually been eroding investors' wealth, net of taxes and inflation, rather than expanding it.

Another of our principles is a concept called **"probabilistic thinking"**– what is probable vs. just possible? Is the war sustainable? Are oil prices of $100/barrel sustainable? Will Fed policy become incremental and consistent after initial aggressive rate hikes? Corporations have so far announced one trillion dollars of buybacks of their own stocks in 2022, and many companies have announced or expect meaningful increases in the dividends this year. Remember, our focus is on companies, not stocks, but on businesses. You own shares in these businesses. This philosophy, combined with a long-term orientation, may tilt the probabilities in our favor.

We are constantly asking two questions: 1.) What to own? We answer that with the types of businesses that exhibit high returns on equity, earnings growth, strong balance sheets, significant ownership by management, with significant free cash flow and pricing power. We call them **rare breeds**. And 2.) What price to pay? We are focused on valuations and methodologies to value businesses that we want to own for compounding earnings and dividends for many years to come. The central dividing line for many investors is that the equity asset class carries with it a great deal more volatility. We seek to own shares that we would like to hold as investments for the next 10 or more years.

Some people view change as crisis, defined as danger vs. opportunity at the same time. We view change as a significant opportunity, and we have learned to deal with, despite never learning to enjoy, the volatility in an effort to accomplish the objectives.

The irony is that all investors must know that change is inevitable; so why the reaction when change actually occurs? The reaction is what causes the volatility in the first place. That's why there are roller coaster markets and gyrating share prices up and down. If everyone accepted change as the norm, not the aberration, that would likely quell volatility, and that's the difference in actual businesses versus markets. The focus of the companies, their policies, their very best management is *not* to overreact, but to consider times of fear and pessimism as opportunities to grow the business, in the midst of share price declines. It is extremely important to never lose sight of how businesses are actually thinking about markets at any particular time.

**"Common sense is far superior to nonsense."**

In positive stock market environments, many investors tend to have a confident long-term view; in negative periods, the time horizon can shrink to months, weeks, days. Short term-ism is a real concept and represents the fear and bearishness of an investor, just as confidence represents the bullishness. Forecasters can never know the future, so they look to the past for guidance. The reality is that investing is not about the past, but only about looking forward. **Those who forecast do not know, and those who know do not forecast.**

In bull markets, which typically last for many years, a buy and hold strategy becomes prevalent, and in bear markets, which are much more sudden and dramatic, and last for much shorter periods, a "buy and hold" approach is criticized. There are many who instead advocate for short term trading, market timing, guessing at the volatility. Either can be right and successful, and both can be wrong and disappointing, if viewed only over the short term.

I don't believe a company could operate with such a strategy, and we do not advocate that investors should ever want to own the shares of any company with such a philosophy. Trading and speculation differ from investing; hence, the dilemma of making the choice of what type of investor you are… and what your time horizon is, and when you may actually need the funds you are investing. Many investors actually may not need the funds in the short term, so their time horizon can be longer (perhaps the rest of their lives), and then they pass on untaxed gains at a stepped-up basis, like an interest-free loan from the government.

This is what the stock market is. It is not like real estate or private companies. Public company shares are priced throughout the trading day all over the world, and investing in the short term is simply the collective guesswork of trillions of dollars invested by billions of investors and their representatives. The owners of private businesses, or homes, or other property do not buy and sell or move in and out, even if they wanted to. The greater the management and the company, despite any natural emotions of the moment, the less they react and the more they proact… and the more courage, patience, flexibility, and humility; the longer the view, the longer the time horizon, the greater the potential for fortune.

Investors typically multiply corporate earnings by a reasonable multiplier in order to decide on fair valuations, and the price you pay determines your rate of return. **The market is a voting machine in the short term, not a weighing machine;** hence the extreme differences in what a stock price may be versus what a private investor, a strategic company, or a private equity investor will pay in a merger or acquisition, often dramatically higher than going prices.

**"We must avoid thinking like the famous comedian from years ago, W.C. Fields, who said, 'Get up in the morning and smile and get it over with.'"**

We focus on the fundamentals and spend many hours differentiating companies. There's always going to be elasticity in markets– expansion during positive and contraction during troubling times. Typically, there is a flight to the best known quality companies in the down times, thereby presenting the most opportunity in shares of the companies that have recently declined the most.

Investing requires a philosophy, a way of life—with a willingness to morph and adjust—but not to abandon the discipline. At The Hansberger Group, we attempt to analyze and understand the factors and characteristics that account for a company's success. It is one concept to produce a product or service that meets the interest in a fad or trend; yet another to build a brand or a dominant position over decades. All such great businesses experience multiple major stock price declines over the course of years.

Monopolies and duopolies, iconic brands, life changing technologies and healthcare cures and treatments, and international empires develop over many years. Great companies survive recessions, depressions, wars, elections, revolutions and all manner of crises, and their histories consist of a long series of innovations. All of the greatest futures were maximized when shares were out of favor, especially so during periods of maximum pessimism, exactly the time when investors were the least confident and had the least financial staying power. In the US, the Roaring 1920s led to the devastating losses of the Depression; the postwar booms of the 1950s and 1960s led to the 1970s recession, then the 1987 "crash", the extraordinary 1990s to the 2000-2002 dotcom collapse, then the 2008 banking and housing bear market, followed by the 2009-2020 expansion and bull market, Covid in 2020, then the lockdown and recovery highs of 2021 to the bear market of 2022.

While the broadest market indices have experienced a meaningful decline and a bear market this year, they have not reflected the true nature of the selloff, with many growth companies declining far more dramatically than the market average in the first half of 2022, such as Home Depot (-34% YTD), Nike (-35% YTD), Starbucks (-35% YTD), Alphabet (-24% YTD), Meta (-52% YTD), and Microsoft (-24% YTD). Indeed, many of the best-known funds and portfolio managers have experienced significant short-term drawdowns this year. Included below are performance numbers from the flagship growth funds of some of the best-known money managers, as examples:

| Fund Name | Symbol | Performance (%) 12/31/21 - 6/30/22 |
|---|---|---|
| Fidelity Magellan | FMAGX | -27 |
| Baron Asset Fund | BARIX | -33 |
| Fidelity Growth Company Fund | FDGRX | -33 |
| T. Rowe Price Blue Chip Growth | TRBCX | -34 |
| Polen Growth Institutional | POLIX | -34 |
| Baron Opportunity Fund | BIOIX | -39 |
| Baron Fifth Avenue Growth Fund | BFTIX | -45 |
| Baillie Gifford US Equity Growth Fund | BGGSX | -55 |
| Morgan Stanley Inst Growth Fund | MSEQX | -57 |
| ARK Transformational Innovation Fund | ADNIX | -57 |

The higher a fund's performance over the past two years, which came largely from shares of rapidly growing large and small companies, the larger the decline experienced year-to-date.

So, here we are again, dealing with volatility amidst the domestic stock market sell-off since early January, catalyzed first by the Federal Reserve shift in reaction to a supply/demand mismatch and inflationary pressures, partly COVID-driven, hastened, extended and exaggerated by the Russian invasion which has implied to many an even higher inflationary threat due to surging oil prices and resulting shortages in food and other commodities. Certainly, the sudden market reversal is troubling, and we have the same worries, the same anxieties, as any investor would. It would be easy to be pessimistic, short-term, while at the same time, optimistic long-term. We must avoid thinking like the famous comedian from years ago, W.C. Fields, who said, "Get up in the morning and smile and get it over with."

So, what does an investor do? How should investors think? Does one attempt to market time, exit during periods of trouble, danger, fear, and risk, with a plan to reinvest later? Or to withstand the current pressure with staying power? The answer is maybe both, neither extreme, and taxable investors also must consider taxes and the problem with taking profits on very significant gains, short or long term, and then sending 25 percent or more to the government, realizing the capital gain and attempting to find another company just as outstanding as the one you just sold. That is speculation, not investing. We do periodically take profits for multiple reasons, but our goal remains to be highly tax efficient.

**"Investors have experienced many cross currents these last few years; an awful lot has been thrown at us, resulting in a great deal of uncertainty. I can only say the world would be a wonderful place if it just weren't for the people!"**

**I believe most opportunity is found during periods of maximum pessimism.** There's an expression that says, "Be fearful when others are greedy, or greedy when others are fearful." I think greedy is the wrong word. I doubt seriously if anybody's greedy in this particular market environment, but courage is something else. At the heart of all of these market reactions over all the years is this concept of change. Nothing is as certain as change, and it seems now that nothing is as certain as death, taxes, COVID, world conflict, increased volatility in share prices, and political tension. Investors have experienced many cross currents these last few years; an awful lot has been thrown at us, resulting in a great deal of uncertainty. I can only say the world would be a wonderful place if it just weren't for the people!

A little over two years ago, we had just begun the anxiety around the COVID pandemic, and that led to an economic lockdown that led to a market meltdown of about 30 percent. All of the fear was exacerbated by the suddenness of it all. In the summer of 2020, there was domestic tension– protests, riots, cities under attack, questions about police and crime, then the contentious and divisive election in November of 2020. In 2021 began the supply chain issues and rising inflation– huge disparities in business outcomes, depending on which companies were actually damaged by the lockdown, and which companies actually benefited because of working from home and e-commerce and new technology.

Finally, as we began to come out of COVID, mask controversy was waning, schools and a lot of businesses were reopening, and travel was beginning to return. Inflation ramped up, and the Federal Reserve officially declared that they were "behind the curve" and signaled plans to raise interest rates, leading to the beginning of the stock market correction, which, historically, does follow a sea change in monetary policy. It is understandable, particularly after decades of a world awash in liquidity, near-zero interest rates, and near-zero inflation.

Next followed the Russian war in Ukraine. Commodity prices skyrocket, adding more pressure to the rate of inflation, and creating extraordinary headwinds for European economies particularly, which in turn delayed the global reopening and international travel. Now, we have more political conflicts over tax proposals and climate change, attempts to discourage fossil fuels at a time that countries need oil and gas more than ever, and with Russia-Ukraine, the world has become like a circular firing squad; hence the uncertainty; hence the fear; hence the volatility.

Bull markets typically last for many years and rise hundreds of percent. Bear markets typically last nine months to two years and decline up to 50 percent. There was a severe recession in the 1970s around the oil embargo and the Vietnam war; again during the dotcom 2000-2002 period, in which there also was 9/11, and again in 2008, with a meltdown in banking and the housing collapse due to sub-prime lending.

Today, we have 24/7 coverage everywhere. There is more fear than there is confidence, or markets would not be experiencing the current drawdown. Investors should never forget that a wonderful business selling at an attractive valuation is actually the friend of the investor. The way businesses look at this today is not a time to panic, but possibly an opportunity to buy back their shares in the open market; to spend in areas where the competition cannot afford to compete, thereby gaining market share; to acquire complementary companies; to utilize the balance sheet to spend, or borrow, to hire, to acquire technology, all for the long-term success of the business.

Logic may say that consumers and investors should hunker down during such a period, similar to what many thought during the 1970s, or 2000-2002, or 2008 and, actually, much more often than investors remember, because there were also serious concerns in 2007, 2010, 2011, 2015 and 2018. We saw a median 24 percent decline during recessions for the market averages during those difficult times, but also resilience with dramatic rebounds, very quick and long lasting.

The really significant sell-off in markets is a result of the fear of recession. It is not just Russia or the Fed or COVID. Whenever we have experienced oil price spikes, it has typically been associated with some level of inflation, then a Fed reaction, and then the fear that drives the economy into recession. Nevertheless, I must add that the stock market's penchant for overanalysis has resulted in discounting at least *ten* of the last *five* recessions.

We concentrate on an assessment of the long-term expectations of the actual businesses themselves, most of which we have followed or owned for years. Our portfolio positions typically exhibit returns on equity far above the average – we believe return on equity is the single most important measurement of profitability– and have earnings growth that is far above average, maintain balance sheets with little or no debt, possess an outsized ability to pass along price increases and iconic companies that are clearly seen as unique and extraordinarily valuable.

**"Calling a trader an investor is like calling a person with many one night stands a romantic."**

A lot of market activity and volume comes from tax-exempt trading organizations, hedge funds, quant funds, and index funds. It is no surprise to us that people who called themselves long term investors in index funds fled to the exits at the first sign of a correction. Calling a trader an investor is like calling a person with many one night stands a romantic.

This is what markets are, and what we emphasize is there should be more focus on the actual businesses in the portfolio, the marvelous companies that over time can be like owning great art in a museum. Such focus can be difficult in a bear market. Everyone has an opinion. Academics, journalists, talking heads on television, social media, economists. I remember when Mickey Mantle, after he retired, said "It's amazing how easy baseball is from the broadcast booth."

There's also the story of a European reporter from a newspaper who came to America to interview Andrew Carnegie, the great steel industrialist billionaire, and whose philanthropy built libraries all over the country, and wrote back to his editor: "It's amazing how much money there is in building libraries in America!" Sometimes the questions are wrong. Sometimes the views are wrong. Sometimes there's not a thought process of what happens *after* what's already discounted in the marketplace.

I remember a time at the end of the 1970s after a dismal period for financial markets in this country: Oil prices through the roof, 20 percent interest rates, Vietnam, Watergate. Apple went public in 1980 in the midst of the worst inflation and interest rates in history, and despite the fact that Xerox, National Semiconductor, Intel and Hewlett-Packard all had considered the personal computer way before the Mac and the iPhone, Apple received a mere $91,000 from an investor for 26 percent of the company: a $360,000 total valuation. Then they got another investment for $300,000 for 10 percent, a $3 million valuation before the company actually went public in 1980, and the valuation passed $2 trillion in 2021.

The same thing happened with Google, a company that figured out a way to navigate the Internet. Yahoo and many others had already tried it. Google raised $1 million from just four people and finally went public in 2004, right on the heels of the significant decline of 50 percent in the market, and 9/11, and a difficult recession, before surpassing a $1 trillion market capitalization in 2021.

We search for the long-term compounding of earnings and dividends of the very best companies, large and small, and rarely can we ever buy such companies at discounts. While we don't know what's going to happen short term, we do focus on the fundamentals long term. The Dow Jones average, rose from 66 at the beginning of the 20th century, to 11,500 at the end of the 20th century to a high earlier this year of nearly 37,000. Consider the S&P 500 Index. During World War II, there was a decline in the market over three years from 1939 to 1941, certainly not pleasant, but the market rebounded in 1942, '43, '44, '45, up 19 percent, 25 percent, 19 percent, 36 percent, in the midst of World War! Such a study of the history of investing reveals amazing facts regarding the long-term average versus any given year.

Inflation is not necessarily the enemy. It can have a positive effect on increasing values of great businesses because of their pricing power, because of their intangible assets and innovation. Inflation in the United States has averaged about 3% to 4% per year[3] and actually reduces the burden of the government's debt as it devalues our currency over time. It accounts for about two-thirds of the actual growth of the American economy, over time[4]. There are positives to be found in the midst of negatives.

I also remember the "crash" of 1987. By the time it was built into the psyche of the investor, the market recovered almost one year later. The same thing after 9/11. After about a year, the perception was it was safe to fly again, to go up an elevator again. The market returned attention to fundamentals, not fear, and experienced a dramatic rise.

## S&P 500 Annual Returns on Investments[2]

| Year | S&P 500 (includes dividends) | Max Intra-Year Drawdowns |
|---|---|---|
| 1928 | 43.81% | -10.30% |
| 1929 | -8.30% | -44.60% |
| 1930 | -25.12% | -44.30% |
| 1931 | -43.84% | -57.50% |
| 1932 | -8.64% | -51.00% |
| 1933 | 49.98% | -29.40% |
| 1934 | -1.19% | -29.30% |
| 1935 | 46.74% | -15.90% |
| 1936 | 31.94% | -12.80% |
| 1937 | -35.34% | -45.50% |
| 1938 | 29.28% | -28.90% |
| 1939 | -1.10% | -21.20% |
| 1940 | -10.67% | -29.60% |
| 1941 | -12.77% | -22.90% |
| 1942 | 19.17% | -17.80% |
| 1943 | 25.06% | -13.10% |
| 1944 | 19.03% | -6.90% |
| 1945 | 35.82% | -6.90% |
| 1946 | -8.43% | -26.60% |
| 1947 | 5.20% | -14.70% |
| 1948 | 5.70% | -13.50% |
| 1949 | 18.30% | -13.20% |
| 1950 | 30.81% | -14.00% |
| 1951 | 23.68% | -8.10% |
| 1952 | 18.15% | -6.80% |
| 1953 | -1.21% | -14.80% |
| 1954 | 52.56% | -4.40% |
| 1955 | 32.60% | -10.60% |
| 1956 | 7.44% | -10.80% |
| 1957 | -10.46% | -20.70% |
| 1958 | 43.72% | -4.40% |
| 1959 | 12.06% | -9.20% |
| 1960 | 0.34% | -13.40% |
| 1961 | 26.64% | -4.40% |
| 1962 | -8.81% | -26.90% |
| 1963 | 22.61% | -6.50% |
| 1964 | 16.42% | -3.50% |
| 1965 | 12.40% | -9.60% |
| 1966 | -9.97% | -22.20% |
| 1967 | 23.80% | -6.60% |
| 1968 | 10.81% | -9.30% |
| 1969 | -8.24% | -16.00% |
| 1970 | 3.56% | -25.90% |
| 1971 | 14.22% | -13.90% |
| 1972 | 18.76% | -5.10% |
| 1973 | -14.31% | -23.40% |
| 1974 | -25.90% | -37.60% |

| Year | S&P 500 (includes dividends) | Max Intra-Year Drawdowns |
|---|---|---|
| 1975 | 37.00% | -14.10% |
| 1976 | 23.83% | -8.40% |
| 1977 | -6.98% | -15.60% |
| 1978 | 6.51% | -13.60% |
| 1979 | 18.52% | -10.20% |
| 1980 | 31.74% | -17.10% |
| 1981 | -4.70% | -18.40% |
| 1982 | 20.42% | -16.60% |
| 1983 | 22.34% | -6.90% |
| 1984 | 6.15% | -12.70% |
| 1985 | 31.24% | -7.70% |
| 1986 | 18.49% | -9.40% |
| 1987 | 5.81% | -33.50% |
| 1988 | 16.54% | -7.60% |
| 1989 | 31.48% | -7.60% |
| 1990 | -3.06% | -19.90% |
| 1991 | 30.23% | -5.70% |
| 1992 | 7.49% | -6.20% |
| 1993 | 9.97% | -5.00% |
| 1994 | 1.33% | -8.90% |
| 1995 | 37.20% | -2.50% |
| 1996 | 22.68% | -7.60% |
| 1997 | 33.10% | -10.80% |
| 1998 | 28.34% | -19.30% |
| 1999 | 20.89% | -12.10% |
| 2000 | -9.03% | -17.20% |
| 2001 | -11.85% | -29.70% |
| 2002 | -21.97% | -33.80% |
| 2003 | 28.36% | -14.10% |
| 2004 | 10.74% | -8.20% |
| 2005 | 4.83% | -7.20% |
| 2006 | 15.61% | -7.70% |
| 2007 | 5.48% | -10.10% |
| 2008 | -36.55% | -48.80% |
| 2009 | 25.94% | -27.60% |
| 2010 | 14.82% | -16.00% |
| 2011 | 2.10% | -19.40% |
| 2012 | 15.89% | -9.90% |
| 2013 | 32.15% | -5.80% |
| 2014 | 13.52% | -7.40% |
| 2015 | 1.38% | -12.40% |
| 2016 | 11.77% | -10.50% |
| 2017 | 21.64% | -2.80% |
| 2018 | -4.40% | -20.20% |
| 2019 | 31.2% | -6.84 |
| 2020 | 18.02% | -33.92% |
| 2021 | 28.47% | -5.21% |

There are always so many moving parts and macroeconomic influences in financial markets. Some of the controversy today relates to government, and political action to shift away from fossil fuels to an emphasis on climate change after America had become largely energy independent. The very reason that America reached energy independence only a few years ago was because of earlier dependence on OPEC. After reaching energy independence, inflationary pressures declined, only now to be back with a vengeance. It is difficult to understand why such an achievement has been wasted.

Prevailing sentiment and lack of confidence weigh on current share prices. With a rotation from positive to negative momentum and back again, there is a heavy influence these days on the tug of war between the public and private sector,

**"I remember when Mickey Mantle, after he retired, said 'It's amazing how easy baseball is from the broadcast booth.'"**

between Congress and the Administration and the growing concern that there are anti-investor, anti-business, anti-capitalist policies. Whether you agree or disagree politically, any social issue winning priority over a business issue is not positive for shareholder-ism, in my opinion.

So much of today also reminds me of the 1970s, and also of the 2000-2002 "dotcom" era. Some reminds me of 2008. Certainly, there's a long history of markets during turbulent geopolitical events– Pearl Harbor, Bay of Pigs, Korean war, Desert Storm, even COVID, all declines of 30% or more, until it all combines again in an unemotional, fundamental assessment, and common sense, when opportunity outweighs the panic or short-term tension.

We are never cavalier about these kinds of markets, and certain developments and changing information do sometimes make us change course. We always come back to the discipline that centers on monetary policy and corporate profitability, and the question of what characteristics make up for a great company, whether large or small, domestic or international.

After three outsized years of market gains from 2019-2021, on top of a very positive bull market since 2009, on the heels of the 2008 recession, certain developments are to be expected, especially when prompted with an actual change in monetary policy and easy money. The other key variable is corporate earnings. We have seen a positive but mixed bag of revenues and earnings, stock buybacks, dividend increases and proposed mergers and acquisitions. There have been, however, some disappointments: slowing sales, supply chain issues, and pandemic-damaged companies, but we also continue to witness powerful, ongoing themes in economic sectors and outstanding corporate profits in other companies that may use this volatility to gain market share.

This is how we think: we typically do not fight new Federal Reserve policy in its early rollout, nor do we fight the initial profit taking and aggressive action from many traders, hedge funds and computer algorithm quant funds, trading for short term repositioning. Inflation has risen but may become more subdued as supply chain bottlenecks ease later this year. Labor costs have become a problem, the rise of unions, difficulty in getting people to work, commodity costs rising, and borrowers are incurring interest costs as rates on loans rise. Housing and autos are also experiencing significant shifts.

**"I've often thought a committee consists of a group of people who, as individuals, can do nothing, but who as a committee can meet formally and often and decide that nothing can be done. That's what gridlock actually is, and it historically has generally been positive for the financial markets."**

Many companies are damaged and destroyed during crises, when profit margins are under attack due to rising labor and materials cost, and higher taxes and interest rates. That is less true of the great, rare breed companies. We have been concerned about Fed policy since last autumn, and we are very aware of the sea change that's going on with the Fed, and that corporate profits could be weaker. We surely are very aware of the geopolitical and the purely political influences in the country and the world today.

Yet…we are quite confident. We do know that after experiencing such kinds of declines in the past, that, typically, markets that sell off 20% or more, on average, have had about a 15% average return in the following year[5]. There have been seventeen non-recession S&P sell-offs of 10% or more in the last sixty years[6], and you know the result in the resiliency and the comeback.

We invest in businesses with excellent economic characteristics, managed by outstanding management. We allocate capital by concentration in a relatively few businesses at intelligent prices based on a minimum five-year holding period. We take great care in identifying and analyzing CEOs and their management teams, with careful attention to their judgment and insider ownership. We want to own shares in great businesses and think like true owners, and we want to invest in those businesses ourselves, just as our clients. Together we are actually the owners of the businesses in the portfolios. **We would rather own a great business at a fair price than a fair business at a great price.**

Today, while financial markets are volatile, there does exist a certain angst, political discontent, worry about tax proposals, mid-terms, vaccines, a re-opening of the economy or a renewed closing in some cases, a social and political divide far more than in the past.

Low inflation and interest rates historically support higher stock prices; the opposite, historically, creates declines. The rule of 20 generally remains in place: subtract a normalized rate of inflation from 20 and you have a reasonable price/earnings ratio valuation for the overall market. For example, if inflation becomes a lasting ~3-4%, not the recent spike of >8%, the P/E multiple for the S&P could be 16-17x. It then depends on how corporate earnings come through each quarter and long term. Earnings and profit margins are two of the greatest drivers of stock prices.

There is no clear relationship in investment performance following early interest rate hikes[7], but equity returns 24 months later were strong in past cycles[8]. Stock prices may continue to be vulnerable short term as many investors look at the Fed's new stance and do not wish to fight it. Many look at a cascading down of stock prices and don't want to fight it. Many see share leaders falling in price; so many ask: "Will such weaknesses make the Fed bearish and soften up aggression, especially to avoid a recession?" Maybe.

Milton Friedman said: "Inflation is always and everywhere a monetary phenomenon". He believed inflation was caused by increases in the money supply, i.e. too easy monetary policy. Volcker under Reagan and Carter raised rates, reduced the growth in the money supply and broke the back of inflation – and along with it, the stock market. Two recessions resulted– and then a 20-year bull market ensued. Tough love led to record gains; we had recession and bear markets in 2000-2002 and again in 2008 and ever since more record financial market highs, now being challenged by hawkish Fed policy for the first time in 40 years and a declining stock market in 2022. Was it worth it to endure the 1970s to get to the ‘80s and ‘90s? A matter of personal perspective.

There is constant tension between big government and the private sector. The private sector thrives on innovation, government more on control, bureaucracy, and rule by committee. I’ve often thought a committee consists of a group of people who, as individuals, can do nothing, but who, as a committee, can meet formally and often and decide that nothing can be done. That's what gridlock actually is, and historically it has generally been positive for the financial markets.

Don’t mistake my comments here as a political argument. It is a wealth management and investment management argument. It was the capitalist culture that built America. It began at the dawn of the 19th century and for well over two centuries it was capitalism that turned the United States into the most important and affluent country in the world.

**“We've been very aware that whenever in history there has been such upheaval, radical and extreme ideologies prosper, none of which can lead to increased productivity or economic growth or innovation, in my opinion.”**

In the first 100 years, there was the creation of currency for the first foreign exchange, the dollar. There was the innovation of railroads and steamships leading to what was called the “American Century” in the 1900s, with the arrival of automobiles and TV and radio and computers and at the end of the century, the internet. All along there was entrepreneurship and innovation and booms and busts and wars and the Great Depression and the Great Recession. There were waves of appreciation and respect or acrimony regarding wealth, pendulum swings from the progressivism of Teddy Roosevelt in the early 1900s and the presidency of Woodrow Wilson and then the reversal in the roaring ‘20s, then a return to an anti-private business period under FDR and the New Deal, then another reversal in World War II, then a boom and the explosion of wealth in the ‘50s and ‘60s, then somewhat the opposite in the ‘70s with high inflation and interest rates and Watergate and the oil embargo.

Wall Street and wealth were lionized again in popular culture in the ‘80s and ‘90s, before another recession in 2008, before a boom again from 2009 until COVID in 2020 and to today. That's the volatility of markets over long periods of time, appreciation for wealth and capitalism, shifting from lionizing to demonizing capitalism and free markets and free enterprise.

The Hansberger Group is not thinking or dwelling on the topics you see in the majority of 24/7 financial news or headlines today. It is a crucial point. Indeed, I don't even believe in or place much weight in or give more than a passing nod to so many talking points that are supposed to be influences today, buzz words, headlines that attempt to change certain realities.

I don't agree with the majority of academics, many of whom never managed money. I don't agree with most convoluted financial ratios that people come up with in attempts to predict markets; there are so many ways to evaluate companies and markets.

I don't believe in factors or labels, and we are agnostic about styles. The Hansberger Group does not focus on value vs. growth, or choosing between market capitalizations or what you see in the newspapers or on TV about how to “play the market” – that’s speculation versus investing and has nothing to do with the management of money. Indeed, as Warren Buffett pointed out in his famous essays: “the very term ‘value investing’ is redundant. What is investing if it is not seeking value at least sufficient to justify the amount paid?” I also don't believe in technical analysis, charts of the past to tell you the future, any more than I rely on reading yesterday's news to make the final decisions about tomorrow.

I don't agree with most of progressive taxation or estate taxes, or capital gains taxes, or property taxes, mostly because they are an interference in the capital markets.

While I believe the principles of Modern Portfolio Theory can serve as one kind of foundation for an investment plan for certain investors, I do not believe it deserves the pedestal it has been given in college classrooms and on Wall Street. Instead, I think that priority should be given to searching for and investing in sound businesses versus adherence to a strict allocation percentage.

I also don't believe in passive investing or indexing, and we don’t invest in ETFs; there's a commercial that says: “Why would you own one company when you can own an entire sector?” It is a form of indexing. I would say “Why would you want to own an entire sector or an entire market index when you can instead own a select few of the very best companies?”

Many financial journalists have recommended emerging markets over all other developed markets for the last 10 to 20 years with disappointing results. In our view, in terms of market liquidity and other infrastructural concerns, there are no solid emerging market opportunities to speak of with the exception of China, and now even China seems to be at least temporarily destroyed as a predictable opportunity.

ESG, or socially responsible investing, is a popular topic these days. While I recognize the importance of holding corporations to be responsible citizens, to govern themselves fairly, and to protect the environment, in my opinion, the decision to invest is to be based solely on the investment merits of the company.

**"Ronald Reagan said in the '80s that 'Government is not the solution; government is the problem.' Bill Clinton said in the '90s, 'The era of big government is over,' but in the last 20 years, there has been an explosion of government spending and government overreach."**

Midterm election years, historically, are subpar market years[9]. In my view, we are in need of better leadership from government, and many of the proposed governmental changes may lead to more concern in financial markets. Amidst crime and immigration issues, contested elections, shifts of guidance from medical health experts, government leaders, many corporations and selected well-known investors, we are battling with a world of challenges, all of which appear to me to be striking at the very base of capitalism and free enterprise.

Massive government spending legislation has passed, but in reality we still operate mostly under Trump tax cut policies to this day, and the frenzy and fear of losing estate tax exemptions, higher corporate and personal income taxes, higher capital gains and dividend taxes have so far not been addressed. If they had passed, we believe this economy and market would never have reached the heights of 2021. Government spending and too much debt in the system represent the most important concerns today, in our opinion.

I was hiking not long ago in Colorado, deep in the woods, all alone. Normally, I'd be concerned about a bear coming around the corner, but the way popular rhetoric is going I was actually concerned about a "billionaire" surprising me around the corner. It is an odd shift for a 50-50 country, and it appears, somewhat counterintuitively, to have some support even in corporate America – via stakeholderism versus shareholder-ism. The role of business is to maximize the value and opportunity for the actual owners, the shareholders, who take the financial risk with their capital, rather than to benefit the largess of society as a whole, at the expense of the owners.

Stakeholderism likely cannot increase profit margins as it assumes a portion of profits are to increase wages to employees and better prices to suppliers. Earnings drive stock prices. Stocks represent business, and business *is* the private sector, which depends upon capitalism and accountability to shareholders. We have seen it for decades on a lot of different fronts, but today it seems to be more pronounced. It is economic suicide, in my opinion. Conservative versus progressive, private versus public, income and wealth differences, socialism versus capitalism, higher or lower taxes, all contributing to a culture war which can have an impact on the markets.

It seems that a great deal of this debate is coming to a head with the mid-terms in November 2022 and the 2024 presidential election. Who knows if this is anything other than just another swing in the long-term volatility of wealth and business in versus out of favor? When I look back over the last 200 years in America after the fight for American independence, there is nothing but a predictable history of such culture wars, even in the face of all the evidence of failure and danger in history with Marxism and socialism.

Even without the threats of regulation and over-taxation and the anti-business rhetoric of today, it is very difficult for even the most capitalistic, even the most outstanding innovators and creative companies, to maintain that spirit of productivity and leadership, which is why so many companies in the S&P or the Dow Jones Average of 20 or 30 years ago, even 10 years ago, are not in these indices today[10].

It has always been interesting to me that a young, entrepreneurial company can disrupt an entire industry, maybe an entire economic sector, and displace an existing industry power. In the United States, it happens over the years and over and over again, but it depends on a free market environment, and it depends on new ideas, new companies, new services and new products, and such a system exists in America more than anywhere.

Rarely have I heard of a Nike, or Starbucks, or Apple, among others, or a breakthrough in healthcare coming out of Europe or Russia, most of South America or Canada or Mexico or the Middle East. Why wasn't it General Motors or Ford, instead of Tesla, to develop the leadership in electric vehicles? AT&T didn't develop the cell phone, the smart phone, but instead it was Apple. Why didn't IBM develop the personal computer instead of Microsoft?

Why didn't Coca Cola formulate the energy drink instead of Monster or Red Bull? Why didn't most of the banks seize the opportunity for fintech, financial technology, and new payment systems? Why didn't the major movie studios and TV networks originate streaming? No, it was Netflix who also earlier had put Blockbuster out of business in a new approach to video rental. In fact, Netflix approached Blockbuster to sell itself for $50 million and was turned down! Disney is now a formidable competitor to Netflix, but only after allowing Netflix to create the industry which Disney had dominated for years.

Why didn't Microsoft, itself the monopoly in software, develop the cloud instead of allowing Amazon to become number one? Why didn't Walmart lead in e-commerce and retail instead of Amazon? Walmart earlier had put Sears and JC Penney out of business, but it allowed Amazon to become, well, Amazon, which had in turn already nearly put all the dominant bookstore retail markets out of business.

At the same time, why didn't Amazon take it all the way to the thousands of small businesses moving to e-commerce that opened the opportunity for Shopify to emerge as the industry leading platform for small business? Why did McDonald's allow Starbucks to take over the coffee market and charge $2 a cup when McDonald's was charging 20 cents?

The point is that it comes down to the entrepreneurial inclination, the spirit essential for successful long-term investing. It must be maintained as the primary focus of investors and business if the American capitalist system itself is going to continue to provide historic opportunities.

So many leaders didn't have the imagination, the original thinking, the forward thinking to maintain the high level of success. I worry that corporate America ceases to disrupt, to empower, to protect the greatness in American business and in people and in research and development, mostly out of self-protection from government regulation and social pressure.

The future *is* coming. We know it will be different from the past and we continue to be irreverent regarding anything about investing that does not focus on outstanding business models, and to be demanding and vigilant about businesses–never stocks, never short-term trends, never focused overall on the macroeconomy.

Why didn't some of the most spectacular businesses keep creating, instead letting the next big thing get away? Too busy? Too successful already? Too big? Too bureaucratic? I believe slowdowns and gaps in innovation reflect losing their grasp on the spirit of innovation and entrepreneurship and a focus on the future, which ultimately comes down to relying on these principles of investing. It is being awake and alert and always mindful of anything that becomes an obstacle to free markets, free enterprise and capitalism.

**"When panic happens, they always blame it on capitalism, a gross exaggeration that leads to cultural brushstrokes."**

In my view, a certain anxiety and deep concern have descended upon America. It is not COVID to which I refer, and it has been developing for years. It includes stakeholderism and social movements that attempt to overtake capitalism, innovation and free enterprise. It is intended to fundamentally transform the United States of America from what has been the dominant economic engine and the balance of power in the past 200+ years.

It has resulted in a growing movement attacking success, undermining free speech, faith-based initiatives, entrepreneurship and financial ambition, and has influenced institutions from political parties to universities. Some would say it is a threat to institutionalize the dominance of the federal government over the states.

In 2020 the outbreak of the pandemic, riots and protests, deep isolation and the election all gave full steam to this transformation, exacerbated by the shutdown of the economy. We've been very aware that whenever in history there has been such upheaval, radical and extreme ideologies prosper, none of which can lead to increased productivity or economic growth or innovation, in my opinion.

There is a world of difference between the ownership of great businesses and an economy or a market as a whole. All of 2020-

2021 saw a breakneck pace of change with a flurry of proposals, executive orders and pandemic shutdowns. All of it focuses on how government deals with business and wealth and on the underlying philosophy of how the federal government and the private sector should interact.

Ronald Reagan said in the ‘80s that “Government is not the solution; government is the problem.” Bill Clinton said in the ‘90s, "The era of big government is over," but in the last 20 years, there has been an explosion of government spending and government overreach.

The basic premise of fiscal policy is that a government has no money whatsoever. It depends on borrowing and tax revenue to cover its desired expenses. Borrowing means issuing treasury securities, and the interest has to be paid, and presumably the principal eventually. You cannot possibly pay for it without printing money and taxing anywhere there is income and wealth.

The real answer is economic growth: growth to pay down the debt, growth to increase tax revenues, and you can only have real growth with low inflation, low interest rates, deregulated corporations, and national incentives to save and invest. Social programs are typically only supported by massive deficits, taxes, or both, which have the potential to endanger free enterprise, in my opinion. The action by the Federal Reserve in 2022 comes from the refusal by government to control spending in the past.

We have had the great honor and privilege to represent many different types of clients across the country, far left, far right, middle, social vs. political vs. economic opinions. All are in the **investor** class, our clients to whom we offer advice on investment management and wealth planning. The American experiment has resulted in a standard of living never seen in world history. About a hundred years ago, the Great Depression was in full force; 1200 banks failed; deposits were lost forever. There was no federal deposit insurance. Even the titans of Wall Street were teetering under the weight of credit they extended that couldn't be paid back.

In the hundred years before that, the 19th century, there was a long series of economic crises, along with the development of the structure of government, commerce, trade, the creation of the Federal Reserve in 1913, a system of banking, taxation and share ownership. This is the history of America: government and business, public and private: attempting to find the balance, a certain amount of chaos that inspires innovation and entrepreneurship, but enough order to not go off the rails.

Capital flowed to railroads, automobiles, telephones, computers, a system that supports rather than opposes growth and opportunity, a formula that unleashes productive capital. At the heart of it all is the shareholder, the investor in the private sector, innovators, wealth creators, who provide the capital, the bedrock of the world of wealth management. The 1800s saw the issuance of paper notes, a currency, granting the federal government the sole power to print money. It was then that America actually became America, and ever since there's been volatility and growth and expansion and failures and contractions and recessions. In 1862 was the creation of the IRS. In 1863, the new concept of chartered banks was created via the National Banking Act. About 20% of all capital invested in that period was in railroads. Before that, somebody hung the wheel on an axle and changed everything. It went from horse-drawn cars to locomotives, today's equivalent of the information highway and internet.

**“I believe for a business to be capable of progress, it must be healthy. To be healthy, it must be profitable. To be profitable, there must be a climate that serves as an incentive to innovate, disrupt, invest and create.”**

The more growth, the more debate. There has been disdain for government or disdain for business capital, investments in newfangled things called stocks, shares, not just oil and real estate. America became defined by money and the pursuit of it and has been ever since, which in turn has created charity and tax revenues and western expansion and trade and exports. It created a Gilded Age with Carnegie in steel, Vanderbilt in railroads and shipping, Rockefeller in oil and Morgan in banking. They were all heroes or villains, depending on the booms or panics, and when panic happens, they always blame it on capitalism, a gross exaggeration that leads to cultural brushstrokes.

The progressive movement and the backlash to wealth are nothing new. Teddy Roosevelt was galvanized a hundred years ago by the failure of those fighting the progressive party to forestall the Depression, which in turn ushered in FDR and the New Deal. Such a schizophrenic relationship has existed for 200 years between the wealthiest entrepreneurs villainized by the masses. Such a period led to the prosperity of the Roaring 20s before turning into the depression of the '30s.

America became a creditor nation rather than a debtor. The U.S. became the savior for Europe. The child became the parent, a watershed period when America, unlike Europe or any place in the world, became the dominant force when it came to business and the private sector.

A century ago, the Federal budget was $3.3 billion; four years later, in 1926, it was $8 billion. Since then, we've seen nothing but an explosion of taxation and borrowing– today the Federal budget is over $6.5 *trillion*, and our debt is over $30 trillion. I believe for a business to be capable of progress, it must be healthy. To be healthy, it must be profitable. To be profitable, there must be a climate that serves as an incentive to innovate, disrupt, invest and create. To sustain such a climate there must be keen awareness of and respect for the institutions and values that have driven American excellence, achievement and wealth creation for more than two centuries. Investors should be vigilant that in times of crisis, those institutions are especially vulnerable to ideas and policies that have all too often not lived up to the promises.

If the 20th century was the American Century, what will the 21st be? Change has been the only certainty that we can count on. It has been immense over the last two hundred years and accelerates every year; same conflicts, arguments, culture wars amidst change in attitudes toward wealth. So as with the history of America and with The Hansberger Group investment philosophy, we again remind investors that there *is* no perfect formula, but there *are* principles. We believe that capitalism is served only if we embrace the future, and we have nothing but confidence in our investment process and our investment discipline.

In my opinion, it is not a good idea to bet against the United States stock market. In the end, it moves the world. It is a powerful influence in politics, world central banks, the Federal Reserve; it is the significant force behind capitalism. The U.S. stock market is ultimately an engine of money, wealth, jobs, living standards and prosperity. It is not political. It is not symbolic. It plays a part in all recessions, inflation, and expansions, and it affects families of every economic status.

The American stock market serves as a foundation for innovation and progress, and a barometer for public companies and investors, including private equity and venture capital. There are more than seven billion people in the world, and most of them aren't investors; yet, the United States stock market ultimately, directly or indirectly, has a profound effect on every person on earth.

**"There are more than seven billion people in the world, and most of them aren't investors; yet the United States stock market ultimately, directly or indirectly, has a profound effect on every person on earth."**

We are blessed to be alive at a time with the highest ever standard of living. Even as it seems the world is upside down, at the heart of all of this is the American stock market. Despite the volatility, it represents hope and belief in the future. It is where businesses are born, change hands, and where innovation happens, and can be the conveyor belt to a prosperous future. It is not the *stock* market; it is the United States *business* market. ■


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## The Hansberger Group is pleased to introduce new additions to the team since the publication of our last issue of Original Thinking:

**Lucas Livaditis - PWM Registered Associate**
Lucas graduated from The University of South Carolina Honors College magna cum laude, where he received a B.S. in Business Administration from the Darla Moore School of Business with a double major in International Business and Economics. Lucas started his career as the third generation of his family's decades-old Atlanta businesses, where he gained deep and broad exposure to all manners of business operations, focusing on sales and financial strategy. Lucas joined The Hansberger Group in 2021.

**MaryClare Breyel – PWM Client Service Associate**
MaryClare joined The Hansberger Group in August 2021 after graduating from The University of Georgia magna cum laude. She earned a bachelor's degree in Human Development and Family Science from The College of Family and Consumer Sciences.

**Joe Donald – Registered Client Service Associate**
Joe joined The Hansberger Group in April 2022 after graduating from the Manderson Graduate School of Business at the University of Alabama, where he received bachelor's degrees in Finance and Marketing, as well as a master's degree in Economics. Joe participated as a member of the Alabama football team, which won the National Championship during their 2020 season.

**Brendan Douglas – PWM Client Service Associate**
Brendan joined The Hansberger Group in 2022. He earned a full scholarship to play football at The University of Georgia, where he went on to letter all four years. After graduating with a degree in Economics, he began his career as a Financial Advisor. Following a few foundational years in the wealth management business, Brendan co-founded a restaurant franchising group based in Athens. After selling the business, he returned to wealth management.

## THE HANSBERGER GROUP

**The Hansberger Group at Morgan Stanley has represented the high net worth marketplace for over four decades, assisting our clients in the creation and maintenance of significant net worth. It all comes down to Original Thinking, our mantra for over 30 years, a disruptive growth strategy that decommoditizes a commodity business. We compete on the power of our investment discipline and original ideas. In a time of an overload of advice today, what is still in short supply are insights and real innovation in investment management.**

*"If we can find companies with high historical and sustainable returns on equity with consistent above average earnings growth, we will have found purchase candidates for the substantial increase in net worth. Add in a healthy balance sheet, heavy insider ownership of the shares, and a management team that focuses on the successful deployment of cash flow (stock repurchases, debt reduction, dividend increases, and when appropriate, focused acquisitions that are accretive to earnings) and we will have identified great businesses. Great businesses purchased at attractive valuations should lead to significant capital appreciation over time."* —Jim Hansberger

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