



Holland Macro Views – Part 1 of 2

Market Cycles, Owner Managers & Road Trips

While markets have swooned, we have recently spent much time with a wide variety of owner managers. This included sitting down with Michael O’Leary for an hour in Paris and a 10-day US road trip to Texas seeing companies. This note is about our learnings along the way on markets, owner managers and a few other things.

- We think recent share price collapses are far more about greed and fear than they are about a new economic cycle
- We are learning a few intangible nuances as to what we want from the owner managers we seek out, to add to our tangible list
- Time spent travelling in the US gave us a few new observations that don’t come from sitting in our UK office

Three different cycles

It has been interesting to be away from our Bloomberg screen while unfolding daily news of corporate profits disasters seemingly accompany daily share price plummets. Some 15 years ago your author wrote a piece that called out the distinction between three different cycles. These being: i) the **political cycle** that often dominate the vast majority of our news airwaves; ii) the **economic cycle** that many spend their time fruitlessly trying to predict; iii) the third distinct cycle is one that we think is too often overlooked and can be independent from the preceding two. It is arguably also the most important of the three for investors to understand. It is the **market cycle**. The market cycle is the pendulum of greed and fear that populates equity and credit markets. Market and economic cycles can of course interact with each other, but they do not always. We think it crucial that investors understand these cycles as distinct from each other.

Greed and Fear

Investing markets today are not a place for puritanical thinking. That said some framing of our thinking is helpful. Your author, for better or worse has for the last 15+ years only thought about investing in terms of the absolute dollar compounding it offers. As such he analyses any share considering its likely growth, capital allocation and possible valuation change giving potential prospective returns to consider. If these numbers are 13-20% we are interested. If they were sub-10%, less so. These are nominal returns, not outputs of some overly complex DCF.

Whilst we could of course see the logic many observers described for why some growth equities might have higher valuations in a low interest rate world, in truth it had little affect on our thinking. This is because the risk of being wrong about something such as an uncertain outlook for a company was to us far more important than a change to a 1% or 4% risk-free rate. Simply put if nominal IRRs looked good, adjusting for risk we were/are interested, if they are not, we pass.

Surprisingly maybe, we actually think the vast majority of investors think this way (sort of), whether they are prudent, boring types like us, or Bitcoin speculators. I.e., they are not putting a 1% risk free rate into a DCF calculation and coming up with a higher target price. Instead, they are thinking about what their future investing profits are going to be. Their confidence in this outlook, whatever its detail or process, gives them conviction. The trouble lies in the word ‘confidence’ which for many investor changes as the sentiment around them does. While there is clearly a link between bond markets and say a sector like property it is not as direct as the commentators suggesting QE and low interest rates have driven all assets prices higher would have you believe. In other sectors there is no link at all except the hunt for yield as investors are driven away from low yielding bonds in search of income. This to us has always smacked of desperation and even danger. We recall a quote from Seth Klarman’s brilliant Margin of Safety book.

“Beware reaching for Yield” **Seth Klarman**

So, if QE and low interest rates are not directly responsible for rising and then falling share prices, what is? That we think is simple, it is **greed and fear**. Greed makes you more certain that the projections of the future you have (however complex or simple they may be) are likely to be right. Greed is also why an investor (or many a wealth manager) thinks it’s a good idea to reduce the amount invested in bonds or cash to ‘get a better return on your money’ in say fast growing equities. Looked at in hindsight or the cold rational light of day this of course seems crazy, but we have to remember this is an industry populated by human beings. Herds of them with all their collective biases and individual faults. As ever, Charlie Munger summarises the emotion best:

“Nothing is worse than watching your neighbour get rich”. **Charlie Munger**

[Your ‘professional’ advisor or money manager is nothing of the sort](#)

Your author some years ago opined that there was no such thing as ‘professional’ investors. The reason being that professions learn by their mistakes and from their predecessors. (Engineers today build concrete bridges, not wooden ones and thankfully the medical profession stopped using leeches c.100 years ago). Where is this learning and evolving in professional investment decision making? Yes, this generation is better at information gathering, spreadsheet building, using AI etc. But there is no evidence at all that we are any better at the end decision making than were our grandfathers. The reason for this of course is our emotions and inbuilt biases. In the investing world these inputs ultimately show themselves in the output extremes of greed and fear.

[But the company and economic news is terrible...](#)

Investors sceptical of our, too simple greed and fear portrayal will note the new economic and company news that seemingly gets worse every day. We see that too. As Ray Dalio’s brilliant [economic cycle video](#) explains the world is linked, today more so than ever.

CEO’s and those that work for them watch the news, they watch their share prices and they have Bloomberg terminals. They are linked to the same cycle of greed and fear as investors, and that cycle of information spins a little quicker today than it did say 40 years ago. In this way stock and credit market cycles *can* create economic ones as happened in 2008 or they can just blow off their excesses without a lasting impact on the economy. The likely lasting effect on the real economy is we suggest not just in this linkage, but in the presence and scale of any in-balances that were present before.

How do we assess this cycle?

We find ourselves strangely optimistic from today's starting point. We felt during the depths of the Covid-19 crisis that a period of optimism would follow. We are actually still inclined to that view. Whilst events such as supply bottlenecks and the war in Ukraine have been unexpected shocks to the global economy their effect *could* reduce significantly as we look forward. Indeed, there is good news for those that look for it in supply bottlenecks that look to be easing/improving.

As for the effect of interest rates, again we are sanguine. We hear the FED speak and actually welcome its determination after so many years of seemingly being impotent. All global economic regions are now searching for a new neutral interest rate. Maybe this is 2-3% depending on your region. Anyone that thinks this is a disaster clearly has a great deal of leverage we suggest. Whilst this is new news, is it *really* that surprising? Did any of us really think that the right neutral interest rate was zero? Do we think that many companies planned and budgeted for such a zero rate? We also note that very few borrowers ever benefited much from uber-low rates, as there was always a lending/risk margin added on, say in credit cards or car loans. Arguably only the very strongest companies benefited (Berkshire Hathaway selling bonds at <1%). Of course, mortgage rates in some countries are affected more than others, but so are savers. Many savers having earned nothing in terms of interest income for c.10ys. To now earn c.2% on deposits will help some.

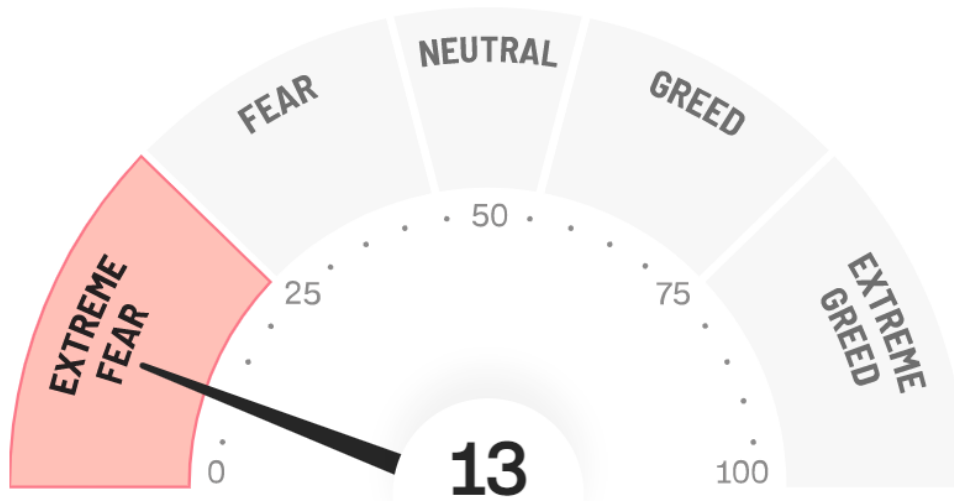
In short, we think the economic assessment is complex and thus unclear. Crucially the speculative excess we have seen in this recent period was not in the real economy or lending – as was the case in 2008. Instead, they have been in investing circles, with those with money who tried to get rich a little too quick. Many, having arguably made foolish decisions which today they are likely regretting, maybe even exiting. As this bubble bursts, its scale and therefore knock-on consequence are hard to know. As such it has a 1999/2000 feel to us of investment rotation that follows a greed exposing cycle. This is different from a required economic contraction. Yes, maybe some slowing will be required to slow inflation, but a Ukrainian and supply chain resolution might bring that outcome also.

Bad news sells/good news does too!

When you next turn on the financial news please bear in mind that bad news sells newspapers and eyeballs. It has always been this way, never more so than in this always-on world. Covid/Ukraine and now the popping of investing bubbles has been a field/pay day for those paid to entertain you (sorry, tell you the news!). We ask readers to imagine re-watching all the financial news they saw in the last 5 years. Every tech booming new IPO, every new high in the Nasdaq or S&P. Each of these stories came with a different commentary of exciting new technology, or reason as to why investors should be excited about what was occurring. *Everyone should be doing this* was implied. Now consider re-watching all those stories with a single commentator just saying ... "*the reason why this is happening is that investors last week were 8.6 on the greed scale and today they are 8.9, so things keep going up*". Imagine how boring the news would be if week after week that was all we heard by way of commentary. And yet arguably this commentary is far closer to the truth that the constant stream of information investors were fed at the time to justify ever higher prices.

Today the commentary is the opposite, explaining why values are falling and investors should be worried. Imagine if instead we just heard ... *“values are falling just because investors are more fearful than they were last week”*. Those that have seen cycles come and go (Bolton, Buffett, Munger & Templeton) see these long cycles for what they are. A great many investors sadly do not.

Fig.1: Greed vs Fear at 25th May – An uncomfortable place and new for many investors



Source: CNN Business, as of 25th May 2022

The above chart, courtesy of CNN Business shows how far we have come in this emotional investing rollercoaster. As today many are rushing to sell the mistakes of their recent speculative investing past, we are minded to the following:

“It is not timing of the market that counts, but time in the market” **Investing proverb**

Today we think the above chart is more helpful than all the economic forecasting you might choose to do. Additionally thinking about future growth/cheapness in absolute terms with prudent assumptions has to still be the right way to assess investments. When that leads to the conclusion you have found value, then you buy, irrespective of what message you are worried falling share prices may be telling you.

In closing we lift a quote from the front page of today’s Wall Street Journal

Cash is kind right now, the latest evidence: the markets embrace of dividend-paying stocks over another long-time favorite, firms that do buy backs...

Investors are rushing to companies promising regular payments to shareholders...

“If you have a choice between buying more of your stock and giving me the cash, I’d rather have the cash” said Max Wasserman, founder of Miramar Capital.

Source: Wall Street Journal article, 25th May edition

All the best investors know that the use of genuinely excess cash to make astute share buy backs is great capital allocation. That today’s front page is a calling for jam today (i.e. dividends) rather than great allocation to create future value perhaps show just how far the pendulum has now swung away from ‘greed’ to ‘fear’.

“This too shall pass” **The Bible**

Swings of sentiment such as those we are witnessing at both extremes are really nothing new. After all the above quote is said to have been written 2,000 years ago!

Part 2 will look at our owner manager learnings and US trip reflections.

Kind regards

Andrew

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