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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Insurance Is Attractive Due to Strong Pricing, Strong Fundamentals

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SECTOR — GENERAL INVESTING

TWST: Could you tell me about the firm?

Mr. Auxier: We basically are a smaller boutique firm, $800 million to $900 million in assets, and we have a mutual fund started in 1999. We have separate account management going back to 1983 and a verified track record back to 1989.

TWST: Can you talk about the fund?

Mr. Auxier: Yes. I started the fund with kind of more of the principal mentality versus the agent mentality, where I put all my money in 1999. We started at the all-time market high in 1999. And since we started, it's basically outperformed the market.

A $10,000 investment in the fund through September 30th is worth $55,114 versus $48,175 for the S&P. The actual equities have returned 877.55%. It's more of a retirement type fund, with about 80% equity exposure through that period. The best returns really in our history were 1999 through 2009.

We're more of a defensive type of fund. We tend to outperform in flat to down markets.

TWST: And could you comment on what's been going on in the stock market in recent months and where you think things are headed?

Mr. Auxier: I think we're returning to normal. We're coming off the biggest bond market decline in history, the biggest bond crash. And if you look at the time since March of 2020, the bonds with maturities over 10 years are down 46%. The 30-year is down, I think, 50%. So we've been talking about how the rates were the lowest in recorded history.

A lot of our banks, like **Silicon Valley**, extended their durations. It took **Silicon Valley** 40 years, and in 40 hours, they were gone. Also, **First Republic**, they were issuing 30-year 1% mortgages and retaining. So you're kind of getting back to normal on rates.

If you go back, actually in the 1990s the 10-year on average for most of the decade was over 8%. And if you look at the T-bill going back to 1965, 3-month bills average about 5%, 7%. So we're kind of coming back to normal.

And the government's getting out of the bond market. Most people don't realize that a free functioning bond market is more volatile than the stock market.

But you have a whole generation that's never seen higher interest rates or higher inflation. There are wars and we've got reshoring and more government fiscal spending and higher deficits. So, this last quarter, you had kind of a strike. Well, the bond vigilantes sort of came back from hibernation.

Before, in the 1980s, rates would be ahead of inflation. Now, deficits are ballooning with bond supplies and surging defense spending, and then the government is basically selling bonds instead of buying bonds like they had in the last 13 years.

So that's kind of all reversed and that's led to a lot more volatility, which is a good thing. But everyone thinks it's not normal, but we're really getting back to normal.

That's kind of why there's so much volatility, because there's more volatility in the bond market. It's impacted, for example utilities — they were down, I think 9% last quarter. It's hitting those kinds of businesses really hard.

TWST: And what about a sector like the large-cap sector? What's been going on with that and where do you see that going?

Mr. Auxier: Well, the large cap — it just depends on the fundamentals. Obviously, AI, artificial intelligence, is gaining a lot of excitement.

And so, with the rise in rates, anything with an indebted balance sheet has been getting hammered. And those companies, like the big tech companies with strong balance sheets who are basically immune to higher rates — that combined with **Nvidia** (NASDAQ:NVDA) and those types of names have attracted a lot of momentum.

But we saw this back in 1999. I mean AOL, for six years, was growing 50% a year. AOL and Yahoo back then were, I think, $300 billion. And then I think within the last two years, they were sold together for $5 billion.

Back then, when we started the fund, these were the top index holdings in the S&P. Lucent was 108, and it went to zero. WorldCom was 88. It went to zero. And **Microsoft** (NASDAQ:MSFT) actually was underwater for 17 years since that period. So you've got to be careful.

Pfizer (NYSE:PFE) was 138. It reached a p/e of 92 on the back of Viagra, and it was underwater for over 20 years. We've seen this before. I have a chart of these index names in 1999. Our equities are up almost nine-fold since that period. But since that time, **GE** (NYSE:GE) dropped something like 50%. **AIG** (NYSE:AIG) was at 33 times earnings. Now, we've been buying **AIG** at around 9 times earnings.

The markets are pretty virtuous. They're going to purge all the bad behavior and the undisciplined will get hammered. And we're coming off the COVID pandemic and all the boom and bust, and we're normalizing this out. But it's a treacherous time.

Travel is both domestic and international. Travel is really strong. People are spending on experiences.

TWST: What kind of companies would people want to invest in to take advantage of travel?

Mr. Auxier: Well, we like better models. We like **Booking.com**, which used to be the Priceline. They're more on the digital side.

With airlines, you have to be really careful. You look at **Alaska Airlines** (NYSE:ALK), for example — they get half their income from their credit cards. So, the problem with a lot of those businesses, they're just real high capex businesses. We like companies that have nominal capex.

Airbnb (NASDAQ:ABNB) would be another business that's not quite priced here. You want to look at the really strong models, but the airlines have been horrible.

Like Buffett said, with the airline industry, the best thing would have been if they would have shot down Orville and Wilbur Wright. I think they lost for 90 years more than they ever made.

You have to have a good model and good fundamentals. That's why insurance brokers are great. They're just a royalty on price. But you have to be careful because with the airlines — they're just high mandatory capital spending. You got all the labor. I talked to a **FedEx** pilot who got a raise to $500,000 a year. You got labor and you got unions.

"Buffett is sitting with over $150 billion at 5%, and before he was earning maybe 20 basis points. So you get a double play with those insurers because they get higher cash flow — assuming they're not too long duration on their bonds."

If you stick to the fundamentals, you're doing OK. But that bomb bubble really hit a lot of industries hard.

TWST: And are there certain sectors or individual stocks that you think would be of interest to investors?

Mr. Auxier: Well, the fundamentals. We've been talking about this the last year or so. This is one of the strongest hard markets. In insurance, the hard market is real. Strong pricing, strong fundamentals.

I went to the **Berkshire Hathaway** (NYSE:BRK.A) meeting. This was my 25th **Berkshire** meeting this last spring. CEO Warren Buffett has never written this much business ever. That tells you they're very disciplined underwriters.

But the insurance component of the S&P was recently at 12 times earnings. The fundamental pricing is really strong. That benefits companies like **Aon** (NYSE:AON) and **Marsh** (NYSE:MMC), the brokers, and **Berkshire** and companies like **Travelers** (NYSE:TRV), and **Ryan** (NYSE:RYAN) which is an insurance broker.

Buffett is sitting with over $150 billion at 5%, and before he was earning maybe 20 basis points. So you get a double play with those insurers because they get higher cash flow — assuming they're not too long duration on their bonds.

But that's why you've got to watch out for the banks. They all went long. Even **Schwab** (NYSE:SCHW) and **Bank of America** (NYSE:BAC), just when they should have been going short, they went long.

And so you have disciplined underwriters in insurance right now. **Progressive** (NYSE:PGR) is probably the best auto insurer, it went from 102 to over 150. That's a really strong area.

The other area is travel, like **Booking.com** (NASDAQ:BKNG).

You need to have a really good model, really good management, and a lot of free cash. Unfortunately, a lot of those businesses, they're pretty capital intensive.

1-Year Daily Chart of Aon PLC

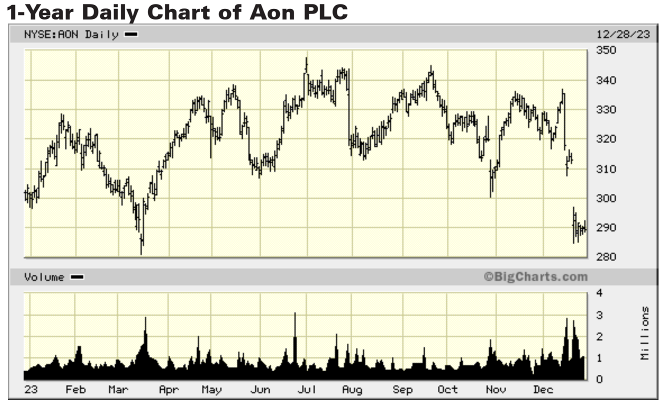

Chart provided by www.BigCharts.com

TWST: And with cruise lines, should investors still be a little careful?

Mr. Auxier: Yes. There's not a real good model because, like I said, anything with all this inflation, the capex is what kills everybody. The cruise lines for the average investor, it's just like autos. Those models are not something you want, in my opinion, because you can't really buy and hold those because they're too risky. Their balance sheets require a lot of capital.

TWST: Any advice for investors when they're looking at different large-cap companies?

Mr. Auxier: We like the owner-operators, like Buffett or **Aflac** (NYSE:AFL). **Aflac**, I think, since it's gone public, is up over 50,000%. And **Progressive** — those are really good. Right now, **AIG** has finally got their underwriting. Peter Zaffino at **AIG** has got their underwriting. You have to be really disciplined on underwriting. And so those companies are doing well.

Marsh and the brokers have a lower risk model because they're not writing business, they're just taking advantage of the pricing. And they're more risk mitigation companies.

Generally, the industry is pretty cheap. **Chubb** (NYSE:CB) is another one that's really well managed.

So you've just got to stick to the tight underwriting. There's too much risk in insurance, especially some of the long tail type. A lot of companies got hit insuring for long-term medical nursing home type coverage — that killed a lot of companies. I think **GE** got killed in that area years ago.

So, there's a time and a price for everything. We have a lot of **Mastercard** (NYSE:MA) and **Visa** (NYSE:V) versus the banks because there just isn't the risk model. It's kind of like the insurance brokers, we like the capital-light model.

But those banks, unrealized losses on their balance sheets are pretty massive. Most of these banks they're just drinking the Kool-Aid, and they're buying mortgage-backed securities. And those trade like a 30-year bond when rates go up, and they trade like a two-year bond when rates go down.

There's just no substitute for cumulative knowledge in these markets because you can just get absolutely killed.

TWST: And what about for people that are in retirement or nearing retirement? What should they be doing?

Mr. Auxier: Once you're retired, unfortunately, then you really have to be aggressive on the research because you can't lose that money. I had people come to me with everything in municipal bonds and they had lost 50%. So you have to know what you own. Like Buffett says, risk is not knowing what you're in or what you're doing.

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TWST: And if there's a year or two when there are a lot of natural disasters, hurricanes, tornadoes, can that affect some of these companies too?

Mr. Auxier: Well, that's what's led to the good fundamentals. Ironically, it's kind of an oxymoron. I mean, you've had six or seven record years of losses, so then if you have a big loss, you tend to have more insurance. And then the insurance companies raise their prices, so the companies are trading on future price increases. So the pricing has been really good.

And now that's not going to go on forever. But for right now, like the EV insurance for electric vehicles, this year is up like 70%. So stocks will generally follow pricing.

Like I said, I've followed **Berkshire** for 30, 40 years. I've never seen this kind of a price environment. But that'll change too.

But if you stick to the disciplined underwriters — and they're finally getting back to where their bond portfolios, with no risk, can make 5.5%.

TWST: And you would prefer insurance than maybe some of the other financial services?

Mr. Auxier: Well, we look at everything. During the thrift crisis in the late 1980s, a third of the thrifts failed and one of our clients was the number one thrift manager. So we bought a lot of banks during that decline.

But the insurance fundamentals have been really strong. Banks with their duration, a lot of these younger managers are on these models — and they modeled low rates in perpetuity. The banks, the problem is their funding costs have gone up and they were taking advantage of zero money. And then you've seen what's happened in commercial real estate.

The problem is our industry is in all these pools, and everyone has these models. They just put everybody in these diversified pools. Well, you go into MSCI Asia and half of it's China. You could have been in Russia — in three days, it went down 98%.

1-Year Daily Chart of Travelers Companies Inc.

Chart provided by www.BigCharts.com

And so again, risk management is more important to me. We price everything daily by hand. It's kind of like the John D. Rockefeller ledger, making sure everything is disclosed.

The other thing is, don't get into these blind pools. Look at FTX and look at the blow ups. You just have to know and have someone who's doing the research on the individual balance sheets. Look at **WeWork**. That was around $46 billion. Now it's bankrupt. And a lot of the big firms were saying it was worth $90 billion.

We always tell retirees, don't believe what you hear and half of what you see, and talk is really cheap. I mean look at all the crypto, 19,000 crypto firms gone under. There's an old saying, a fool and his money are invited everywhere.

But now you have to know what the cash flow is. What the balance sheet is. **AT&T** (NYSE:T) at one point was over $220 billion in debt. They were overpaying for spectrum and overpaying for media companies. The power of compounding is phenomenal.

Remember the two Buffett rules. First rule is: Don't lose your capital. Second rule is: Don't violate the first rule. We've just seen so many Ponzies in this environment with easy money. You've got synthetic derivatives, 100 to 1 leverage. But a lot of the shadow banking, that's another area you've got to be aware of. So we're on high alert.

We have clients who are 102 that have 80% equities, and we have a lot of clients in our fund that are in their 90s. You can be invested, but you have to make sure you've got a solid margin of safety in these companies.

TWST: Is there anything we haven't talked about you'd care to bring up?

Mr. Auxier: I think it's an exciting time. I think the smaller businesses, back when the bubble burst in 1999 through 2009, we were actually net up that period when the Nasdaq dropped over 70.

But there's a lot of really good values in the smaller businesses. You got to know the small businesses. We're meeting a lot of the CEOs, but there's some really good potential returns there and there's a lot of concentration.

People think, well, these stocks can stay up forever. But like I was saying, I mean, **Microsoft** back when we started, we bought it at 22 or 25. But **Microsoft** back when we started the fund was 89. And for 17 years, that stock didn't hit the '99 high.

So it's just a game of humility — humility and tenacious hard work and research. And that research is what mitigates the risk. But like I said, there's a lot of hype and you got to just really be careful with talk being so cheap.

TWST: Thank you. (ES)

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