

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Snoozer Stocks Prove Exciting Over the Long Haul



J. JEFFREY AUXIER is President of Auxier Asset Management LLC and Founder of the Auxier Focus Fund. Prior to forming Auxier Asset Management in 1998, Mr. Auxier spent 16 years at Smith Barney — formerly Foster Marshall American Express, then Shearson — where he was on the Portfolio Management Advisory Board and the Chairman’s Council and was Senior Vice President of Investments and Senior Portfolio Management Director. Mr. Auxier graduated with honors from the University of Oregon with a degree in finance and an emphasis on accounting. Mr. Auxier and his family choose to live far from the influence of Wall Street, on a hazelnut farm just outside of Portland, Oregon.

SECTOR — GENERAL INVESTING

TWST: Is there an overall investment philosophy at the firm?

Mr. Auxier: Yes. The overriding focus is on the power of compounding. We’re looking to buy good businesses at prices that represent the potential for a double or triple play. We focus on dedicated research efforts to find these great businesses and managements. Then, we try to buy them at prices where there is a margin of safety and where we get paid for the risk.

TWST: Since the pandemic, and with inflation, what has it been like to use that investment approach?

Mr. Auxier: It’s great. When I started in the business, inflation was roaring in the early 1980s. So, we had the old saying: It’s either eat or heat. And during the 1970s, everyone carried a lot of cash and had to make great buys. Because from about 1964 to 1982, the Dow went from 1000 to 888. So we were buying things like drugstore chains and supermarkets, waste disposal, insurance companies, things that people had to have. And it worked out really well.

You had to have high inventory turns and low mandatory capital spending. You really had to know your stories and you made it on the buy. There was no momentum. Also, Federal Reserve Chair Paul Volcker was not your friend. And so, you could not make mistakes and get bailed out by money printing. We welcomed this because we’ve been in this speculative mania and with client money, you can’t speculate. But everyone has been. Last year was the most speculation since March of 2000, the dot-com bubble. The Nasdaq dropped 80%.

We were actually net up those three years when the Nasdaq dropped 80%. So we do better. Our fund, since 1999, we’re up over 830% on the equities versus the market, which is about half that. But our best performance was 1999 through 2009 relative to the market. So we do way better in flat to down periods, historically.

TWST: And when you talk about the power of compounding, what do you mean by that and how would that benefit investors?

Mr. Auxier: Especially in high tax states, you’re trying to defer tax if you can.

You want a business that — like **Costco** (NASDAQ:COST) — we actually had some clients that were lucky enough to get in before it went public. But I think **Costco**, right around the pre-IPO was about \$0.19, and, you know, up to \$400 to \$500. So if you have the right business model and it is enduring and you can buy it right, it absolutely crushes everything else, I think.

I think the number-one performing stock since 2000 has been **Monster Beverage** (NASDAQ:MNST), over 70,000%. But the problem is, you’ve had major corrections along the way. You’ll have what they call a correction or drawdown of over 50%. So you really need to know your businesses. For example, in our fund, the biggest holding is **UnitedHealth** (NYSE:UNH). We bought it back when it was hopelessly out of favor, back in the first decade of the 2000s. But we were in at \$45 and now it’s \$513.

The power of compounding is so phenomenal. It’s like the two Buffett rules. The first rule is: Don’t lose your capital. Second rule is: Don’t violate the first rule. Sounds trite, but again, if you go down 50%, you’ve got to go up 100%. If you go down 90%, you’ve got to go up 1,000%. So it’s OK to go down 50% if the business earnings are going to be there. I think Peter Lynch said, there’s like a 100% correlation — your return on stocks is just correlated with that earnings stream. So we focus all the time on the earnings power, the business model, how enduring that model is. You’ve seen SPACs and IPOs. There’s a lot of hype out there. There’s a lot of carnage, because people love great stories. But we focus rather on enduring cash flow that can compound over decades, not over months.

TWST: And did you want to highlight a company that you find interesting?

Mr. Auxier: The bear markets are incredibly painful. But that's where you build, you make it on the buy.

We're not aggressively buying right here. But the insurance fundamentals, as an example, have the best pricing since 2003. You need to buy your car insurance. There are still pretty low valuations. We have companies in that group all the way from **Marsh & McLennan** (NYSE:MMC), **AON** (NYSE:AON), all the way to **Travelers** (NYSE:TRV) and **AIG** (NYSE:AIG), **Aflac** (NYSE:AFL). So insurance has done pretty well because it's dull, mundane, cheap, and has good pricing. And that's a combination for a double or triple play. The exciting euphoria attracts way too much capital and that's why you're seeing all these companies or industries that were flooded with capital — they're blowing up now.

TWST: And are the companies that you mentioned in the insurance sector from diverse areas? It's not just car insurance, for instance?

Mr. Auxier: Right. Our biggest is **UnitedHealth** and now it's **Elevance Health** (NYSE:ELV), which was **Anthem** — and **CVS** (NYSE:CVS) and **Travelers**. I mean, they're boring. You're not going to get people too excited, but we've been in **Marsh & McLennan** — typically, they have a bond portfolio that's ballast. Things like **Aflac** are around nine times earnings. They're all showing good earnings. And **Cigna** (NYSE:CI) is another one. These are nine, 10, 11, 12 times earnings. So they're not expensive.

AIG is, I think, about 80% to 90% of book. It's nine times earnings. Back in 1999, **AIG** traded for, I think, over 30 times earnings and traded three or four times sales and now it's less than one time sales. So, all of these cycle around. We price everything daily in our fund and our client accounts.

TWST: Did you want to identify another sector where investors might want to look?

Mr. Auxier: Well, we think some of the best values are going to be in high-quality industrials, things like **Parker Hannifin** (NYSE:PH). They sell, I think, over 400,000 to 500,000 little hydraulic hoses. **Gates** (NYSE:GTES) is another one. They've probably got the best hydraulic hose. We like small ticket. We don't like large-ticket items. So companies like **Sherwin-Williams** (NYSE:SHW). I mean, if you're spending \$50 an hour to paint your house, you're not going to buy lousy paint. They've had tremendous pricing — or like **Lowe's** (NYSE:LOW). The housing stock is over 30, 35 years old and you've got to maintain it.

We have a company in the fund, our biggest winner of the fund, **FirstService** (NASDAQ:FSV). I met the management team way back in 2005. Really super high-quality managers and they're Canadian based and they do property maintenance. That stock has gone from split adjusted \$1.96 to \$121. It was even higher, but you think property maintenance, what a snoozer, but that's pretty exciting stuff.

So we like whatever is recurring and dull and mundane. I mean, again, people want all this excitement. But that euphoria, you can see, whether it's crypto or SPACs this last year, or great stories with no cash flow. They're getting killed, whereas the lower p/e stocks are finally outperforming. For years, they've underperformed growth. But that spread got to be the widest in history. And so now you're seeing just like in 2000, real strong outperformance. They have all these categories. But really, if you're buying cash flows cheap, which we try to do, that approach, I think, is going to do much better in the next five to 10 years.

TWST: With some of these areas that you've been talking about, are they somewhat recession-proof? Are consumers and businesses still going to need these things?

Mr. Auxier: Yes, it's back to the necessities. Assuming we're going to have higher-than-normal inflation because of wars and because of decarbonization and re-shoring, these are all kinds of themes that probably will lead to higher prices. Like I say, people don't have a lot of discretion. They need to buy their insurance. They need to buy their food. They need to buy their beverages. But they don't need to buy fancy furniture.

Companies are getting hit really hard, like the **Restoration Hardwares** (NYSE:RH). The stuff that's holding up — you've got to go to **CVS** and get your prescription or **Kroger** (NYSE:KR) is another good example. We've had **Kroger** all the way back to

10 and it's around 48 to 50. But you go to the grocery store and if inflation is roaring, you buy the **Kroger** brand. And then not only that, but then they turn things over, like **Costco** has 18 times on their inventory turns. So very low capital intensity.

When I first got in the business, I went back 50 years. I said, what did well? And it was supermarkets, it was drug stores, it was food companies. Because that's where the constant demand is. And then the stuff that was big ticket, big mandatory capex got killed, like utilities.

And that's kind of what's going on now with their capex, the utility sector is running at \$140 billion. The next couple of years in capex, there's rarely an Olympic venue that's avoided bankruptcy. So

Highlights

J. Jeffrey Auxier discusses the investment philosophy behind the Auxier Focus Fund. He says they look for good businesses at prices that represent the potential for a double or triple play, and they try to buy them at prices where there is a margin of safety and where you get paid for the risk. In general, they prefer dull, mundane, cheap companies and avoid high flyers that attract too much capital. Mr. Auxier says that they are not buying aggressively right now, but that certain sectors look good, such as insurance companies, which he says have the best pricing since 2003. He also finds good values in high-quality industrials. Based on the assumption that we're going to have higher-than-normal inflation, he also favors companies that provide consumers with necessities, such as food and beverage providers.

Companies discussed: Marsh & McLennan Companies (NYSE:MMC); AON PLC (NYSE:AON); Travelers Companies (NYSE:TRV); American International Group (NYSE:AIG); AFLAC (NYSE:AFL); Elevance Health (NYSE:ELV); CVS Health Corp. (NYSE:CVS); Cigna Corp. (NYSE:CI); Parker-Hannifin Corp. (NYSE:PH); Gates Industrial Corp. PLC (NYSE:GTES); Sherwin-Williams Co. (NYSE:SHW); Lowe's Companies (NYSE:LOW); FirstService Corp. (NASDAQ:FSV); RH (NYSE:RH); Kroger Co. (NYSE:KR); Netflix (NASDAQ:NFLX); Mondelez International (NASDAQ:MDLZ) and PepsiCo (NASDAQ:PEP).

when you see big spending — it's kind of like when everyone went into streaming, \$10 billion, \$15 billion, \$20 billion a year on content. Look what's happened. **Netflix** (NASDAQ:NFLX) dropped 70%. And on and on. The euphoria — like the marijuana industry, those things are down 90%-plus. So that's the danger. Euphoria leads to over-investment, whereas the necessities — everyone's bored to death of the likes of **Mondelez** (NASDAQ:MDLZ) or **Pepsi** (NASDAQ:PEP). But snacks are pretty good, especially during a recession.

The markets are pretty virtuous. They're going to purge out all the bad behavior. So all we've had is just really bad behavior on the part of Wall Street. And what's happening is we're just purging out all that bad behavior. I mean, 19,000 cryptocurrencies, 100-to-1 leverage, synthetic derivatives with these hedge funds applying — you know when you have a 100-to-1 leverage all over, that's blowing up. So you're getting back to basics.

And so the idea of a recession — it's more like, pick the area, the biggest bubbles, like the bond market bubble. What's happened this year? The worst bond market declined since probably the 1800s. And why? Because if you go back, according to the history of interest rates — the book, *A History of Interest Rates* — rates last year got to the lowest in 5,000 years. Well of course, you're going to get killed, because the bond prices are correspondingly the highest. You've got a Fed that's got 200-to-1 leverage. The Fed lost \$500 billion — more than that — in the first half on their bond portfolio.

“So insurance has done pretty well because it's dull, mundane, cheap, and has good pricing. And that's a combination for a double or triple play. The exciting euphoria attracts way too much capital and that's why you're seeing all these companies or industries that were flooded with capital — they're blowing up now!”

So the whole idea of predicting recessions is kind of like going back to the 1930s. John Maynard Keynes was among the most famous economists. He said, wow, how do you have all this knowledge of forecasting? I don't do that. I buy a handful of companies that I really know intimately. And then I buy them when they're hopelessly out of favor and then I wait patiently for my ship to come in. Same with Joe Kennedy — he got hit really hard in the 1918 recession. Financier Galen Stone took him aside. He told him, look, you've got to know what you own and you've got to know more than the market.

Right now, investing is the craft of the specific. You've got all these pools out there, and no one knows what they're in. And it's fine on the way up because the indexes are momentum based. But people don't realize that last century, most of the time the indexes are down and people are kind of sold a bill of goods. We're getting back to the craft of the specific. We've been in speculative mania and everyone calls that investing. So that's why we don't forecast.

We made eight times our money buying small banks from 1991 to 1998. That was a great opportunity. Then you had the Mexican peso disaster in 1994 after the rate increases in 1994. Some of the biggest money that we've made, it was the 1987 crash and everyone was worrying about a recession back then. In 1987, the rates started at

7% at the beginning of the year and then by the summer, late summer, they were up to 10%. Yet, the market was up 40% before the crash. So then, we had the rates go up. Then the market crashed, and everybody's going: We're going to have a recession, we're going to have a recession, and we never did.

1-Year Daily Chart of Costco Wholesale Corporation



Chart provided by www.BigCharts.com

And then in 1994, we had rates go up 3% and the bonds got killed. We didn't have a recession. In fact, '95, '96, '97 is when we had

three years over 25%. So it's more about the business, and knowing your businesses, because you can do really well coming out of recessions. I mean, the last recession we had in 2009, the bond market, the spreads went from 5 to 22. So you get a bond like Smithfield Foods 17%. And finally the government's getting out of the bond market and so it's creating value. So that's why we don't get too much into the macro forecasts.

TWST: And what advice would you give to people who are in retirement now or nearing retirement?

Mr. Auxier: Well, again, you have to know what you own. Like Buffett says, risk is not knowing what you're in or doing. And unfortunately, a lot of people and advisers just don't know what they're doing. I mean, they buy indexes or ETFs. They're just flipping around. And you've got to know what you own and these retirement accounts are sacred, that's a sacred trust. And we tend to do a lot better in the downs. A lot of people will have to go back to work after this decline. The retirees have got to know what they own and whoever is advising them, make sure they're locked in. They need to share the pain on the downside.

The older I get, the more humble I get, and the more you've got to be a voracious learning machine. Like George Gilder says: Wealth is not cash, it's knowledge and cumulative knowledge. And so, you want to be grinding and you've got to be dealing with someone who's got that cumulative knowledge, because that's where there's risk mitigation.

Carlos Slim, one of the wealthiest guys in the world out of Mexico, was asked: You must have taken a lot of risk over your life. He goes, no, we strive to eliminate risk. And so that's the problem now, everyone is pooled up. They don't know what they own and then there is no price discovery. And then you've had the government in there buying all these bonds and the government balance sheet is up to \$9 trillion. And then they back off a little bit and immediately rates double.

So it's a game of humility. Like I say, the markets are pretty virtuous. If you don't know what you're doing, they're going to hammer you to death. And we love that environment, because that's investing. All this other stuff is speculation in higher inflation and interest rates.

“Assuming we’re going to have higher-than-normal inflation because of wars and because of decarbonization and re-shoring, these are all kinds of themes that probably will lead to higher prices. Like I say, people don’t have a lot of discretion. They need to buy their insurance. They need to buy their food. They need to buy their beverages. But they don’t need to buy fancy furniture.”

Just like in the 1970s, the Nifty Fifty, they were over 80 times earnings. And once inflation whipped up with the oil embargo and you saw the p/e on that group, which included Polaroid and Eastman Kodak, etc. They dropped from 80 times earnings to under 10. That's just happening right on the market — you've got 40%, probably 40% revaluation, because high multiples do not survive high inflation, it levels everything. I mean, there's an old rule, the market should be at 20 less inflation. Like in 1979 inflation was 12, where was the p/e? At 8. In 1982, same thing, the p/e was 8 to 9. So if you take a 5% inflation rate, 20% less 5% is 15%. So all these pie in the sky projections on all these growth stocks have no earnings or cash flows, they just keep compressing and that's why it's just serious business. To me, it's too many hobbyists out there.

When you study those compounding tables, you will focus on not losing money, I guarantee it. Because if you get 15%, you double every five years, 12% every six years, and if you take hits, you interrupt that power of compounding, and that's the focus. So it's almost like Bobby Knight talking about the power of negative thinking: Don't turn the ball over. It's just the same thing with investing. Minimize the downside first. Don't think about making 10 times your money and that's kind of what's going to happen. Most people I've talked to, they've never even seen inflation, they never have seen a rising interest rate environment.

TWST: Anything else that you want to bring up?

Mr. Auxier: It's a time for you to say, you've got to know what you own. You've got to know what it's worth ahead of time. And during these severe drawdowns, if you know what you own and you know what it's worth and it's solid, those are the tennis balls. The tennis balls bounce back. If your earnings and fundamentals are strong, the stocks will go down and the average stock fluctuates 50%, but they'll come back. So the key, as an analyst, we're looking at that sustainable earnings power, because if the fundamentals are strong, they'll bounce back. If they don't, we call them the chicken eggs. They go down, they break and they splat and they don't come back.

So the job of an analyst is really to determine the power of that franchise and make sure it's enduring and it's not just some story. But I think, like I say, it's an exciting time; we much prefer the negative sentiment. The consensus is this is no time to buy stock. Euphoria is the enemy of the rational buyer. If it's euphoric, run. Like Buffett says, when money is easy, grab your wallet and run the other way. But when money is tight, like in 1994, that was the last time we had this kind of a dramatic rate increase of 3%, that set up for '95, '96, '97, three huge years in the market. But you had to know what to buy and it's kind of the same thing. But the good news is, we're getting back to the basics of investing and away from mindless speculation.

TWST: Thank you. (ES)

J. JEFFREY AUXIER
Founder, President & CEO
Auxier Asset Management
(800) 835-9556 — TOLL FREE
www.auxierasset.com
email: info@auxierasset.com