Super Mario Strikes Again

In a 2012 speech, European Central Bank (ECB) President Mario Draghi promised to do "whatever it takes" to save the euro. He one-upped himself this week by promising to continue to do so for as long as it takes. Pushing borrowing costs even lower in order to boost what has been anemic growth in the euro-zone economy, the ECB cut rates deeper into negative territory (from -0.4% to -0.5%) and promised bond purchases with no end-date.

We struggle with the whole notion and implied effectiveness of going deeper into negative yield territory to stimulate the economy through even greater purchases of European sovereign debt. Nonetheless, regardless of the imbalances it may cause and our longer-term concerns, as investors we must play the hand we are dealt. That hand is a very unsettled and unpredictable global economy. Consider where things were just 12 short months ago. The US ten-year treasury yield was over 3%, with the consensus outlook predicting continued rate increases alongside a strengthening global economy. In recent months, global growth concerns have taken hold, the US ten-year yield dipped below 1.5% and much of the rest of the global bond market is yielding negative rates.

It's not easy to predict where we will be in another 12 months. But, as history has shown time and time again, uncertainty breeds opportunity. Investors have bid up the price of safety - including bonds, consistent and stable equities, gold, safe haven currencies, etc. - at the expense of many decent businesses offering above-average dividend yields and below-average multiples.

These businesses tend to be lumped into three baskets:

1) businesses that are negatively impacted by lower interest rates,

2) businesses that are sensitive to economic growth, and

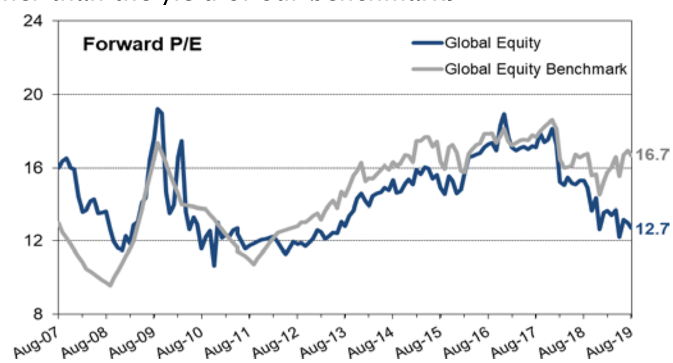
3) slow growing businesses.

We have sizeable exposure to such companies. We feel the risk of long-term capital loss is limited, with many of these holdings exhibiting a significant margin of safety and considerable upside. This year's stock market rebound has not been focused on such names, but we believe the upside will more than reward us for our patience in the future.

Risk Management Monday

Once a month our Investment Committee meets to review our portfolio risk management audit. We measure certain key risk characteristics, including valuation, growth and balance sheet metrics. Across several of our strategies, from global to small cap, we are seeing materially better valuations, balance sheets and dividend yields. Our portfolios are generally much more diversified by sector than their specific benchmarks, something that has ironically been a hinderance to performance in the recent past.

Let's consider our global strategy for illustrative purposes. The chart below shows our Price/Earnings multiple. Not only is it near absolute lows, including the financial crisis years, but today the portfolio is at a near 25% discount to the broader market. We are also at all-time lows on a Price/Book value basis, having recently traded down to 1.5 times book (over a 30% discount to the market). Our balance sheet strength is also evident with a 20%+ advantage to the market. We are finding opportunities in high dividend-yielding businesses while paying what we believe is a very attractive multiple. As a result, our dividend yield recently approached 3.5%, nearly 35% higher than the yield of our benchmark.



Source: Capital IQ

These are not the characteristics of a risky portfolio - in fact, just the opposite. However, what we have been missing from the equation above is performance, as our strategy has underperformed the market year-to-date. Performance, though, is not a risk management metric; it is an outcome of our portfolios and the preferences of the market at a given point in time. If the central banks of the world push on the growth accelerator once more or if trade war fears diminish, the market’s preferences will also likely change, as will our relative performance.