THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Being Disciplined, Consistent and Patient as a Value Investor

JOHN BUCKINGHAM is Principal and Portfolio Manager of Kovitz. Mr. Buckingham joined AFAM Capital in 1987 and Kovitz in 2018 as part of the Kovitz acquisition of AFAM. He has more than 30 years of investment management experience and serves as Editor of *The Prudent Speculator*, which has been a trusted newsletter for over 40 years. Mr. Buckingham chairs the AFAM investment committee, leading a team that performs comprehensive investment research and financial market analysis. He has been featured in *Barron's*, *The Wall Street Journal* and *Forbes*, and frequently contributes to CNBC, Bloomberg and Fox Business News. Mr. Buckingham is a recognized industry contributor who regularly speaks at prominent industry seminars and events.

SECTOR — GENERAL INVESTING

TWST: When *The Wall Street Transcript* last spoke to you, it was before the acquisition that led to you joining Kovitz in 2018. Please tell us about the new parent company.

Mr. Buckingham: Given that we had long been an asset manager, we are thrilled to be a part of Kovitz, which was founded in 2003 and is based in Chicago. Kovitz is a wealth manager, which entails financial planning, tax advice and really working more deeply with clients, so we found that to be a valuable service that we didn't have the capability to build out.

We thought it was a very good union in that we have a lot of clients who have utilized us for our equity strategies, but then as their needs evolve, we have additional products on the fixed income side, in real estate, even hedging strategies, that allow our clients to stay with us and potentially even add to the relationship with us and, of course, to serve their needs throughout their lifetime. As folks get older, their usage of equity strategies generally diminishes, and so we want to be able to serve our customers for life.

TWST: Despite that change, you are still Editor of *The Prudent Speculator* and manage the two portfolios that you track as part of the newsletter. Do those continue as before? Would you remind us a little bit of the history of *The Prudent Speculator*?

Mr. Buckingham: Our headquarters remains in Chicago, but my team is here in California. There are three contributors to the newsletter on our asset management, research and portfolio management, and they are Jason Clark, Chris Quigley and Zachary Tart. We're all still in California. We all do what we were doing before, which is we write the newsletter and we implement our managed account strategies out of our Orange County office. So nothing has changed in that regard.

The newsletter remains as it always has been. The newsletter goes back to 1977. It was founded by a gentleman named Al Frank, and it was a diary of his investment experiences. I came on board in 1987 as a senior in college and worked my way up the totem pole to where I eventually became Director of Research and Chief Portfolio Manager in 1990. And then, when Al passed away in 2002, I became the Editor of *The Prudent Speculator*, so I'm 18 years now of being Editor of the newsletter.

But the philosophy and the strategy has not changed. We like to say we reserve the right to get smarter, but it's always been a value-based approach, and that really hews to Al Frank's upbringing. He didn't come from money, so he knew the value of a dollar, and bargain hunting was in his nature because that's how he had to live his life. So it just made sense to him that buying stocks that were trading at inexpensive valuation metrics, that were on sale, that made perfect sense.

Happily, in the research that Al did — back in 1977, you didn't have the internet. You couldn't Google what works well on Wall Street, but you could go to the library and investigate. What Al learned was that inexpensive stocks, value stocks, stocks trading for low price to earnings ratios, low price to sales ratios, low price to book value ratios, those historically had outperformed. So it was a match made in heaven in that, philosophically, Al was a bargain hunter.

But then, on top of that, we also had a situation where history confirmed that buying inexpensive stocks was the way to go. It really worked out well, and it allowed Al to maintain the discipline through thick and thin to implement the value-based strategy.

If you look at newsletter performance, there's an entity called The Hulbert Financial Digest, which tracks investment newsletters that pay to be evaluated. It evaluates how our recommendations have done — it started in 1980, so there's now 40 years of history — and we're a top-performing investment newsletter with returns in the 14% range per year versus an 11% return for the market — Wilshire 5000 — since the inception of the Hulbert Ratings on June 30, 1980. So we must be doing something right in that performance has been very good.

And when I say performance, it's also important to understand that Al put his own money to work. He started with $8,000 back in 1977, real money, and tracked and invested in what he was advocating in the newsletter, so investing right alongside readers and, ultimately, clients. We didn't manage money in the beginning. So he put his money where his mouth was. That $8,000 portfolio we still manage for his estate, and it's worth more than $3 million, despite significant withdrawals along the way.

Like Al, I went out in early 2003 and established the Buckingham Portfolio, which is what you were talking about with your question about the two portfolios, and that's real money as well. I started with $23,000 or so, which was the inflation-adjusted amount that Al started with in 1977, $8,000, and that's grown to more than $800,000 today. Again, Hulbert tracks that, and it's outperformed the Wilshire 5000 by a score of 11.9% per year to 10.5% per year since its inception on January 28, 2003, for the market, so we've done something right in terms of the strategy, the philosophy, and it's independently tracked. So obviously, Kovitz was interested in us continuing to implement what has been our historical bread and butter.

TWST: In addition to the focus on value stocks, what else would you add in terms of your overall philosophy or strategy for the equity portfolios?

Mr. Buckingham: Well, like Benjamin Graham says, when shopping for stocks, choose them the way you would buy groceries, not the way you would buy perfume. Unfortunately, these days, we're in an environment where investors are fascinated or fixated on stories, on companies that appear to be able to grow significantly, especially given the pandemic, and they're paying little attention to the price they pay for those stocks.

We saw the euphoria around the **Tesla** (NASDAQ:TSLA) stock split, and somehow people thought that because it was cheaper in price, it was worth more, and so the stock was bid up significantly by a lot of investors, even though a stock split doesn't alter the pie, if you will. It's still worth the same. It should be worth the same.

I would imagine, given that many value investors have closed up shop, we're one of the few that are left that have been disciplined, consistent and patient in implementing our strategy. I've been here for more than three decades. There aren't too many folks that have followed a value approach for three decades. We're always going to be that way.

Value is in our DNA, Kovitz as well, and that's why I think the union has worked so well. They're very much guided by value in everything they do, whether it's bonds or real estate or whatnot. We all want to buy things that are trading at inexpensive valuations relative to what we think their long-term value is, and that philosophy or strategy doesn't waver.

If you go back and look at market history, as remember Al Frank did in 1977, if you look at it today, value is still winning the long-term race by a wide margin. There is data readily available free of charge for anybody who wants to Google it. Professors Fama and French slice and dice the market going back to the 1920s, and you can crunch their numbers and see what has worked. Value stocks historically have had a 12.8% annualized rate of return. Growth stocks have been 9.6%.

So when you have that kind of performance advantage, you tend to have a lot of faith in value, and we don't think this time is different. We think value is still the way to go, and we're always going to be value investors, and we think that gives us a margin of safety because we're buying things that are reasonably priced.

We're not paying for perfection, as many investors seem to be these days. We think that many of our companies are priced for failure as opposed to priced for perfection, and there's a reversion to the mean because we don't think our companies are going to fail, just as we don't think many companies are going to remain perfect in terms of their growth trends. The nice thing is that we think that our companies will revert higher in terms of how the market values them, whereas many growth stocks will revert lower.

Highlights

John Buckingham discusses the Buckingham Portfolio and The Prudent Speculator newsletter. Mr. Buckingham is a value investor, and he notes that when looking at market history, value is winning the long-term race by a wide margin. He buys quality companies at reasonable prices. He also likes dividend payers as they provide higher returns and lower volatility. Mr. Buckingham is currently overweight technology, consumer discretionary and industrials.

Companies discussed: Tesla (NASDAQ:TSLA); FedEx Corporation (NYSE:FDX); Apple (NASDAQ:AAPL); Lowe's Companies (NYSE:LOW); Newmont Corporation (NYSE:NEM); Qualcomm (NASDAQ:QCOM); Deere & Company (NYSE:DE); JPMorgan Chase & Co. (NYSE:JPM); Walt Disney Co. (NYSE:DIS); Tyson Foods (NYSE:TSN); Total SE (NYSE:TOT); CVS Health Corp. (NYSE:CVS); ManpowerGroup (NYSE:MAN); Cisco Systems (NASDAQ:CSCO); Pinnacle West Capital Corporation (NYSE:PNW); Morgan Stanley (NYSE:MS); Nordstrom (NYSE:JWN); J.C. Penney Company (OTCMKTS:JCPNQ); Williams-Sonoma (NYSE:WSM); Microsoft Corporation (NASDAQ:MSFT); Intel Corporation (NASDAQ:INTC); Oracle Corporation (NYSE:ORCL); Hewlett Packard Enterprise Co. (NYSE:HPE); NetApp (NASDAQ:NTAP); Benchmark Electronics (NYSE:BHE); IBM (NYSE:IBM); General Motors Company (NYSE:GM); Foot Locker (NYSE:FL); Hasbro (NASDAQ:HAS); M.D.C. Holdings (NYSE:MDC); Caterpillar (NYSE:CAT); 3M Co. (NYSE:MMM); Lockheed Martin Corporation (NYSE:LMT); PG&E Corporation (NYSE:PCG); Edison International (NYSE:EIX); Cummins (NYSE:CMI); HSBC Holdings (NYSE:HSBC) and Carnival Corp. (NYSE:CCL).

"When shopping for stocks, choose them the way you would buy groceries, not the way you would buy perfume. Unfortunately, these days, we're in an environment where investors are fascinated or fixated on stories, on companies that appear to be able to grow significantly."

Sure, there are going to be companies that grow into their valuation. There always have been. But unfortunately, there are many that just can't, the valuations can't be justified, especially today, at least in our view.

We want to buy quality companies, we want to buy them at reasonable prices, and we want to be patient with them and milk the dividend income. I didn't mention dividends yet, but if you look at Fama-French data going all the way back to the 1920s, dividend-paying stocks have outperformed non-dividend-paying stocks by over 1 percentage point per annum. And by the way, they've done so with lower volatility.

Investors are always looking for higher returns and lower risk, if risk is defined as volatility, and market history shows that dividend payers give you the holy grail, so to speak, which is higher returns and lower risk or lower volatility. So we do like dividend payers, and especially in the environment today, where interest rates are extraordinarily low, dividend payers make a whole lot of sense to us.

Federal Reserve essentially told us that they want inflation to run moderately above 2%. So the Fed is doing everything they can to help the economy and to help inflation rise, which again, historically speaking, has been very good for both value stocks and dividend-paying stocks and not as good for growth stocks. So that is a factor that in our mind favors value going forward over growth.

Further, and perhaps even more importantly, as economies rebound from recessions, value has outperformed over the ensuing one, three and five years by a wide margin over growth. Q2 saw a massive decline in GDP. We don't know for sure when the official arbiters of recessions will declare it over, but clearly, Q3 is going to see a massive rebound in GDP. We don't have the number yet, but the estimates are, on an annualized basis, something like 35% of GDP growth, whereas it was a 31% contraction on an annualized basis in Q2. So there's certainly an economic recovery underway, albeit from a very low base, but we have an economic rebound happening. Again, market history suggests that when you have that situation, value has outperformed.

"So I'm not going to say that the tide has completely turned because nobody knows the answer to that question, but I do think that we're definitely in an environment where investors who have a long-term time horizon should be gravitating toward value stocks, and there are many reasons for that."

TWST: There has certainly been more focus on growth stocks for a few years now, but some say that a shift toward favoring value stocks is taking place now. Do you agree with that?

Mr. Buckingham: Well, value has had many false starts. We've had numerous periods where it outperforms for a month or a couple months and then investors go back to fixating on the fast-growing stocks. So I'm not going to say that the tide has completely turned because nobody knows the answer to that question, but I do think that we're definitely in an environment where investors who have a long-term time horizon should be gravitating toward value stocks, and there are many reasons for that.

Of course, I hate to keep coming back to the **Teslas** of the world, but there are some companies that are very, very expensive on a price to sales basis, on a p/e basis. Yes, the "e" is supposed to grow. But there's tremendous competition in many of the "sexy" areas of the market, and there are no guarantees that growth will actually materialize to justify those valuations.

So whether or not this is the turning point — I think it might be, and I have some reasons that I'll share in a second — but I do think over the long haul, even if it's not the exact bottom, if you will, for the value-growth dynamic, I think you want to be emphasizing value stocks. And the reason for that is we are now at relative levels on value versus growth that are on par with the peak of the tech bubble in March of 2000, and in actuality, if you look at indexes like the Russell 3000 Value versus the Russell 3000 Growth, today, believe it or not, it's actually at a lower relative ratio than it was at the height of the tech bubble.

Looking at it another way, value stocks are more attractive today than they were back then, and of course, the tech bubble burst and value did extraordinarily well in the ensuing one, three and five years. They went up, whereas the "market" or the growth stocks actually went down. So we're at this point in time where value looks really attractive, relatively speaking.

But if you're a student of market history, as we are, you can crunch data and look at things like periods where inflation has been rising, or is concurrent with or subsequent to increases in inflation. I know that inflation today is not a big issue, but back in August, the

1-Year Daily Chart of JPMorgan Chase & Co.

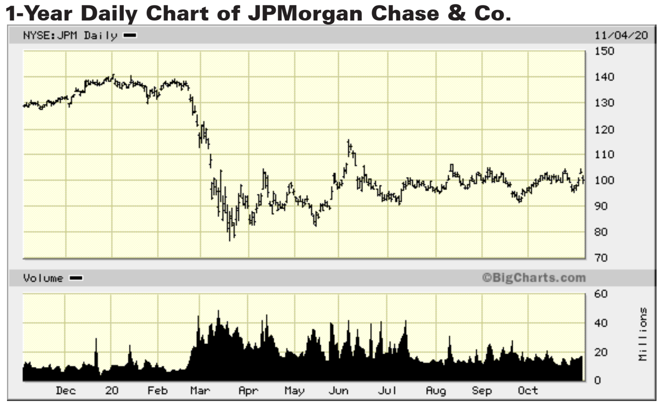

Chart provided by www.BigCharts.com

There are many factors that favor value in our mind today, but again, common sense should be one that favors it. If you're getting a dividend yield of 3%, as we are on our portfolios, and you're trading at valuation metrics that are significantly below the market average and significantly below metrics associated with growth stocks, far more so than they usually trade, the odds — no guarantees, of course, because there's never a guarantee in the stock market or anything — the odds, in my mind, are in favor of value stocks.

TWST: Would you tell us about a few of your favorite stock picks right now and share with us what makes them attractive and perhaps why you think the rest of the market is undervaluing them?

Mr. Buckingham: We seek to buy the things that other people aren't interested in. And we're like a farmer; we plant the seeds in the spring and harvest the crops in the fall. But when you plant it, you have an empty field of dirt, or so it appears, and so it takes time for the market to recognize the value inherent in stocks that we might like.

We own stocks like **FedEx** (NYSE:FDX), **Apple** (NASDAQ:AAPL), **Lowe's** (NYSE:LOW), **Newmont Mining**

(NYSE:NEM), **Qualcomm** (NASDAQ:QCOM), **Deere** (NYSE:DE) — things that have done well this year. But the same mindset that attracted us to those way back when we bought them, which was that other people were not interested in them and they were trading at very reasonable valuations, governs the way we're thinking today about things that we might be advocating if investors are looking to put money into the value space.

What are we looking at today? Given the gap between the haves and the have-nots, there are some very high-quality — in our view anyways — companies that are on sale. They include things like **JPMorgan** (NYSE:JPM), which is the big banking powerhouse; **Walt Disney** (NYSE:DIS), the entertainment giant; **Tyson Foods** (NYSE:TSN), which is a protein producer as well as involved in the plant-based food craze.

In the energy space, there's a French integrated giant, **Total** (NYSE:TOT), which of course is not just pumping oil and gas, it's also involved in renewables. In the health area, **CVS** (NYSE:CVS), which is obviously pharmacy but also managed care via their acquisition of **Aetna**. We like a company in the staffing services area, **ManpowerGroup** (NYSE:MAN), and in technology, **Cisco Systems** (NASDAQ:CSCO), which is networking equipment. In utilities, in Arizona, **Pinnacle West Capital** (NYSE:PNW).

But as **JPMorgan** and **Morgan Stanley** showed in the latest quarter, even in a low-interest-rate, pandemic-ridden environment, they can still produce substantial profits and, in all likelihood, will continue to grow over the long haul.

For those who are willing to be maybe a little more speculative, we also recently bought **Nordstrom** (NYSE:JWN), which is the department store giant. Why did we like **Nordstrom**? Well, we like their online presence. We like their commitment to customer service. We think that **Nordstrom** shoppers are loyal and will continue to frequent the company, whether it's brick-and-mortar or online. The stock this year has lost more than half of its value. The **Nordstrom** family has talked about taking the company private in years past. So there's certainly opportunity there in our mind.

But again, these are things that the investing world is saying, "I don't want anything to do with brick-and-mortar retailers," and yet many of them are going to make it through and, frankly, will be able to take market share. Not that **J.C. Penney** (OTCMKTS:JCPNQ) is a direct competitor, if you will, of **Nordstrom**, but as the number of department stores dwindle, those that remain, in our mind anyways, likely benefit.

"We seek to buy the things that other people aren't interested in. And we're like a farmer; we plant the seeds in the spring and harvest the crops in the fall. But when you plant it, you have an empty field of dirt, or so it appears, and so it takes time for the market to recognize the value inherent in stocks that we might like."

So those are the names that in our mind are quality companies that are trading at very inexpensive valuations relative to where they historically trade and relative to the overall market. And by the way, aside from **Disney** at the moment, they all reward us with generous dividend yields as well.

The common theme is that they're trading at attractive valuations and that we think the market is unfairly putting them in the penalty box because of near-term difficulties. **JPMorgan** had earnings out this week, which were very good. The stock went down on the news. Just because we like it doesn't mean they're going to turn around immediately. But that's why, again, generally speaking, we like to have the dividend income that allows us to be patient as we're generating a return on our investment along the way.

Our time horizon is three to five years, if not longer. We're not buying these stocks because somehow we think that in November they're going to skyrocket. We're buying them because we think they're quality businesses that are trading at attractive prices.

So these are names that we've held for a while. Some would say, well, what have you bought lately? What are your more recent picks? In our newsletter, of course, we have recommendations each month, not always something brand new every month, but we have had a few first-time names. For example, in the latest issue, we recommended **Morgan Stanley** (NYSE:MS), the big financial services conglomerate.

Why do we like **Morgan Stanley**? Well, it's trading at a very inexpensive valuation. They just had earnings out this week, which were very good. They have the diversification, if you will, of having a Wall Street presence, so they're making money from trading, underwritings and offerings, and of course still have the asset management, wealth management side of the business too.

The problem with financials these days is they all get lumped together, and the thesis is that low interest rates are bad for financials.

1-Year Daily Chart of Nordstrom

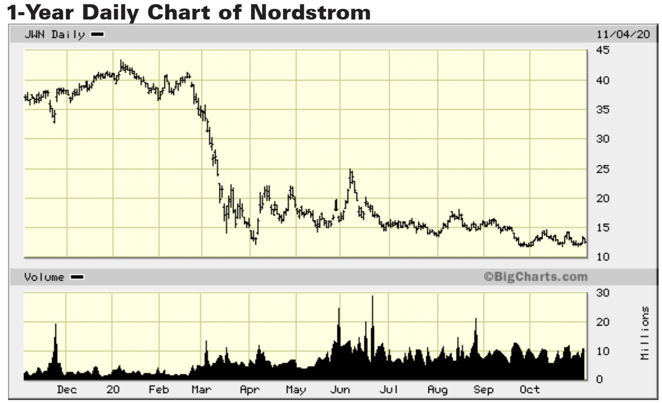

Chart provided by www.BigCharts.com

TWST: The department store area seems like a tricky one.

Mr. Buckingham: I agree with you. Historically, it has been. We know that many companies have struggled. But we believe that **Nordstrom** is a premier operator.

We owned **Williams-Sonoma** (NYSE:WSM), which last I checked is in the mall, but which performed well during the pandemic. Why is that? Because they had a substantial online business, and of course, now we're all cooking at home, and so there was much more interest in their products. Doesn't mean that the malls were open and you can shop in those stores. But again, people are mistaking the 1990s retailer for the current generation of retailer.

So in looking at **Nordstrom**, we think it is a name that discounts a tremendous amount of bad news. It doesn't discount bankruptcy, of course, but it discounts a lot of negatives that we do not think are going to materialize, so we feel we've got a margin of safety. But again, it is a very volatile stock, as it has been going up and down 3% every day it seems.

TWST: In terms of sectors or industries, are there any that stand out in your mind as presenting better opportunities?

Mr. Buckingham: When we look at our sector exposures, there are two things that should stand out if you are viewing us as a value investor, which is what we are, and that is that we are overweight by a wide margin in technology, and we are underweight by a less wide margin in financial stocks. It's not that we dislike financials because again, as I mentioned, we like **JPMorgan**. I mentioned **Morgan Stanley**. We have a whole host of financial stocks we like; we just don't feel that we need to have the kind of exposure that most value investors seem to have, which is often in the 18% to 20% range of a portfolio. We're more in the 14% to 15% range.

(NYSE:HPE), which is IT services; **NetApp** (NASDAQ:NTAP), which is a data storage provider; electronic manufacturing services company **Benchmark Electronics** (NYSE:BHE), which is a small cap; and even **IBM** (NYSE:IBM). **IBM** is in the process now of splitting into two to try to maximize shareholder value for their faster-growing cloud business, and we think that the sum of the parts of **IBM** is worth more than the whole, but by the way, we get a 6% yield while we wait for that all to play out.

So your question is, where is there opportunity? Clearly, we're making a larger bet on tech. We also are making bigger bets than maybe the benchmark on the consumer discretionary space. I mentioned earlier **Nordstrom**, but we also would look at stocks like **General Motors** (NYSE:GM), the big automaker; a footwear/apparel retailer, **Foot Locker** (NYSE:FL); toymaker **Hasbro** (NASDAQ:HAS); and homebuilder **M.D.C. Holdings** (NYSE:MDC).

"When we look at our sector exposures, there are two things that should stand out if you are viewing us as a value investor, which is what we are, and that is that we are overweight by a wide margin in technology, and we are underweight by a less wide margin in financial stocks."

1-Year Daily Chart of IBM

Chart provided by www.BigCharts.com

Technology, we are in the 23% to 25% range, which is significantly higher than the Russell 3000 Value benchmark weighting in the 9% to 10% range. So technology would be a key differentiator for us. I mentioned earlier that we own things like **Apple** and **Qualcomm**. We own **Microsoft** (NASDAQ:MSFT). Those stocks have performed well, but many value managers do not hold them.

People ask, "Well, what do you like today in tech? Hasn't everything in tech just gone up dramatically?" The answer is no, not everything has appreciated. I mentioned **Cisco** earlier, and **Cisco's** trading much closer to its low than it is to its high.

But the nice thing today is that there's a lot of opportunity in tech for companies with good balance sheets, with very reasonable valuations and with a generous dividend yield. In the past, tech stocks seldom paid dividends because the idea was that they would reinvest in their businesses and continue to grow as their sole focus. **Apple** pays a dividend, **Microsoft** pays a dividend, **Intel** (NASDAQ:INTC) pays a dividend, and **Oracle** (NYSE:ORCL) pays a dividend, and we own all of those names.

But things that haven't had their day in the sun would include, in addition to **Cisco**, something like **Hewlett Packard Enterprise**

We do see value in the consumer space. I know that consumers are pressured in terms of their own balance sheets, and obviously, there are a lot of people that are out of work, yet there are still a lot of people who are working, and as we saw with today's retail sales numbers, they're still shopping. In the case of something like an **MDC**, which is a homebuilder, they're benefiting substantially from lower interest rates and the desire of people to get out of the city and get into the suburbs. **MDC** is well-positioned for that. So consumer discretionary is an area where we're also overweight.

1-Year Daily Chart of M.D.C. Holdings

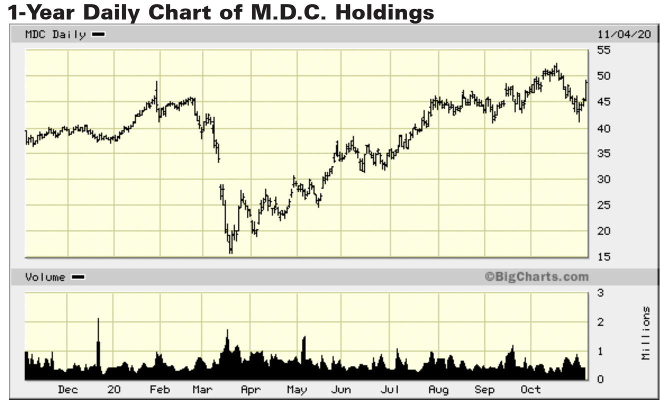

Chart provided by www.BigCharts.com

And then, industrials would be the third area that we're overweight. I mentioned **Manpower**, which is an industrial staffing service company. That's how it's categorized, as an industrial. We like **Caterpillar** (NYSE:CAT), big construction machinery maker. We like **3M** (NYSE:MMM), which is a diversified conglomerate; **Lockheed Martin** (NYSE:LMT), aerospace and defense contractor. There's opportunity, we think, in the industrial space.

So those are the areas where we would be overweight relative to other value managers. And then, if we think about underweight, in the utility sector, I mentioned **Pinnacle West Capital**, which is an Arizona utility, but that's our only holding in utilities. Most value investors have a greater position in utilities, but we just don't see a whole lot of opportunity there outside of **Pinnacle West**. Valuations are not that inexpensive; frankly, they're rich, and utilities generally speaking don't have a great growth potential to justify those high valuations. And frankly, dividend yields, which is usually an attractive part of utilities, aren't that great relative to what's available in the rest of the market.

There are a few opportunities, especially in West Coast utilities and electric producers, but we have a big issue out here on the West Coast, which are fires, and unfortunately, the utilities get blamed — often rightly so — for them. **Pacific Gas and Electric** (NYSE:PCG) and **Edison** (NYSE:EIX) were blamed for fires in the past. Oregon recently had horrible fires, and there's blame being placed on utilities there. There's a lot of potential risk in some of those names that may be attractively priced but, in our mind, just have too much uncertainty associated with them to justify a purchase.

TWST: You mentioned earlier typically looking at a three- to five-year hold. Describe your sell discipline, and is there a recent exit from a holding that you could share as an example?

Mr. Buckingham: The way we operate is that we assign target prices to all of our stocks, and when they're trading at discounts to those target prices, they would be things that we are comfortable holding, but as they approach or eclipse target prices, then we would be trimming or selling. The primary reason for us to sell something is it becomes fairly or overvalued.

Examples of things that we have sold recently, we've trimmed positions in some of our big winners, while we still think there's potential for higher prices and valuation, so we're willing to keep a portion of the holding. But from a risk-mitigation standpoint and to free up cash for other opportunities, in the last few months, we've sold some of our positions in **Apple**, **Microsoft**, **Deere**, **Cummins** (NYSE:CMI) and **Lowe's**.

I mentioned earlier **Williams-Sonoma**. That was an outright sale because that, in our mind, had reached its potential, and some of the concerns that you might have mentioned in regard to **Nordstrom** still exist with **Williams-Sonoma**. It's still a brick-and-mortar retailer. When you've doubled your money in a short amount of time, we felt it was time to move on to something else.

So that's the primary reason we sell, that stocks have reached our price objective, but we also know that every stock is fighting for its spot in our portfolios. We have a limited amount of money, and there are sometimes new names that look attractive, but as we don't have an infinite amount of cash, we have to evaluate what we own versus what we don't own. If a more attractive name becomes available, then we will make a switch.

An example of that recently was we exited our position in **HSBC** (NYSE:HSBC), the London-based Asia-exposed financial giant, and we bought **Morgan Stanley**. We sold our **HSBC** not because we necessarily dislike **HSBC** but because we like **Morgan Stanley** better from a risk/reward perspective. These days, **HSBC** struggles with issues associated with England and with China's influence on Hong Kong, and so we think there are too many question marks associated with **HSBC** going forward. Plus, the dividend has been suspended, and we wanted what we felt was a better risk/reward opportunity with **Morgan Stanley**, which sports a solid dividend yield of 2.7%.

The final piece of the puzzle in terms of when we would sell is that sometimes that risk/reward profile I mentioned becomes very unfavorable in our mind, even though we don't necessarily have something else to swap into. Something we sold not too long ago was **Carnival Corp.** (NYSE:CCL), which is the cruise operator. We still think the cruise industry is viable; as a guy who has cruised and I speak on investment cruises, I think it's still viable.

The problem with **Carnival** is they have to get from here to there, "there" meaning when we actually start cruising again, and in order to get there, they've got to issue a lot of debt and/or stock. They have to raise capital to survive. Unfortunately, the likelihood of cruising coming back keeps getting pushed out further into 2021, and so they've continued to raise more debt and issue more stock, and we felt that ultimately means that our ownership is going to get diluted so substantially that there wasn't a rational reason for us to continue to hold today. Once cruising begins again and they don't need to raise tons of money, then we might actually go back into **Carnival** at that point, but we wanted to free up that cash for other opportunities.

"The way we operate is that we assign target prices to all of our stocks, and when they're trading at discounts to those target prices, they would be things that we are comfortable holding, but as they approach or eclipse target prices, then we would be trimming or selling. The primary reason for us to sell something is it becomes fairly or overvalued."

TWST: We're speaking a few weeks before Election Day, but this will be published just a few days after Election Day. I am curious what you anticipate in terms of the potential impact on the markets of a Trump White House versus a Biden White House.

Mr. Buckingham: There's going to be, at least in our view, elevated volatility as we get closer to the election and potentially even after the election if we don't know who the winner is, or even if we do know who the winner is. Investors need to be braced for volatility. But our only vote, as we like to quip, is for maintaining a broadly diversified portfolio of undervalued stocks through thick and thin, no matter who is in the White House.

Conventional wisdom is that somehow the Democrats are going to be bad for the stock market, that a Democrat in the White House or a Democratically controlled Congress or both would somehow be bad for stocks. And the reason for that is that Republicans, in theory, are more pro-business, less regulation, creating a better business climate. But in reality — we're students in market history— stocks do better, believe it or not, under Democratic administrations.

Another reason to support value stocks is value stocks do extraordinarily well with a Democratic White House and Democratic control of Congress. The polls today anyway and the betting odds are telling us that it's going to be a Biden victory, and it's going to be a Democratic sweep of Congress.

I'm never going to make major portfolio moves based on the perceived outcome of an election, but I don't lose any sleep over a Biden victory. There's this view that Biden — he said it, he's going to raise taxes if he wins. Obviously, you need control of Congress to get that through, but let's say that actually happens. Well, there's this thought that taxes are going to go up, which again in theory is not great for the economy or great for the investor class, but in reality, again, stocks have done better under Democrats.

Even if you look at dividends, we've studied tax regimes and returns on dividend-paying stocks versus non-dividend-paying stocks because, again, the perception is that a Biden tax plan will raise dividend taxes back to ordinary income rates, rather than the preferred qualified rate where we're at today. But if you look at history, when taxes have been higher on dividends, believe it or not, dividend-paying stocks have done better than non-dividend-paying stocks, and vice versa, when there's been a "favorable environment" for dividend taxes, non-dividend-paying stocks have done better than dividend payers. There are these myths that exist out there that aren't true, aren't supported by historical data, so we think it's important for investors to actually crunch numbers before they just make a knee-jerk reaction and say, "Well, gee, a Biden presidency is somehow going to be bad for stocks or value stocks or bad for dividend-paying stocks."

The final thing that I think everybody is really worried about is the potential for a contested election if we don't have a winner on November 3. That seems to be the bigger risk. Ironically, and I know this is not coming out until after the election, so we're talking about recent events, but last week, the stock market had its best five days since July. As the media tried to figure out why, because of course that's what they're paid to do, the financial journalists have to tell us why it happened.

We were told that the market rallied last week — at least *The Wall Street Journal* told us this — because investors were pricing in less of a chance of a contested election and more of a chance that Biden would win. So a Biden landslide victory was a good thing according to *The Wall Street Journal* last week, but of course, two months ago, that wouldn't have been a good thing. The moral of the story is, even if you had the crystal ball and you knew what was going to happen, it doesn't mean that you can be sure of what the stock market is going to do or how it's going to react.

If you think back to the contested election in 2000, there was some turmoil in the week or so afterward, but value stocks went up in the time after that, and so it wasn't a bad environment for value even though we had lots going on with Bush versus Gore. The conventional wisdom does not always match up with what has happened historically. So I don't lose sleep over the election. Yes, there'll be volatility, but volatility creates opportunity, and again, stocks have done very well throughout history facing far worse environments, if you will, than Trump versus Biden.

TWST: Are there any other big-picture topics on your mind, for better or worse?

Mr. Buckingham: Developments on the health front, i.e., the fight against COVID-19, are super critical to the near term. Yes, I do worry about the increase we've seen in cases, especially in Europe, and the potential for renewed lockdowns. Obviously, we have flu season that is approaching, so that is something to worry about. But we locked down earlier this year, and well, the S&P 500 is higher now than it was then. So this idea that somehow the world is going to end because of COVID-19 just hasn't materialized.

I know it's not a good thing. I know if you have a loved one who died or you have the disease, that's obviously very personal and a different story. But the business of America is business. We adapt, we evolve, some businesses won't make it, others will thrive, but life will go on, as callous as that sounds. As an investor, you need to recognize and understand that.

We had terrorist attacks on U.S. soil on 9/11. The world changed. But we're 19 years after 9/11, and stocks are dramatically higher today than they were then, even though the threat of terrorism still exists. I don't think any of us think that, well, now that we have TSA screening at the airport there's potentially never going to be another problem on a plane. There are going to be other events, there have been other events around the world, yet life goes on, we adapt, and the markets continue to work their way higher over time. And the reason they do that is that corporate profits grow over time, and we don't see a reason why corporate profits won't continue to grow over the long haul.

Yes, there will be blips along the way such as we saw this year, but it's important to understand that when you're looking at owning a business, one or two quarters should not be the lion's share of how you're going to assign value to a particular company. Some might argue that 90% of the value of any stock should be on business and earnings that are going to be generated 12 months from now and beyond. And so yes, it's important what happens in the short run, but really, we're always focusing on the long run.

"Unfortunately, the likelihood of cruising coming back keeps getting pushed out further into 2021, and so they've continued to raise more debt and issue more stock, and we felt that ultimately means that our ownership is going to get diluted so substantially that there wasn't a rational reason for us to continue to hold today."

We've owned **Apple**, for example, since 2000, and back then nobody wanted it because it made computers that were used by 2% or 3% of the population, that was their market share, and you had to be a graphic designer to want to use an **Apple** product. Literally, **Apple** was in danger of failing, but they had a great balance sheet with tons of cash and a lot of rabid fans, and Steve Jobs became a visionary, even though on his first go-around with **Apple** he was fired.

The moral of the story is that life goes on, and if you can buy what we think are quality businesses when they're on sale, then you can have significant potential for long-term success, especially today when your potential yields on competing investments — I don't want to say there's no alternative, or TINA — but yields on competing investments are extraordinarily low today. That makes stocks attractive, and it makes dividend-paying stocks particularly appealing.

Again, we crunch a lot of numbers. We know that markets will be volatile. We know that in any given month there's something like a 37% chance that the market will be down, which means there's a 63% chance it'll be up. But if you can hold for a longer time period, you have a much greater chance of investment success.

For example, if you held for five years, at least based on historical data, your odds of not just making money but doing better than you might do today by buying a 10-year Treasury — the yield is about 0.7% — the chance that you'll get better than a 0.7% return over the next five years on value stocks has been about 88%. That's pretty high odds. If you went out 10 years, it becomes 96%, and if you went out 20 years, it's 100%. There's never been a period where you haven't made at least 0.7% a year.

So the longer you hold, the less the chance of loss, and that's really a lesson I think that many investors should learn: They need to stick with it, and they need to not be their own worst enemy and try to outguess the gyrations of the market.

TWST: Thank you. (MN)

JOHN BUCKINGHAM
Principal & Portfolio Manager
Kovitz
email: jbuckingham@kovitz.com