No One to Answer To
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Dear Fellow Investors:

Two watershed events were announced in the last two weeks. First, Warren Buffett disclosed a massive amount of open market purchases of US large-cap stocks. Second, Legg Mason announced that Bill Miller is "stepping down" as Chief Investment Officer of his firm and as manager of the Value Trust. These are two of the greatest stock pickers of all time and the change in direction for both men is driven by who they answer to and how favorable investing could be in the US large-cap space going forward.

In 1999, at the Allen and Co. event in Sun Valley, Buffett warned how poorly technology stock investments would do going forward and how muted US large-cap returns would be from 1999 to 2016. He explained how the Fortune 500 companies were trading at 30 times profits and that profit margins were at the high end of historical ranges. Therefore, he laid out an incredibly difficult road for those who pick large-cap US equities.

Buffett runs a holding company in which he is the largest shareholder. In effect, he answers to no one. When publicly traded US large-cap stocks got way over-priced in the late 1990's, Buffett shifted to private equity purchases of entire companies. He bought all the outstanding shares of General Reinsurance and Geico. He made numerous smaller acquisitions like Mid-American Energy. Buffett got his investments away from having the prices quoted every day and allowed his publicly traded portfolio to become a minority of Berkshire's assets. He continued that approach in 2009 by buying all of Burlington Northern and recently bought Lubrizol.

Bill Miller beat the S&P 500 index for 15 straight years making his shareholders, his parent company and himself very wealthy. The last five of those years included much less spectacular returns between 2000 and 2005. He ran relatively concentrated portfolios and was adored by the media. The index has gone nowhere for 12 years and Miller answers to shareholders. They have expressed their disappointment by driving Value Trust's assets down to $2.8 billion from a peak of $20 billion. Bill stepped down voluntarily or was asked to. Either way, it is exactly what happens at the end of a stretch where investors have been massive net liquidators of US Large-Cap stocks.

Buffett has no career risk and no one to answer to. He told Becky Quick on TV that he feels US large-cap stocks are undervalued relative to other asset classes. He bought $10.7 billion of IBM (IBM) and added to Wells Fargo (WFC). His underling, Todd Combs, bought shares of numerous US large-caps for Berkshire as well. Buffett is happy at these prices to get back into public shares priced every day.

In 1999, Buffett felt that two things beside market levels could affect overall stock prices. He said that a drop in government interest rates from 6 percent to 3 percent would double the value of stocks. He also said that high sustained profit margins would positively impact stock prices. Both of those have happened. Lastly, stocks have done worse than Buffett expected despite these facts.

We believe putting this all together for us as contrarians means one thing. The time to net liquidate US large-cap equity is over because Bill Miller is being given up on and Warren Buffett believes the risk reward in these stocks is very favorable. In our opinion, it is time to buy a concentrated portfolio of US large-cap stocks. We suggest you do this while avoiding the BRIC trade, in case you have someone to answer to.

Best Wishes,

William Smead

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