FRIDAY, OCTOBER 20, 2023

Well, Hello and welcome to the Dividend Cafe. I am at the end of our annual Money Manager Week and here in New York City. By the time you're watching this, actually, I should be back to California. I'm recording for my apartment at the end of the day on Thursday, and it's been an absolute whirlwind of a week. It our last meetings concluded this afternoon with a luncheon event at the Economic Club of New York put on with Federal Reserve Chairman Jay Powell. And prior to that, the money manager and hedge fund meetings and so forth. A couple of the research firms we work with, we really had a very busy schedule, but as always is the case, very enlightening illuminating and I will take advantage of my time on the plane Friday to get a lot of the takeaways organized and condensed and written up. So count on hearing a lot more about this week. I want to let the, these things appropriately percolate and come back 'cause there's definitely some actionable items and some key takeaways I think will be fun to summarize for those who are interested in that deeper dive. What I decided to do with this week's Dividend Cafe is get caught up again with the questions that come in. We try to answer one or two per day in the DC Today , but sometimes the volume gets up to a level where there's a few that build up and we can use this to answer the questions in Dividend Cafe, but of course, it's not really about merely responding to somebody.

I could always just do that, and in fact, I do quite a bit just respond directly by email and it doesn't necessarily make the print. The reason that I think this is an effective way to do Dividend Cafe about once a quarter is that, the questions cover

topics that are probably on everybody's mind. And that's the ideas to cover a multitude of topics from real life questions. That then can help hopefully be helpful to a wider audience. And it doesn't hurt that this week, not only am I trying to do that for you all, but the idea of writing a whole Dividend Cafe after this week. I have a big dinner event downtown tonight and then leaving at five in the morning Friday. It just works out to make this a Q&A. So let's get into it.

The first one was somebody wondering about our desire to see dividend growth in the holdings that we buy and our equity portfolio strategy revolving around companies that can consistently and do consistently grow their dividend and what type of grace we allow for extraordinary items that when something comes up unexpected, could it even be a positive for the company to not raise the dividend and maybe even cut it.

Because of maybe a cyber attack or an unforeseen impediment or interruption to business? I think it's a very good question, and the answer though is very reaffirming of what we believe about the dividend growth, portfolio integrity, which is I do believe there are times that the right thing for a company to do may be to cut their dividend.

But I do not believe that it is right for us to own that company and that the exceptions that I've seen where we don't even necessarily mind that a company had cut the dividend in the past. We're forward looking is one of the best examples is

coming out of the financial crisis, there were certain huge banks.

There's one that we bought after the financial crisis that we still own to this day, that their dividend cut was forced upon them by the Federal Reserve. Now most of the companies, the financial firms that were cutting the dividend then didn't bring it back 40 years, and in some cases still haven't because there are no position to do so, and they are still all good, medium and bad companies.

Ones that were good, medium or bad at the time of the financial crisis or good, medium or bad. Now they're still subject to very intense federal reserve stress test every year. But we didn't hold against some companies that we believe had managed their affairs well through the financial crisis that actually were liquidity providers to the country, and that had been in a absolutely robust position of annual dividend growth ever since.

Based on the Federal Reserve forcing them at that time. Now, we didn't own it when it happened. We bought it after. But my point being, that's an example where we want to do discernment about past events as we think through the future. And we're well aware that if you're gonna own large financials in the United States, post GFC, post Dodd-Frank, that the Federal Reserve is going to be telling you if you can and cannot pay a dividend.

And we factor that into our thinking. But the example of like a cyber attack, the example of a business interruption to me is part of the reason we care so much about a firm's balance sheet. The defensiveness within the company operation and company capital structure that allows them to be able to maintain a dividend through a business interruption so that they can take a hit and still have the balance sheet strength to persevere when one is over levered.

Or has a very high dividend payout ratio with no margin of error and then has some sort of intervening event, extraneous event that it's, they obviously would be in a very weakened position for dividend payment. But we want to own companies that we think have the durability to continue. And I'll look at a couple of the largest oil and gas companies in the world that we own and have owned for a very long time.

That they basically went to $0 oil during COVID because of the excess supply, excess inventory lack of storage capacity lack of any demand. You had just a as bad a circumstances you could make up. And the companies were able to maintain their dividend, but they weren't able to do that because the cash flows were so good in that period.

It's 'cause they had levers. Around both their balance sheet strength and their ability to decrease capital expenditures for a period of time and then ramp those back up when appropriate. And so those were extraneous circumstances that you would think like, Hey, that'd be okay if they cut the dividend then,

right? And yet they still didn't. And that's a byproduct of the defensiveness that they've embedded in their financial structure. And that is the defensiveness we really like. So we would always take it case by case, but there have been companies. We believed we're going to cut the dividend and we decided to sell and they ended up cutting the dividend later. And almost always, it's a very bad situation. There are times that could be the right thing for the company to do. There are also times that we believe the risk reward trade off indicates the dividend cut could come and that we just make the decision to exit and it doesn't end up coming. And I wouldn't change a thing because. Our job is not to predict the future, it's to think about the risk reward trade-offs around those scenarios. That's how we think about it. Great question. Much appreciated. All right.

Jeff had asked what I think about the dollars reserve currency status when you have China and Russia allegedly wanting to end that reserve status and maybe cut them out international because of what the US has done to impact China and Russia's presence in the international banking system. Is there some fear of China and Russia ending the dollars reserve status? I've obviously written about this a lot. I've talked about it a lot. I've devoted a whole podcast with Sam Res to this subject, but it's worth repeating because the media harps on it and a lot of people in the professional fear-mongering industry harp on this.

That, oh, the US will lose its dollar status. And I first of all wanna remind people of a difference between reserve currency and transactional currency. When you talk about Middle Eastern countries trading oil and gas with China, and something like 0.003% of transactions have now gone in the wand instead of petrodollar, which is 0.003% more than before.

But nevertheless, let's not get carried away here. Okay? That is still settling at the end of the day in dollars. In other words, what people end up holding in their reserves are dollars. And for the very simple reason that a country like China doesn't allow the free flow of capital, nobody is going to use Chinese currency is the currency they hold in their reserves.

It is the free flow of the dollar. You say, well, yeah, but . The dollar. Sometimes they do reckless things with American fiscal policy. You still have to show me a company, a country that does less reckless things that's hard to come by. You look at monetary policy right now, we're actually tighter. A lot of, you're getting a higher yield to carry us denominated, dollar denominated treasuries, for example, than you are most other countries. But that has not been the case for a long period of time, and yet even then, most other countries were attempting to weaken as well. So you have a fiscal and monetary race to the bottom.

Everybody's bad and the dollar represents the best neighborhood, the best house in the bad neighborhood type of

deal. Ultimately, I think that trade flows, capital flows, economic strength, and military strength. It isn't like there's this second place country coming up on our heels. It's just simply not even quotes.

And I think people fail to understand the reserve currency versus transactional, and I think they fail to understand the relative nature of how foreign exchange currency works to begin with, and I simply do not fear the dollar, losing reserve status anytime soon. Someone asked about California governor Gavin Newsom had signed a bill that increased the minimum wage for fast food workers to $20 an hour.

What my thought on the ramifications would to that would be I think that and by the way there, it doesn't have to limit this to Newsom in California because there's higher minimum wage in a lot of states. And there's been higher price pressure, for labor period. And so, the re higher cost of labor, does that represent some kind of a problem, especially when it's, government intervention, federal or state doing it?

California is as unique to a industry and at a very high level, but the reality is that this is not me waxing and waiting political, I'm just trying to provide a economic common sense. These companies are gonna end up paying less in total labor costs, not more. It provides the incentive for them to accelerate plans to replace workers with kiosks and with technology and with solutions that do not go past the marginal utility.

And so if it is affordable and reasonable, And in the right cost benefits trade off that they're going for to pay someone 14 an hour and they have to go to 20 an hour at that level of unit cost divided by the massive amount of hours and workers they're already doing it. They're already replacing that burden with technology.

And would they clear a price for labor for entry level, low skill labor without such a burdensome minimum wage? I think they would. But I think technology comes in because of that government intervention. So I think this has a political overtone to it, but that's not my intent. I'm just very confident in my economic analysis on this.

If the US dollar's getting stronger, which it has been obviously the last several months in particular wouldn't we see imports increase? In other words, other countries exports increase, which is our imports because the other countries gain an advantage in trade. The, they're receiving higher value dollars and a weaker currency helps those export driven companies.

Then when they receive the dollars, wouldn't that cause them to buy more treasuries? And if that's the case wouldn't we, eventually see this current period of lower foreign ownership, lower foreign purchases of treasuries cycle through? That's the setup of the question. The answer is theoretically yes, by the way, but the reason the answer is practically no for now is that construct, that setup, the framework isn't Volatile.

It can't be volatile. It has to become a bit more embedded. And right now you actually had a lot of volatility. The dollar had weakened at some point a number of years ago, but then really strengthened substantially in 22. It had come back down a little in 23 before rallying again the last couple of months.

And I think at this point now we're actually over three months. So I think if you had a more stable, strong rising dollar, that would result in theory all else being equal to rising imports, which would result in more dollars having to be repatriated in the us. Now one of the big theories that I'm very sympathetic to is that it, while people think China's buying less treasuries, that they're likely buying treasuries to a lower, a slower pace, but not as low as people think and holding them outside of us custodians that it's a little harder to track, but that they're definitely buying

Agency bonds, Fannie Freddie Bonds, I think it's $75 billion worth this year. And so there's still dollar denominating there. So that is resulting in dollars coming back in, but instead of putting into treasuries, they're putting it into different type of dollar denominated US debt. But no, I basically would agree that at some point, if you see imports rise, you just gotta remember that it's more than just dollar, relative dollar strength that would drive imports.

You also need greater economic growth globally. I. Because then there's higher exports from other countries, higher imports, US countries, the production and consumption side,

working pro cyclically, and that's why exports plus imports is indicative of greater economic strength if you have weakening economic metrics.

Or there is some sort of forward vision into weakening economic metrics, the currency that might become second place and you may still not yet grow higher imports. That's one of the issues with China right now in exports, is that the weaker economic conditions are just simply resulting in less trade and therefore less on the back end of this question, less dollars that could be go flowing into treasuries.

Okay. What else do we want to cover here? How long have I been going? Alright, we got time for a little more. Someone had asked, based on what I wrote in Dividend Cafe last week about the 50 years of Middle East tensions, the long precedent of up, down, up, down, and the long-term story of what human nature really represents.

It manifested in geopolitics, and yet if there were to all of a sudden just be a real escalation, some very severe break that, what would our kind of disposition about asset allocation be? And in a way, with all respect, the question is okay, I read Dividend Cafe, but like, what if it really does get bad?

And of course, what the different cafe said is, well, it has gotten bad and it will get bad. And I still am standing by my belief that there needs to be a properly constructed asset allocation in anyone's portfolio at any time. That accounts for

these realities of human nature. And so if what someone means is, well, what if there's a nuclear war that wipes out humanity?

I find that prospect hard to think about hedging. I find, world War three, four and five apocalypse stuff. To produce unreliable counterparties. But if one just means, look, what if things really get scary? Do I really actually believe what I'm saying? And the answer is, yes, I do.

And in fact, there are sit times in which as a opportunistic and long-term investor, Those things. I don't want any death. I don't want any destruction. I don't want bad things to happen to people, but bad things that can happen out of these tail risk events in the market are extremely opportunistic. I would love to buy more risk.

The S&P is trading at 19 or 20 times earnings right now. I don't think people are exactly pricing in World War III here. Okay. But to the extent that you had a significant move down in markets catalyzed by an escalation in the Middle East, catalyzed by China invading Taiwan, catalyzed by an economic super recession in the United States.

Anything that people do love to think about, worry about my response would not be to become more defensive. It would be to become much less defensive. Do I need to think about the X dividend date when buying a dividend stock? No, you don't.

The market has already thought about it for you. Markets aren't dumb.

It's already priced in. Finally, I wanna reiterate about the similarities between China now and Japan and the late eighties, early nineties. I more or less believe that there are a lot of things playing out and overinvestment and misallocation of capital and real estate. Property. Declining demographics in terms of working age, population various elements of governmental malfeasance that are problematic, some more sinister than others, but nevertheless incompetence in late eighties Japan, and I think communist evil in 2023 China. Do I think that it will all play out the same way? I do not. I did write a Dividend cafe about this a couple months ago. I. I think a lot of things could become very similar. And I do think on the fiscal side, China is facing a lot of pressure. They haven't fully given into all of it yet, but they're facing a lot of pressure to buy into this notion of China ification which is a Japan ification done in China, whereby they use a lot of fiscal stimulus to intervene.

But do I think that the monetary policy will follow suit? It hasn't yet. They've shown indications. It may not, but we're very early innings. That would be, to me, the big question. Will China try to go to a zero bound? Will they go to yield curve control? Will they attempt to dramatically weaken their currency?

I think there's a lot of reason believe they won't, but that would be the question. As to the real follow up of China's economic predicament going the way of Japan. And so that's stuff that

I'm gonna be following for years to come, quite frankly. Okay, I'm gonna leave it there. I do need to get to this event.

I hope you got something outta this. We covered a lot of things and I certainly welcome questions anytime. I love going through them. I have very big plans for next week's Dividend Cafe. I'm quite excited, but I'm gonna leave you in suspense. And with that, thank you as always for reading and listening and watching the Dividend Cafe.

We'll see you next week.

Due to the publishing time constraints for us to produce our daily missive, podcast, and video, the best we can offer at this time is a machine-generated transcription which contains errors. We will continue to work to improve this service and appreciate your patience with us.