April 11, 2023

In the first quarter of 2023, Banyan's equity composite returned 2.5% compared to the S&P 500's total return of 7.5%. Over the trailing three- and five-year periods, our equity composite compounded at 17.3% and 10.6% per year, respectively. We have compounded at 11.3% per year since 1991 (click here for details).

General Thoughts

We long for a boring year after a pandemic in 2020, a bubbly 2021, and a harsh 2022. Maybe 2024 will comply. So far, 2023 has not. By mid-March, multiple banks had already failed, including Silicon Valley Bank and Credit Suisse. We will not get into the gory details here (see our March 14th email, *A Note on Bank Runs*, for our opinion), but these are not good omens.

Despite this, we have no market forecast for 2023. For readers with a strong opinion on the matter, ask yourself this – Had you known in January 2020 that a pandemic would shudder the economy, would you have foreseen the S&P 500's 18.4% gain for the year? If not, we caution against forming a strong opinion now. If so, please submit your resume (and crystal ball) to Charlene.

In the short-run, stock prices are governed by the forces of demand and supply, which hinge mostly on investor sentiment. Sentiment does not lend itself to predictions. For proof, simply think of your most intimate relationships. How often are you surprised by a spouse, child, or friend's mood, much less behavior? Predicting the mood of an infamously fickle herd of strangers is far harder.

As Warren Buffett opined in his 1969 letter to partners,

> "I find it much easier to think about what should develop over a relatively long period of time than what is likely in any short period. As Ben Graham said: 'In the long run, the market is a weighing machine – in the short run, a voting machine.' I have always found it easier to evaluate weights dictated by fundamentals than votes dictated by psychology."

We obviously agree. This has been Banyan's approach to investing since 1987. It strikes us as more logical, more repeatable, and, best of all, more likely to be profitable. Unlike sentiment, value is measurable, albeit inexactly, and stock prices must track business value over the long-haul. For this reason, our time is best spent monitoring the *scales* of value, not the *polls* of sentiment.

Selling Altria

Our time at the scales of value led to a few decisions in the first quarter. Two are worth noting. Altria (MO) resumed its prior habit of malinvestment, so we sold. We also took the weight of a Dutch outfit, Heineken Holdings N.V. (HKHHF), and, surprised by its heft, bought a small position. The latter will be discussed at another time. We will discuss the sale of Altria here.

For a refresh, Altria is America's largest tobacco company. Its main division, Philip Morris USA, sells Marlboro, Parliament, Virginia Slims, and other leading cigarette brands domestically. It also sells the smokeless tobacco brands Copenhagen, Skoal, and others. Finally, Altria owns roughly 10% of the world's largest beer brewer, Anheuser-Busch.

Forget why we sold Altria for a moment. You are right to wonder why we ever owned it. Everyone knows big tobacco is dying, right? In some ways, yes. In 2022, American cigarette volumes were 72% off their 1980 peak due to litigation, regulation, health, and stigma.[1] But times have never been better financially. Altria's tobacco business earned a *record* $11.9 billion in 2022.[2]

This offers a prime example of unintended consequences. Big tobacco's main competitive weapon and expense, advertising, was banned on television via regulation in 1971 and virtually everywhere else via litigation in 1998.[3] Ironically, this made the tobacco business better. In addition to much lower expenses, no advertising meant no competition. Incumbents were free to hike prices at will.

As shown below, Altria's shareholders benefited greatly from this arrangement. Note, however, that the below data includes Altria's various spin-offs, including its non-US business, Philip Morris International (PM). To a degree, excluding the spin-offs would reduce Altria's shareholder return.

Total Shareholder Return
S&P Capital IQ
1981-2022

Altria	27,392%
S&P 500	8,096%

[1] Total cigarette consumption in the United States peaked at 631.5 billion units in 1980 (see Total Cigarette Consumption in the U.S. 1900-2015, Statista Research Department (Dec. 9, 2016)). By 2022, volumes had fallen to 176.8 billion units, according to Altria's data. This equates to a 72% decline in unit volume.

[2] My calculations are for Altria's cash enterprise earnings, or operating income plus depreciation and amortization minus capital expenditures. Years back, Altria earned similar amounts when results included its international tobacco and consumer businesses, which were later spun-off.

[3] *See*, *e.g.*, Sarah Milov, *The Cigarette: A Political History*, Harvard University Press (2019), 152 (noting, "In 1970, the tobacco companies acceded to legislation that banned television advertising beginning at the stroke of midnight on January 2, 1971 . . . ."), *and Id*. at 290 (noting, "Companies [under the Master Settlement Agreement] [] agreed to a range of marketing restrictions: Joe Camel was retired; free product samples were banned; sports sponsorships were outlawed; product placement was forbidden.")

With this history in mind, we saw Altria's predictable business, inexpensive stock, and generous dividend as a decent "safe harbor" for otherwise idle capital. Our results were satisfactory. We originally paid $44.23 per share on February 23, 2021, and sold for $46.59 per share on February 28, 2023. We collected $7.20 of dividends per share in the interim. Our total return was 21.6%, which exceeded what we could have earned on cash, bonds, or even the S&P 500.[4]

We sold Altria for two main reasons. First, the yield on six-month Treasury Bills, a cash substitute, rose from 0.05% to 5.17% during our holding period. This matters a great deal. To belabor Ben Graham's "weighing machine" analogy, government bond yields are used to calibrate the scales of value. Rising yields stretch the yardstick and make the scales more demanding. Businesses fall in value, all else equal, as capital gravitates towards the lower risk alternative.

Second, Altria resumed its habit of poor capital allocation. No habit is more insidious to corporate health. Hence our concern when it was rumored (and later proved) that Altria was buying NJOY, a vaping company, at a very high price. We had assumed Altria's new CEO had learned from his predecessor's disastrous investment in JUUL. Clearly, he did not. This altered Altria's risk-profile and, thus, invalidated its status as a "safe harbor" in our view.

For a time, Altria contributed to our purpose of ***building permanent wealth***. Its contribution was lessened, however, as rising yields made short-term government bonds a more welcoming refuge for idle capital. This made the decision to sell Altria easy once its risk-profile changed for the worse. It could no longer pass muster at the more demanding scales of value.

Sincerely,

Drew Estes, CFA, JD
Portfolio Manager

[4] The S&P 500's total return was 5.3% over this timeframe, according to S&P Capital IQ data.