BANYAN CAPITAL MANAGEMENT

July 16, 2024

Dear Client,

Banyan's equity composite gained 4.5% through the second quarter of 2024 versus the S&P 500's total return of 15.3%. Since the start of 2019, when yours truly officially took the helm, Banyan's equity composite has compounded at 13.8% per year versus the S&P 500's compounded total return of 17.2% per year. For more details about our equity composite, please click here.

A Frothy Market

Our benchmark, the S&P 500, is frothy, perhaps even bubbly. That is a challenge for Banyan. As "value investors," we are price sensitive. We demand more in value than we pay in price, in other words, and we are conservative when estimating value. Banyan's approach has served our clients well since 1987, but it does not shine brightest in frothy markets. Our calculators get in the way.

Our approach may even seem old-fashion today. (That makes me an old fogey at the age of 33!) Admittedly, you will not hold court at a cocktail party talking about our recent buys. Try it. The next time a friend brings up a hot AI stock, tell them you own Vontier (VNT), a gas pump maker. But beware – the conversation may shift to a more agreeable topic like politics.

Seeming old-fashion does not bother us, however. It is a rite of passage that every "value investor" goes through at some point. In the late 1960s, for example, a young Warren Buffett grew frustrated with a frothy market. These were the "Go-Go" years. By 1969, Buffett had had enough and closed his investment partnership.[1] Two years before, at the age of 37, Buffett wrote,

> "I am out of step with present conditions. On one point, however, I am clear. I will not abandon a previous approach [to investing] whose logic I understand, . . . even though it may mean forgoing large and apparently easy profits, to embrace an approach which I don't fully understand, have not practiced successfully and which, possibly, could lead to substantial permanent capital loss."[2]

We feel the same today, which reminds us of another time in Banyan's history. The dot-com bubble was the rite of passage for my predecessor, Gary Watkins. Banyan owned none of the hot internet stocks. As a result, in 1999, the S&P 500 *gained* 21.0% while Banyan *lost* 5.2%. At year-end, Banyan's trailing five-year annual return (1995-1999) lagged the S&P 500 by *over* 6.8% *per year*.

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[1] Buffett Partnership Letter (May 29, 1969), republished by Ivey Business School, page 129, *available at*: https://www.ivey.uwo.ca/media/2975913/buffett-partnership-letters.pdf.

[2] Buffett Partnership Letter (October 9, 1967), page 113.

Despite dwindling cocktail party invites, Gary stuck to his guns. Then, in 2000, the bubble burst. By year-end 2002, the S&P 500 had *lost* 37.6% of its year-end 1999 value while Banyan had *gained* 2.7%. By year-end 2004, $100 invested with Banyan ten years before in 1995 had grown to $418, gross of fees, while $100 invested in the S&P 500 would have grown to $313.

Clearly, seeming old-fashion proved wise once the dot-com bubble burst; we believe it will again prove wise in the years ahead. Perhaps it is merely the old-fogey in us, but we see many similarities between now and the dot-com bubble. Consider the following:

- **General Valuations** | The S&P 500's trailing price-to-earnings ratio was 30.5 at year-end 1999 versus 28.0 at quarter-end.[3] Those who accepted the S&P 500's "earnings yield" of 3.3% at year-end 1999 nursed losses until 2010, more than a decade later. The S&P 500's quarter-end "earnings yield" of 3.6% is hardly better.

- **Big Company Premium** | Today, the valuation premium of large companies over smaller companies is as wide as the dot-com bubble.[4] This is a common attribute of frothy markets, including the "Go-Go" years that frustrated a young Warren Buffett.[5] Hence our recent attraction to smaller companies (e.g., VNT, PHIN, HSIC).

- **Popular Company Premium** | Likewise, popular stocks now trade at a valuation premium over unpopular stocks that rivals the dot-com bubble.[6] Here again, money has flocked to the best performing stocks, which has benefited our best performing investments (e.g., AAPL, PH, AXP). We have trimmed these positions to fund new positions.

Accordingly, we are quite comfortable looking old-fashion today, even if it makes keeping up with the Joneses difficult. We will not leave our calculators at home anytime soon. Banyan's approach has served our clients well since 1987. It provides a well-trodden and proven path to ***permanent wealth***. We will not abandon that path for a fashionable detour to an unknown destination.

Welcome, Bill Knorr

Please join us in welcoming Bill Knorr to the Banyan team. Bill and I have known each other for almost twelve years. We became fast friends at the University of Alabama School of Law. Bill

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[3] Data from S&P Global, *available at*: https://www.spglobal.com/spdji/en/documents/additional-material/sp-500-eps-est.xlsx (using trailing twelve months of reported earnings, which includes an estimate for Q2 2024).

[4] *Diversify Beyond Mega-cap Stocks*, ETF Market Outlook, State Street Global Advisors (June 3, 2024), Figure 2, *available at*: https://www.ssga.com/us/en/intermediary/etfs/insights/etf-market-outlook/diversify-beyond-mega-cap-stocks?WT.mc_id=social_etf-etf_etf-market-outlook-web_us_lkdin_img_n_mf2_n_jun24socialetf&spi=6668675a8d0cde592a73dcad

[5] *A Time for Quality in Small-Mid Cap*, The London Company (Nov. 15, 2023), Figure 2 (citing Furey Research Partners), *available at*: https://www.tlcadvisory.com/a-time-for-quality-in-small-mid-cap/.

[6] Larry Swedroe, *Large-Growth Stocks Are Overvalued*, Morningstar (April 24, 2024), *available at*: https://www.morningstar.com/portfolios/large-growth-stocks-are-overvalued-small-value-stocks-are-undervalued-heres-why-it-matters

enjoyed the study of law, but, like myself, investing was his passion. We spent many nights talking about stocks when we should have been studying. Those countless hours were well spent after all.

Bill has a great pedigree. He has a Bachelor of Arts in Philosophy from the University of Michigan and a Juris Doctorate from the University of Alabama School of Law. Bill, like myself, is an inactive Member of the Georgia Bar. Furthermore, Bill has passed the first of three exams needed to receive his CFA Charter; he will take the second exam this November.

Before joining Banyan, Bill practiced law in the financial industry. He reviewed and negotiated bond and derivative contracts at Credit Suisse and Wells Fargo from 2018 through 2019. In 2020, Bill joined SMBC Nikko in New York City where he focused on corporate and municipal debt as well as compliance. SMBC Nikko promoted Bill from VP to Director before he left in June.

Bill's main priority at Banyan is to become the best investor he can be. His personality is ideal for the task. He is curious, emotionally stable, intellectually humble, honest, smart, and passionate. In addition to investing, Bill will handle compliance, which is an enormous relief to Charlene and I. He will also be cross-trained on all critical tasks in order to make Banyan a more resilient firm.

We are fortunate to have Bill on the Banyan team; he will contribute immediately to our mission of ***building permanent wealth***. Please take a moment to call the office. We would love to introduce you to Bill whether over the phone or in person.

Sincerely,

Drew Estes, CFA, JD
Portfolio Manager