FCI ADVISORS

# PERSPECTIVES

*Second Quarter 2022*

## *Follow the Money*

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The phrase "follow the money" was popularized in the 1976 film "All the President's Men." The film details the Watergate scandal which ultimately led to President Richard Nixon's resignation. Whispered to Bob Woodward by Deep Throat, "follow the money" supposedly meant to filter through the lies and deceptions to find the truth about the Watergate scandal.

As analysts, much like an investigative reporter searching for the truth, we are trained to identify an investment's primary drivers. This objective is complicated by the seemingly endless amount of data, news and opinions available to investors – all meant to supposedly help improve performance. By tuning out the noise and applying certain "follow the money" principles to investing we can uncover a simplified and common sense way to achieve success.

**Insider Activity**

A long-time industry adage is *corporate insiders sell their stock for many reasons, but they buy for only one reason* – they expect the stock to appreciate in value. No matter how much company research is performed prior to investing, the insiders running the day-to-day operations have the ultimate vantage point from which to evaluate their business trends and outlook. In fact, one of the core investment tenets of FCI's Value Equity strategy is to filter stocks based on insider buying activity.

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Year-to-date there has been a violent selloff in many growth oriented stocks that were the darlings of the last several years. Streaming video giant, Netflix, saw its stock drop over 20% the day after their fourth quarter earnings report, which included an outlook for slowing new subscriber additions. Dire news stories on the demise of Netflix appeared and short-term investors were eager to sell at depressed prices.

Shortly thereafter, CEO and Founder Reed Hastings disclosed an open market purchase of $20 million worth of Netflix stock. Not only was this a substantial investment, but it was the first time on record that he has made an open market purchase of his own stock. We could provide a lengthy investment thesis detailing why the fundamental outlook for Netflix will continue to improve over the next several years. However, the person that knows the company better than anyone just gave a pretty clear signal to investors.

**Incentives Matter**

What matters most to corporate executives when shaping their vision and strategy for a company? Typically, management's efforts are focused on maximizing their own performance incentives. A smart board of directors will align those incentives with shareholders. Alphabet, Google's parent company, has incentives in place for all five top executives based on the stock price performance versus the S&P 100. In the case of CEO Sundar Pichai, he can earn an extra $180 million based on the share price performance from 2021-2023.

It is no wonder that recently Alphabet has become much more shareholder friendly. They have increased financial disclosures of key segments, become more cost disciplined, repurchased $50 billion of their stock in 2021 and just announced a 20-for-1 stock split. The stock has outperformed the market for the last one, three and five-year periods, as well as so far this year. Like insider buying, these actions don't guarantee outperformance, but they certainly tilt the odds favorably.

**What is Buffett Doing?**

When Warren Buffett makes an acquisition, investors tend to notice. It is not overly controversial to say Buffett is the most patient, disciplined value investor of all time. Admittedly, he does not face the same pressures to put cash to work or generate short-term performance as most professional money managers. Over the last few years he largely sat on the sidelines not finding any companies that meet his criteria for long-term ownership. Instead, he found more value in repurchasing shares of his own company, Berkshire Hathaway.

Given the lack of acquisition activity and general underperformance of his stock versus the broader stock market, many articles were written in the 2018-2021 time period about Buffett losing his touch. As if right on cue, a few weeks ago he announced the acquisition of property and casualty insurer Alleghany for $11.6 billion in cash, his largest since 2017. Shares in Berkshire Hathaway have also been a safe haven during this recent bout of market weakness with the stock up substantially more than the S&P 500 this year and last 12 months. We have noticed those negative articles on Buffett's performance have quietly disappeared. Hindsight is always 20/20, but his quote "be fearful when others are greedy and greedy when others are fearful" aligns with his actions over the last few years and remains a key reason for his success.

**Signal versus Noise**

So far this year both stock and bond markets have declined, a rare occurrence in market history. A laundry list of reasons, ranging from the Fed and inflation to Russia's invasion of Ukraine help to explain this decline. Soon we will have mid-term elections to consider, after which the markets' attention will undoubtedly fixate on a new issue. These episodes of noise can prevent even the savviest professionals from making sound investment decisions.

At FCI, our research efforts involve the pursuit of the signal, following the money so-to-speak, the meaningful information important to long-term investors. This involves focusing on the long-term, fundamental drivers of a business and determining what factors make that particular business worthy of investment. While unwanted macro events may cause volatility in global markets, the core strategy of a business (such as Alphabet in the example above) is typically not altered. Just like Buffett and Hastings, we continuously seek to place our clients' capital into strong fundamental assets particularly when the day-to-day noise of the current market provides attractive opportunities for investment.

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