October 6, 2022

Q3 2022 INVESTOR UPDATE

Fixed Income markets are now offering one of the best opportunities we've seen in the last decade. A confluence of events – higher interest rates, financial turmoil in the UK, and forced liquidations by fund managers – have come together to provide the rare opportunity to invest in fixed income with the prospect of achieving historical equity-like returns.

But first, a quick reminder of how we think about our core fixed income portfolios. We invest in bonds solely for the economic interest in those bonds. In other words, we purchase a bond with the expectation of receiving timely payment of principal and interest, and with the full expectation that we will hold our bonds to maturity. As the duration of our portfolios is relatively short, and principal and interest continue to be paid to us per expectations, we have a very good idea of what our returns will be over time.

Market fluctuation then, is not particularly concerning to us. It is true, that occasionally the market will offer us the opportunity to sell out of a position at a profit and reinvest at higher rates, thus adding to our total return. But it is also true that when the market sells off, we must only do precisely nothing to achieve our originally targeted results, assuming we have done our credit work well.

Of course, we can also juice total return by buying aggressively when markets sell off, and that opportunity presents itself today. We see the ability to invest in taxable (and often tax advantaged) fixed income securities today at prospective high single digit and even low double-digit yields. In the municipal bond space, we've purchased 10 year-ish duration California municipal bonds in the past week yielding 6%, and are currently focusing efforts on building portfolios with blended yields exceeding 5% and durations of 5 years and under.

As mentioned above, these opportunities are the direct result of our firm handedness in the face of others' jitters.

Segueing quickly to equities, we would note that we think of stock ownership much in the same way we think of bonds – we own stocks for the economic value of the cash flows produced by these businesses. When we buy these interests, we fully intend to hold them for a decade or more – if we're lucky - knowing that long-term ownership is the key to unlocking the power of compounding, and the key to reducing frictional costs such as capital gains taxes. It's a given then, that we'll be invested through periods of market and economic volatility. It's the bargain we make at the outset; accepting volatility in exchange for the prospect of higher returns. In that context, current market conditions are neither surprising nor alarming to us. Nor do we see markets as accurately reflecting the value of what we own – merely what the market is willing to pay today.

Of course, this stance is made easier by a particular mindset. Joe and I both embrace Nassim Taleb's concept of anti-fragile businesses, i.e. businesses which are not particularly vulnerable to technological upheaval, regulatory fiat, or economic cycles. But the term antifragile doesn't just mean "not fragile" or "unbreakable"; It refers to systems that are able to benefit from adversity, stress, and chaos. This explains our attraction to a business such as Apollo/Athene which not only enjoys a fortress like balance sheet but has the capital to buy back its own stock meaningfully when the market misjudges the economic value of the business.

Recognizing anti-fragile businesses is easier said than done. Much of our ability to do so is the result of our experience through previous periods of adversity, stress, and chaos. Often, it's the mistakes we've made in the past which provide us the best guidance for navigating our way forward. Each period of turmoil adds to our body of experience and allows us to become better investors, to learn from our mistakes and to improve our performance, to recognize the time for prudence and to seize the day when action is warranted.

-Arch Peregoff
-Joseph Di Scala