



Guidance from Buffett, Fink, Gross and Siegel An End-of-Quarter Letter to Clients

By Dan Richards
July 12, 2011

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Given recent unrest in Europe and uncertainty about economic growth, many clients are looking to their advisors for direction.

This template for an end-of-quarter letter is intended to be a starting point for your own letter to clients, one that can be a catalyst for a conversation about how to position portfolios.

In the past, I have used quotes from Mark Twain, Winston Churchill, Benjamin Graham and Warren Buffett to set the tone for these templates. This quarter's letter again uses a quote from Buffett, along with Larry Fink, Bill Gross and Jeremy Siegel.



One note of caution – to be effective, this letter has to reflect your approach, personality and point of view. Be sure to take the time to customize the letter to incorporate your own views.

July, 2011

Buffett, Fink, Gross and Siegel – Finding opportunities in today's market

"Money will always flow toward opportunity and there is an abundance of that in America ... Human potential is far from exhausted and the American system for unleashing that potential ... remains alive and effective.

Warren Buffett

Berkshire Hathaway Letter to Shareholders, February 2011

"We are telling investors if you're worried about sovereign credits, if you worry about US Treasuries, there may be greater safety in equities, especially high dividend stocks"

Larry Fink, CEO, Blackrock

CNBC – June 29, 2011

"In terms of the stock market, there are amazing opportunities ... (compared to US government bonds) there's a huge gap and a huge differential."

Bill Gross, Morningstar Fixed Income Manager of the Decade



CNBC - June 7, 2011

“We’ve almost never seen valuations (on the US stock market) this low when interest rates are as low as they are today relative to bonds today, I’ve almost never seen such compelling values.”

Professor Jeremy Siegel, Wharton School

Author: Stocks for the Long Run

Business News Network – June 28, 2011

At the end of each quarter, I send clients a letter summarizing events of the past three months ... and try to find relevant quotations to establish the tone.

Given the recent concerns about European debt and uncertainty about economic growth, in this quarter’s letter I am sharing recent perspectives from four of today’s most respected stock market observers: Warren Buffett; Morningstar fixed-income manager of the decade Bill Gross; Wharton professor Jeremy Siegel, considered today’s leading stock market historian; and BlackRock CEO Larry Fink.

Before getting to their views, here’s a quick recap on the first quarter.

Market performance in the first half

Developed markets registered solid gains in the first quarter, despite the setback from March’s earthquake and tsunami in Japan.

The second quarter was a different story, with concerns arising from growing inflation threats in emerging markets, sovereign debt worries in Europe and a downgrading of growth forecasts for the global economy. Below are first half results for key markets – note that these are in local currencies, so that the effect of swings in the dollar are not reflected here.

Percentage change (all in local currencies)

2011	US	Europe	Japan	Emerging Markets	World Markets
First quarter	+6.0%	+2.2%	-2.8%	+0.4%	+3.3%
Second quarter	-0.8%	+0.6%	-2.4%	-2.5%	-0.7%
First half	+5.2%	+2.9%	-5.1%	-2.1%	+2.5%

Source: MSCI

Now let’s look at what those four market observers have said recently.



Warren Buffett – “Betting on America”

In November of 2009, Berkshire Hathaway spent \$26 billion to buy the 77% of rail giant Burlington Northern that it didn't already own. In interviews, Warren Buffett referred to this acquisition as “betting on America.” Buffett has been consistent in his positive outlook for the U.S. economy, looking past short-term events to focus on American ingenuity and resolve and its ability to attract the best and the brightest from around the world.

Buffett is regarded as the greatest investor of all time. In the 46 years he's run Berkshire Hathaway, annual growth in book value has exceeded 20%, more than twice the gains for the U.S. stock market index. Even more remarkable, Buffett's growth in book value is after tax, while the index's gains are pre-tax. And while he lagged in individual years, in his last letter to shareholders Buffett pointed out that there has never been a five-year period where Berkshire Hathaway underperformed the S & P.

To put his record into dollar terms, \$1,000 invested in the Standard & Poors index of US stocks at the start of 1965 would have risen by the end of 2010 to \$62,620. By contrast, that same \$1,000 under Buffett's stewardship would have grown to over \$4 million.

Here's an excerpt from this year's letter to investors, published in February.

“Last year – in the face of widespread pessimism about our economy – we demonstrated our enthusiasm for capital investment at Berkshire by spending \$6 billion on property and equipment. Of this amount, \$5.4 billion – or 90% of the total – was spent in the United States. Certainly our businesses will expand abroad in the future, but an overwhelming part of their future investments will be at home. In 2011, we will set a new record for capital spending – \$8 billion – and spend all of the \$2 billion increase in the United States.

Money will always flow toward opportunity and there is an abundance of that in America. Commentators often talk of “great uncertainty. Throughout my lifetime, politicians and pundits have constantly moaned about terrifying problems facing America.

Yet our citizens now live an astonishing six times better than when I was born. The prophets of doom have overlooked the all-important factor that is certain: Human potential is far from exhausted, and the American system for unleashing that potential – a system that has worked wonders for over two centuries despite frequent interruptions for recessions and even a Civil War – remains alive and effective.”

Here's a [link](#) to Warren Buffett's February letter to shareholders.

Larry Fink – “Greater safety in equities”

My next two experts are not nearly as well known to the investing public – but are household names among professional investors.



Larry Fink is CEO of Blackrock, the world's largest asset manager at over three trillion dollars. Blackrock's roots are in bond investing. Despite that, here's what Fink said in a June 29 interview with CNBC:

"Corporations worldwide are bigger than ever ... their cash holdings are gigantic right now..."

"We are telling our investors if you're worried about sovereign credits, if you're worried about US Treasuries, there may be greater safety in equities, especially high-dividend stocks and there may be greater safety in very high-quality corporate bonds worldwide."

Bill Gross – The case for dividend-paying stocks

As manager of PIMCO Total Return Fund, the world's largest bond fund, Bill Gross turned in a track record matched by few others and last year was named Morningstar Fixed Income Manager of the Decade. In part, his success stems from his willingness to take contrarian views; in 2010, he went on record talking about the "new normal" of lower growth, higher inflation and increased risk in holding debt of governments around the world.

He has recently turned negative on US government bonds, recommending high-quality corporate bonds and Canadian and Australian government bonds instead of US Treasury bonds. In a June 7 interview on CNBC, he also discussed the appeal of brand-name stocks that pay dividends:

"In terms of the stock market, there are amazing opportunities in real interest space. I mean, a Procter, a Johnson & Johnson, a utility company, Southern, Duke, as a whole they yield 3 1/2 to 4 percent in terms of their dividend yield compared to a negative .5 percent in Treasury space on that five-year. And so there's a huge gap and a huge differential if an investor is willing to take a minor downgrade in terms of credit."

"Corporations are in the catbird seat. They've got cheap financing, cheap leverage. They've got cheap labor and the ability to move from one country to another at their will. And so corporations basically have done very well, will probably continue to do very well."

Gross did add a note of caution:

"But to expect their margins to expand at the expense of labor here in the United States, at the expense of laying off additional workers, relative to their wages, real wages and their total nominal wage growth I think is an unrealistic expectation. I think corporations basically are at the top in terms of profit margins. Doesn't mean that stocks are going to go down. It simply means that the catbird seat basically has been taken advantage of and that the heyday is probably in the past as opposed to the future."



You'll find a transcript of his recent interview [here](#).

And here's a [link](#) to the interview in June of 2010 on the new normal of slower growth globally.

Jeremy Siegel – “Why valuations are attractive”

My final expert is Wharton's Jeremy Siegel, considered today's leading stock market historian. His book *Stocks for the Long Run* examined 200 years of financial market performance and has been ranked as one of the most influential investment texts of all time. Among Siegel's claims to fame is an article in the Wall Street Journal in March of 2000, at the peak of the Internet bubble, warning about the excesses in tech stock valuations.

In a June 28 interview on Business News Network, he explained why he's bullish on US stocks:

“We've almost never seen valuations (on the US stock market) this low when interest rates are as low as they are today ... relative to bonds today, I've almost never seen such compelling values.”

And here's why he, like Bill Gross, likes dividend-paying stocks:

“History shows that dividend-paying stocks beat inflation and are good investments for income, especially in the early stages of a financial recovery such as we see today ... The top 100 dividend-yielding stocks of the S & P 500 over the last half century beat the index by two and a half percent and did so with lower risk.”

Here's a [link](#) to the full interview.

Be sure to modify the section below to your own views

What this means to investors

In today's low interest rate environment, it's hard to make a compelling case for cash except as a portfolio diversifier and a source of liquidity. As for bonds, Larry Fink and Bill Gross represent the growing sentiment that the risk in bonds is rising, as economies recover and interest rates start to rise.

Which leaves stocks. Whether you adopt the “least of evils” view of stocks compared to bonds, as Fink and Gross advocate, or join Warren Buffett and Jeremy Siegel in embracing stocks more enthusiastically, there are clear values in high-quality stocks that pay dependable dividends. Today, you can find quality companies with strong cash flows



that provide a comfortable backing for their dividends and also have the potential for dividend growth in the period ahead.

For the past few years, I've tilted the equity component of client portfolios towards stocks with strong cash flows and above average dividends. These higher-quality companies haven't always outperformed firms with weaker balance sheets and low or no dividends. In 2008, all stocks dropped dramatically, regardless of quality. As for the last couple of years, since the spring of 2009 we've seen a "junk rally" in stocks in which low interest rates favored more levered firms.

I don't believe that's likely to continue, as over time quality stocks will outperform. Meanwhile, dividends provide a floor for stock prices should we see increased markets volatility. Like Bill Gross and Jeremy Siegel, I believe there are exceptional opportunities in the stocks of high-quality, dividend-paying companies for long-term investors.

Some well-known US companies that pay dividends over 4% include pharmaceutical leaders such as Eli Lilly, Bristol Meyers Squibb, Merck and Pfizer and a number of utilities. In the 3% to 4% range you'll find consumer products multinationals such as Heinz, Johnson and Johnson, Campbell Soup, Avon, Procter and Gamble, Kraft, General Mills and McDonalds.

In the period ahead, I or one of my team will be in touch to discuss how your portfolio is positioned. Should you have any questions in the meantime on your portfolio, the contents of this note or any other issue, please give me a call – I'd be happy to answer your questions on the phone or at our next meeting.

As always, thank you for the opportunity to work together.

Best regards,
Name of advisor

[Dan Richards](http://www.clientinsights.ca) conducts programs to help advisors gain and retain clients and is an award winning faculty member in the MBA program at the University of Toronto. To see more of his written and video commentaries, go to www.clientinsights.ca. Use A555A for the rep and dealer code to register for website access.

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