

John Huber, Managing Member

(919) 610-6809

john@sabercapitalmgt.com

www.sabercapitalmgt.com

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Note to Investors: Time to “Zoom Out” (Presidential Edition)

Dear Investment Partner:

This is probably the first and the last time that I’ll go into general political and so-called “macro” concepts in an investor note, but since the election is on everyone’s mind, and since some clients have asked for my (inconsequential) opinion, I thought I’d share some general thoughts. Think of this not as a view on the election, but a view on America: the greatest “business” in the world—one that I am very bullish on and one that I believe will compound intrinsic value over many decades to come.

However, my views have nothing to do (nor were they impacted whatsoever) by the election. My overarching view of this country would be no different if Hillary Clinton had won, and my view remains the same under a President-elect Trump as it has been the past eight years under President Obama. I certainly believe that some candidates and certain policies are better than others, but my general view on America—especially when viewed through the lens of an equity investor—does not change much based on who moves into the White House.

America Needs to “Zoom Out”

Steve Jobs used to talk about “zooming out” when faced with a difficult problem or when thinking about a complicated issue. I think it would behoove the American electorate to occasionally zoom out when discussing the implications of presidential election outcomes, which seem so life-altering in the heat of the present moment.

In 1901, Theodore Roosevelt (a Republican) was sworn into office after the assassination of President William McKinley. As Roosevelt was making his routine daily rides on his horse from Pennsylvania Avenue to Potomac Park, America’s gross domestic product was around \$21 billion.

Let’s fast forward a few decades to Franklin D. Roosevelt (a Democrat who governed much differently than Teddy, despite sharing the same last name). FDR was famous for bigger government and the stimulative projects and entitlement laws that collectively became known as the New Deal.

The time period from the beginning of the Republican Roosevelt’s term to the end of the Democrat Roosevelt’s time in office included a variety of economic adversities including:

- Eight economic recessions
- A lesser known, but still severe Depression in 1920-21 that included the worst bout of deflationary conditions since 1790, with wholesale prices dropping 37%
- An epic financial panic in 1907 that included a 50% crash in stock prices and a run on the banks that nearly collapsed the US banking system, leading to J.P. Morgan himself pledging his own capital to shore up the banks (*"The Panic of 1907" in large part led to the establishment of the nation's central bank—The Federal Reserve—in 1913*)
- The Great Depression, a time when unemployment rose to 25% and stock prices dropped 90%
- Two long, brutal World Wars that exacted a toll on America's psyche and challenged its resolve

However, despite these massive headwinds, America's GDP grew from \$21 billion in 1901 when the first Roosevelt took office to around \$228 billion by the time the second Roosevelt died in office in 1945—a remarkable 11-fold increase in 44 years. During this time from the turn of the 20th century through the end of the second World War, Republicans held the White House for 24 years, Democrats the other 20. America forged ahead, whether being led by the "red" or the "blue".

Postwar to the Present Time

The postwar era has seen a similar balance, as the political pendulum continues to swing back and forth, but all the while the economy marches on. Since 1945 through the end of 2016—a **72 year period—Republicans have held the presidency for 36 of those years—exactly the same amount of time as Democrats.** Not only was the time in office divided right down the middle between the two parties at 36 years apiece, but also the individual presidencies—there have been 12 presidents since FDR: **6 Republicans and 6 Democrats.**

Remarkably, during each of those 12 presidential terms (including the shortened terms of JFK and Nixon), GDP was higher when each president left office than it was when he entered. Through 72 years of Republicans and Democrats, the nominal GDP has grown from \$0.2 trillion to \$18.6 trillion, a 93 fold increase and a 6.4% compound annual growth rate.

A better measure would involve adjusting these numbers for inflation, which produces numbers that are equally astounding. Real GDP per capita was around \$13,000 (in today's dollars) in the mid-1940's. The real GDP per capita today is around \$56,000, more than a 4-fold increase in purchasing power and standard of living in just two and a half generations.

Of course, moving the needle on an \$18 trillion economy is much more difficult, and the economy will not grow nearly as fast as it did in previous decades, but as Buffett has pointed out in his recent letter, even 2% growth in real GDP will produce much greater standards of living just one generation from now:

"America's population is growing about .8% per year... Thus 2% of overall growth produces about 1.2% of per capita growth. That may not sound impressive. But in a single generation of, say, 25 years, that rate of growth leads to a gain of 34.4% in real GDP per capita... In turn, that

34.4% gain will produce a staggering \$19,000 increase in real GDP per capita for the next generation. Were that to be distributed equally, the gain would be \$76,000 annually for a family of four."

America Is a Great Pond to Fish In

America has an incredible two-fold advantage. The first is geographical. The US has benefited from a vast amount of land, including over 300 million acres of fertile farmland, 400 million acres of pasture, and nearly 100 million acres of woodlands. The country also has significant amounts of fresh water, as well as natural borders on both the eastern and western sides of the country that have served to both protect and to be ports of commerce. And the energy resources of this country are immense, including an abundance of coal, oil, and natural gas.

But a big part of the country's success has been combining the benefits of its vast natural resources with a system of government that has allowed its citizens the freedom to work hard, pursue great new ideas, and risk capital in pursuit of financial gain.

The system we have in place here in America has resulted in a level of prosperity that surely would have been unimaginable when the founding fathers were meeting down in Independence Hall to lay the groundwork and the principles on which the United States of America was founded.

Throughout our history, we've had volatile periods. The country has been involved in wars, social injustice, poverty, depressions, financial panics and instability at times. The country has seen great leaders and ineffective leaders, productive lawmakers and political gridlock. But the great thing about our country is the genius behind the framework that was assembled during the decade that culminated in that epic summer of 1787 when the Constitution was ratified and the three branches of government were formed, giving power to lawmakers, executive leaders, and judges—but balancing their power in a manner that has proven to be remarkably resilient over time, especially when viewed through the lens of world history.

My 5th grade teacher taught me a long time ago that the founding fathers designed the Constitution in such a way that no one person would have too much power and control over the government. This balance of power is such a simple concept. Like many great businesses, the concept could have been etched on the back of a napkin. But that simple concept has been stitched into the fabric of our freedom, and it is still just as true today as it was at the beginning.

To be sure, there have been growing pains that at times have been felt inequitably by certain communities or certain portions of the labor market.

Dock workers fought tooth and nail against the mass adoption of the container ships, which eventually eliminated their jobs at the ports in LA, New York, and elsewhere. But the simple invention of the box metal container led to drastically lower shipping costs and allowed manufacturers to reduce their working capital requirements, speed up their asset turnover, make their supply chains more nimble, and eventually allowed them to increase the breadth of products

that they could make and eventually sell to the end-user—all at a significantly lower cost to the individual consumer.

The dock workers were hurting temporarily, but the collective long-term benefit to the overall consumer (in the form of better selection of merchandise at lower prices) outweighed the temporary plight on the docks.

As Buffett pointed out in a recent letter, in 1900 there were about 90 million acres of farmland devoted to corn, with a yield of around 30 bushels of corn per acre. It took around 11 million farm workers to harvest this land. Today, there are around 85 million acres of farmland for corn, but the yield has gone from 30 bushels per acre to around 150 bushels per acre. This significant 5-fold increase in output has been accomplished with just 3 million farm workers (around 25% of the total workforce that it took to farm the land a century ago).

This 20-fold increase in farm worker productivity meant that 8 million farmers had to go find new lines of work. But collectively, just like the dock workers, the farmers and their families (and society as a whole) have benefited in a big way over time.

America will continue to come up with new ideas and will continue to create and build some of the world's best companies—ones that provide necessary services or innovative products to its customers, which will lead to greater revenue and earning power for those companies. Owners (shareholders) of those companies will see their wealth increase along the way.

This economic progress will happen when Republicans hold control in Washington, just as it will when Democrats do.

Political Disagreements Are Nothing To Fear

“What has been will be again, what has been done will be done again; there is nothing new under the sun.” – Ecclesiastes 1:9

Political disagreements have always been a part of this country. The freedom to exchange ideas, to speak freely, and to voice opinions is one of the foundations of our nation's Constitution. But again, it helps to “zoom out” to gain some perspective. No one election poses an existential threat to our existence, which is what you might think if you read the opinion columns or heaven forbid, glance at Facebook or Twitter.

We often view history with a nostalgic filter. For example, we remember our founding fathers for all the great things they did (and they were truly great). But we generally don't focus on the fact that many of them owned slaves and the architects of the Constitution “compromised” by counting slaves as 3/5th the value of a free person when it came to determining the population.

Another example is the collection of laws in FDR's New Deal, out of which came Social Security—something that is now considered a “right”. But in the 1930's, (like the ACA today) Social Security was heavily debated with enormous amounts of heated and opinionated rhetoric being thrown

from both sides. Glance at any newspaper archives from the 1930's and you'll see language and opinions that look very similar to disagreements we face today. But Social Security is now widely considered untouchable.

I mentioned the Panic of 1907 earlier. There are many similarities to this financial crisis and the one that occurred almost exactly 101 years later in 2008. Like many panics, there was effectively a run on the banking system, panicked depositors, crashing stock prices, shrinking liquidity and eventually a bailout. One key interesting difference: in 1907, a small group of individuals (as opposed to the government) led by J.P. Morgan himself pledged to put up his own capital and convinced other Wall Street bankers to do the same (shoring up the banking system in the process). While these two panics a century apart had very different causes, they unfolded with similar symptoms (greed followed by fear and herd behavior) and were resolved using similar remedies (an injection of liquidity from reputable individuals/institutions). Both crises left people angry, led to heated debates, and eventually to government regulations.

The Constitution itself was hotly (and even bitterly) debated, and in the end only secured 39 votes from the 55 delegates, barely enough to ensure support from all the represented states at the Convention. So political disagreements are nothing new, and are nothing to fear.

Last Thing on Politics

If you don't like who won, just wait a few years. Just when all hope seems lost for a particular side, the political pendulum swings the other direction. In 1974, Richard Nixon resigned the presidency in disgrace, and political pundits everywhere were talking about the destruction and end of the Republican Party. Six years later Ronald Reagan defeated the incumbent Jimmy Carter, and four years after that, Reagan won 49 of 50 states in the biggest landslide in modern political history, getting nearly 60% of the popular vote. Eight short years after this 1984 blowout, Bill Clinton took back the White House for Democrats.

The political pendulum is very predictable—like clockwork. In fact, since FDR, Democrats have not held the White House for more than two terms in a row, and Republicans have done that only once (Reagan and Bush held office from 1981-1993).

America's system of government transcends the power of whoever sits in the White House. The fabric of this nation and the foundation of our system are much stronger and much more inevitable than any one man or woman, or any particular body of lawmakers. The country's checks and balances will continue to work, and the pendulum that has swung back and forth between the subsets of ideas that exist on both sides of the aisle will continue to swing.

Throughout the inevitable fights, gridlock, ineffective leadership, and bad policies that have (and will surely continue to) come out of Washington, the American economy marches on and the best American businesses flourish. This has always been the case, and for the foreseeable future, this will continue.

Owning a piece of this great system is a sure-fire way to succeed. It's a lottery ticket that is certain to pay off over time. And the best way to own a piece of America is to own a collection of great businesses that take advantage of this great system. As stockholders of some excellent companies, that is what we are attempting to achieve as investors here at Saber.

So if you like Trump, then bask in the sun for the next four years. If you don't like Trump, then know that your time is just around the corner. But either way, regardless of how good or bad you think Washington is doing, America will collectively be more valuable in 4 years and in 8 years than it is now, just as it is more valuable now than it was 4 years and 8 years ago.

As a quick reminder, I've started writing what I'll call "investor notes" periodically between the two semi-annual investor letters. In the next few weeks, I'll send another investor note that will get back to basics and resume discussing things that are much more relevant to our portfolio, including a new investment we made recently.

I feel lucky and fortunate to be able to do the work that I do, and I want to thank you for trusting me with the management of your capital. Feel free to reach me anytime.

Your Partner,



John Huber
Managing Member
Saber Capital Management, LLC
john@sabercapitalmgt.com