

Forbes

MARKETS

3 Stalwart Stocks For Your Permanent Portfolio®

WALLACE FORBES, CFA CONTRIBUTOR

AN INTERVIEW WITH MICHAEL CUGGINO, PRESIDENT AND PORTFOLIO MANAGER, PERMANENT PORTFOLIO FAMILY OF FUNDS.

I recently spoke with Michael Cuggino, president and portfolio manager of Permanent Portfolio Family of Funds, about his fund's strategies and what sectors and stocks he favors.

Wallace Forbes: What was the genesis of the Permanent Portfolio Fund?

Michael Cuggino: The fund was launched in 1982 as an answer to the market dynamics of that time. Think high inflation, weak economic growth, rising short-term interest rates, poor stock market performance, elevated gold and commodity prices, the energy crises of the 1970s, and the Hunt Brothers and "Silver Thursday." Many of us of a certain age remember gas lines, stagflation and the Ford administration's "WIN" (Whip Inflation Now) campaign.

The question at that time was what should an investor do in such a climate? How do you not only make some money on your investments, but also protect your wealth from uncertainty and erosion? Permanent Portfolio was designed as an anecdote to these questions and that period, but the concerns are universal and timeless, applicable in any market environment, including today's.

Unfortunately, a lot of investing is predictive and forecast-driven; which assets and markets are going to go up and which ones are going to go down and when, and managing this dynamic forecasting on a



constant basis. The problem with this is that human beings are not very good at predicting the future—whether it's football games, what the Federal Reserve is going to do next week, or market performance in any asset class. People get it right once in a while, but more often than not, we're just plain wrong, or we get the idea right, but the timing wrong.

And so, the objective of our fund was to get around that weakness in human nature. To provide an investment that seeks to preserve capital regardless of the investment climate, to grow capital in excess of

inflation, but doing it in such a way that we're not having to predict markets, interest rates, central banks or geopolitical risks, etc. on a day-to-day basis.

We developed a strategy that identified a variety of different asset classes that we believe are an integral part of an investor's overall wealth plan over a long period of time and put them together in one fund at certain target percentages. This spreads investor reward potential and risk mitigation over a wide range of possibilities or outcomes, not betting on just one.

The asset classes we've identified as being necessary to such wealth accumulation are gold and silver, U.S. and non-U.S. equities and fixed income, Swiss Franc assets, commodities and real estate.

Forbes: These are your current sectors?

Cuggino: Yes. We believe that the properly diversified investor should have exposure at some level to these assets all the time. And so, our thinking goes beyond the traditional Wall Street, balanced model of 60/40 stocks to bonds, or some tactical allocation among stocks/bonds/cash. We view our model as being more comprehensive, more "permanent" if you will.

Forbes: So it doesn't really change with time?

Cuggino: The strategic overlay does not. We've identified a target weighting or tar-

get percentages in each of these asset classes: 20% for gold, 5% for silver, 10% for Swiss Franc assets, 15% for hard asset stocks, natural resource and real estate-related, 15% in traditional growth stocks, and 35% in what we call “dollar assets,” which are U.S. Treasury securities and investment-grade corporates and other high-quality types of fixed income securities.

Forbes: Is it an index fund?

Cuggino: No, we don’t balance out to our targets every day like an index fund would, and while we are never that far from our targets, our asset allocation typically does not match our targets. They are more of a guidepost for us. Because markets are always changing, the assets are not expected to match the targets. But when one or more of the asset classes deviate from those targets by more than 25%, we will rebalance or correct the discrepancy within a ninety day period.

While our Permanent Portfolio Fund is an asset allocation fund and rebalancing is a given in such a strategy, we don’t believe that on a day-to-day basis you need to trade that much to achieve the long-term objective of wealth accumulation. We view ourselves more as a low-turnover, longer-term or market-cycle investment product.

There are certain philosophies to our firm that we believe in. Diversification is obviously one, so is tax efficiency. This strategy helps to minimize trading and trading costs and maximize tax efficiency. If you’re trading every day based on short-term dynamics or trends, it gets to be very costly to the investor, with the higher short-term capital gain tax rates, and higher turnover costs, such as commissions, fees and spreads.

Most people think the cost of investing is confined to the costs of operation, the management fees and trading costs. Those are all true, but one of the biggest costs investors incur and don’t necessarily think of is taxes. And while those have been brought down by the recent tax legislation for some investors, they’re still pretty high. Long-term capital gain tax rates are much lower, so if you can minimize the tax cost on short-term trades in favor of longer term trades, that benefit accrues to the investor.

Forbes: Are you primarily invested in the U.S.?

Cuggino: Yes, primarily in U.S. stocks and bonds but have the ability, and do, invest globally. We believe our investments in precious metals and commodities are also global assets. Although our stock and bond investments are primarily U.S. based, most of them have significant non-U.S. operations. It’s our way to play the global economy, but avoid the currency risks that would come with investing directly in local markets. We’ll also invest in ADRs for example. We want to take the currency issues off the table so as to isolate pure equity or bond performance and not get a muddled mixture of currency and equity returns. There are too many other factors that affect currency values, political events, central banks, etc., and by getting drawn into those issues, you’re not getting the true value of the equity or bond.

Recently we’ve had a very strong U.S. dollar vis-a-vis some of the other major currencies in the world. As a result, emerging and certain other non-U.S. markets have really taken a hit so far this year despite generally improving global growth. And so, currency performance can really offset what the price and yield performance is on a stock or bond.

Also, we are a relatively small firm, and believe that our investors are better served by investing in U.S. companies with significant non-U.S. business that have their boots on the ground in a country or countries, and that are involved in those local markets on a daily basis, in a way that we could never be.

Forbes: What have you been investing in during the current market?

Cuggino: As I mentioned, we’re always fairly diversified. I think when you look at where we are for equities in the middle of 2018, we’ve had a very interesting year. The Dow is up about 2% year-to-date, the S&P 500 is up about 6% and smaller stocks are up substantially more than that. We’ve had a tremendous amount of volatility throughout the year, but until recently, we’ve ended up near where we started the year. Much of the gains are concentrated in just a few names. So overall, a lot of drama but not much performance.

When you look at fixed income, you’ve also had some volatility, but overall, a gradual selloff during the year as interest rates

have gone up, mostly on the short end of the curve as the curve has begun to flatten. And I don’t think we are done with the current rising rate cycle. I think there’s more to do there, the questions being, how much more, at what speed, will the long end keep up, and what if it doesn’t.

Inflation also is starting to firm. And we have potentially higher sustainable growth in the U.S., improving growth abroad and rising global interest rates. To the extent that these factors continue, you’re going to have more interest rate increases come from the world’s central banks on the horizon. So obviously bond performance has been down this year in a lot of sectors due to these expectations.

And so, where does that leave us? It leaves us with mixed performance across the board and a lot of volatility. And in that situation, our Fund has historically performed fairly well over the long term because of its focus on diversification, on having exposure to multiple asset classes and multiple scenarios. We are currently about break—even for the year with stock and bond performance being offset by weaker precious metals pricing.

Against that backdrop, on the bond side we’re looking at U.S. Treasuries, and to a larger extent, investment-grade corporates, those with strong balance sheets, solid businesses and short duration, in a variety of industries. The Permanent Portfolio’s overall duration is probably between three and four years right now. A little bit higher on the Treasury side and a little bit lower on the investment-grade corporate side. Our Swiss bonds also have a roughly three-year duration.

In equities, we’re looking at industries we think are going to benefit over the long term from a growth-oriented economy—think financials, industrials, transports, materials, commodities, and traditional growth stocks such as tech and biotech. We believe the marketplace is in a transition phase right now. We’ve had quite a bit of time in this post-2008 period with a low, subsidized, interest rate environment, little inflation, anemic growth in the U.S. and in some countries, recession, higher taxes, increased regulation, etc., so really muted economic performance, if you will.

And over the last couple of years, you’ve had a shift driven by, really, a change in administration, a change in economic think-

ing, to something more that is resembling, stimulative fiscal policy, lower taxes, mostly on the corporate side, the Federal Reserve normalizing interest rates, reducing quantitative easing and bond buying. Global growth has picked up a little bit. Global interest rates are picking up a little bit. We're talking about inflation again.

Forbes: What stocks do you currently favor?

Cuggino: In this growth-oriented economy, we currently like **Freeport-McMoRan** (NYSE:FCX) in the commodity space as a play on infrastructure, manufacturing and improving economic growth. It's an international, diversified, primarily copper miner with ancillary businesses in other metals such as gold. We began emerging from the low point of the latest commodities cycle a couple years ago and we think the stock has some room to run in the long term if we do get the growth story that we think we're going to get. Historically, higher copper prices have translated to higher earnings and dividend payouts for this company and we don't think it's any different this time around.

As I mentioned, financials also look attractive in this environment. They had a good run toward the end of last year and the beginning of 2018 and have cooled recently. We think there is a lot more long-term potential in this space. A name we like is **First Republic Bank** (NYSE:FRC), which is a large regional bank with operations in certain high-growth parts of the U.S. Its high net worth client base is most desirable and they do a great job of cross-selling a variety of services to that client. They are

primarily in commercial and residential real estate and an expanding wealth management business with both lending and fee generation growing rapidly. A lot of growth potential here including a higher dividend payout over time.

Forbes: Any others?

Cuggino: Manufacturing also looks to be interesting in a global growth story. We like **Illinois Tool Works** (NYSE:ITW) here. It's a well-run, industrial products and equipment company operating in a wide variety of industries from autos to electronics to testing and measurement to components to welding, you get the idea, the nuts and bolts of economic growth and manufacturing. They are constantly looking for ways to augment the current grouping of products and services they offer and they do bolt-on acquisitions extremely well. It has an impressive dividend payout history, increasing payouts each year since 1964 and is currently yielding about 2.2% with room to grow.

Forbes: Great, thanks for sharing your ideas today.

Cuggino: My pleasure, Wally.

Wallace (Wally) Forbes, CFA, was President of the Forbes Investors Advisory Institute (FLAI) from 1993 through 2014, the division of Forbes Media that publishes the Forbes Special Situation Survey, Forbes Investor and is responsible for the Forbes participation in the Forbes/CFA Institute Investment Course published by Wiley. He hosts an interview program with lead-

ing money managers that appears on the Investing section. Mr. Forbes, the youngest son of B. C. Forbes, founder of Forbes Magazine, served as Vice President and Director of Forbes, and President of Forbes Investors Advisory Institute, from 1964 to 1969. After leaving the company, he served as president and CEO of Standard Research Consultants, formerly a subsidiary of Standard and Poor's Corporation. He subsequently was a founder and partner-in-charge of Benchmark Valuation Consultants, which merged with KPMG Peat Marwick in 1987. Both firms specialized in the business valuation field. He has also served as a director of both public and private companies and of educational and other non-profit organizations. He rejoined Forbes in 1996, once again as President of FLAI. He has authored or co-authored articles on the valuation of business enterprises and related subjects that have appeared in various business and professional publications, including Harvard Business Review, Business Horizons, Monthly Digest of Tax Articles, Management World, Family Advocate, YPO Enterprise, Chief Executive, and The Business Valuation Handbook. After graduating in 1949 from Princeton University with a degree in civil engineering, he served for five years in the U.S. Navy Civil Engineer Corps and was assigned to Seabee battalions (Navy construction battalions) in various overseas locations. After leaving the Navy, Mr. Forbes attended the Harvard Business School, and, upon graduation, was appointed a research associate in investment management and a member of the faculty. Mr. Forbes is a member of the New York Society of Security Analysts and holds the Chartered Financial Analyst designation.

