

Is Your Portfolio Ready for Winter?

“Now winter is truly coming. In the winter, we must protect ourselves. Look after one another.”

-Ned Stark, Game of Thrones

George RR Martin’s epic (uncompleted) fantasy tale *A Song of Ice and Fire* was made into the popular television show, *Game of Thrones*. What makes the tale unique is Martin’s focus on the monotony of everyday life and how routine occurrences are just as important as slaying dragons and zombies. In the series, one of the most famous lines is “Winter is coming,” which is used to illustrate a dramatic changing in the seasons that all of the characters must adapt to.

Currently, there is a dramatic shift occurring in the global financial markets. Unlike a fantasy novel, it is not as definitive as the first snowfall. However, the global tightening by Central Banks appears to be reversing a more than twenty year policy of easy money. Investors should consider several things when looking at their portfolios.

At Crawford, we lead with quality. Despite being hard to define quantitatively, quality is likely to be the most important factor in investing over the near and medium term. In our opinion, quality companies start with superior competitive positions and offer products or services that cannot be easily substituted. Quality companies also employ a rigorous financial process and rarely have extreme amounts of debt. These companies generate consistent and increasing cash flow, most of the time in excess of any needs for management to grow the business.

We believe the next most important factor in survival will be shareholder friendly management. For companies that generate more cash flow than they need to operate, shareholder friendly management teams will return some portion of that excess cash to investors through a dividend. We use more complicated metrics than the simple paying of a dividend to judge management team strength, but narrowing down the investment universe to consistent dividend payers is likely one of the best steps to outperformance through a market downturn.

Taking the “winter” metaphor an additional step further, investors need to realize that like the calendar has seasons, the economy has cycles. These economic cycles can impact market cycles

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and returns. In the fantasy novel, long summers are often followed by long winters. From our perspective, the U.S. economy and the U.S. investing markets – equity, debt, private equity, and venture capital – have been in a more than twenty year summer. This has several implications.

The most immediate is your financial advisor's ability to understand and navigate different environments. Managers under the age of fifty have not managed through an extended restrictive monetary environment. The current inflationary environment has forced Reserve banks across the globe to take a restrictive approach that has not been seen in over twenty years.

A secondary implication is corporate managers. Most successful long-term companies have a complex budget process that involves ranking projects by return and only funding the most potentially lucrative initiatives. The hurdle for funding corporate projects has been severely lowered over the last twenty years. For any investor looking for sustainable performance, finding management teams that can adjust to this new and more restrictive capital environment should be high on their list of criteria.

Lastly, index investing is indiscriminate in its holdings. As markets go up, rallying cries like FOMO (Fear of Missing Out) or TINA (There is No Alternative) appear to be wisdom. As Central Banks have raised rates, alternatives are now available. Large banks and pension funds no longer need to chase riskier assets (such as stocks) and can achieve many of their financial targets by investing trillions of dollars in government backed securities. This shift alone is likely to result in preferences for risk across the investing spectrum that likely chooses new winners and losers.

We cannot be certain that winter is coming. It is possible inflation is tamed next year, allowing Central Banks to begin a soft landing. A soft landing is the scenario where unemployment does not increase, economies do not slow significantly, and liquidity is constant to the markets. From our current perspective, that outcome may very well be a fairytale. Now is a good time for investors to seek help from an experienced investment manager. At Crawford, we have helped our clients survive the ups and downs of the market for over forty years with quality, dividend-paying stocks as the backbone of their portfolios. Ours is a strategy that should survive this winter.

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