

January 2023

Michael Anderson
Chief Investment Officer

At Hi-Line Capital Management, our intrinsic-value philosophy and decision-making principles drive how we approach investing and provide guard rails for thinking during periods of extreme uncertainty and volatility. Our piece, *Foundational Decision-Making Principles*, details the seven pillars of our decision-making process and its critical function in long-term success and rationality.

ABOUT HI-LINE CAPITAL MANAGEMENT

Hi-Line Capital Management, LLC (“HLCM”), based in Watertown, SD, provides investment management and advisory services for institutional and individual clients. The firm was founded in July 2009, became a registered investment advisor (RIA) with the U.S. Securities and Exchange Commission (“SEC”) in March 2010.

CONTROL THE CONTROLLABLE

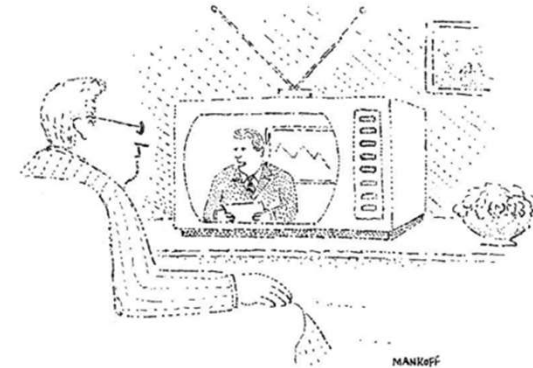
“Forecasts create the mirage that the future is knowable.”
--Peter Bernstein

The investing year of 2022 shocked most investors with inflationary forces as the primary root cause. Since 1982, the investing world has experienced declining interest rates – due primarily to declining inflationary forces. In addition, the developed markets have become accustomed to high levels of liquidity since the Great Financial Recession of 2007.

2022 flipped the equation for investors, inflation increased, liquidity dried up, and interest rates went up. This resulted in a significant decline in bond prices at levels not experienced in 40+ years. And bonds were considered “more safe” than stocks despite the reality interest rates can suddenly change resulting in negative price volatility for bond investments. Furthermore, increased geopolitical conflicts, protectionism and instability in the global supply chain has collectively caused the current investing environment to be classified as “increasing uncertainty”. And investors are seeking answers to many questions such as;

- Will inflation come down?
- Will there be a recession?
- What happens if there is stagflation?
- Will interest rates be higher or lower in 2023?
- Will the stock market be adversely impacted with a recession?

The following is a cartoon favorite regarding “current events” as often summarized by commentators.



“On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates.”
CartoonStock.com

Note: Causes and correlations of the past are not always clear and knowable....which certainly makes the future far less certain.

Good investors will analyze the current environment, and more importantly the future opportunities through a different lens.

Even better investors will focus on controlling the controllable.

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CONTROL THE CONTROLLABLE CONT’D

Principle #7: Control the Controllable

The majority of time must be dedicated towards controllable factors such as; long-term orientation, discipline, consistency, temperament, due diligence, conservatism in analysis, investment selection, prudent diversification, financial planning, managing risks, reacting rationally to current events, stress testing cashflow against adverse future events, and certainly price paid for investment assets.

Only a small percentage of time should be allocated towards uncontrollable factors such as; the economy, interest rate direction, politics, natural disasters, war, currency movement, etc. Understanding the current market environment and “temperature” is important along with future macro-economic outcome, but largely both factors are truly unknowable with consistency and precision.

The adopted principle of controlling the controllable is the process of reduce the risks of negative events by focusing on things that can be controlled. The following provides detailed examples about how to control the controllable without knowing precisely the present nor the future.

Regarding income investing, the following are several controllable factors that will reduce the risk of negative outcomes;

1. Properly plan for liquidity needs and events
2. Maintain short duration and earn the current market rates versus attempting to predict the direction of interest rates
3. Increase due diligence analysis against a wide range of negative scenarios to reduce or eliminate credit risk, also known as increasing margin of safety required
4. Reduce to a minimum the securities exposed to returns less than zero after accounting for multi-year inflation results.

Regarding equity investing, the following are examples of controllable factors including;

1. Maintain a long-term orientation in judging the economics over a full business cycle
2. Stress testing the potential impact to cashflow adverse economic events may cause such as volume changes or inflation pressure
3. Maintain the pursuit of investments with conservative leverage profile relative to cashflow
4. Increase the margin of safety by paying lower and lower prices relative to expected cashflow

The above are a sample of elements that can be controlled which ultimately support the level of patience, discipline, conservatism desired for good long-term investment decision making. Warren Buffet has said “forecasts usually tell us more of the forecaster than of the future.” And a good investor will have a good process that includes controlling the controllable, which allows one to “sleep well” even without knowing the future.

