REPRINTED FROM NOVEMBER 7, 2016

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

# Focusing on the Power of Compounding

**J. JEFFREY AUXIER** is President of Auxier Asset Management LLC and Founder of the Auxier Focus Fund. Prior to forming Auxier Asset Management in 1998, Mr. Auxier spent 16 years at Smith Barney — formerly Foster Marshall-American Express, then Shearson — where he was on the Portfolio Management Advisory Board and the Chairman's Council, earning the distinction of Senior Vice President of Investments and Senior Portfolio Management Director. In 1997 and 1998, he was named one of the top 10 brokers in the country by *Money* magazine, winning two consecutive stock-picking contests.

**SECTOR — GENERAL INVESTING**

**TWST: Could you tell me a little bit about the firm?**

**Mr. Auxier:** Yes. We're an asset management firm, close to $700 million in assets. And we founded the firm back in 1998. Prior to that, I started in the business in 1982 with a regional firm up in the Northwest called Foster Marshall, a value-oriented investment firm, and worked there from 1982 through 1998, then started Auxier Asset Management in 1998. We set up the Auxier Focus Fund in 1999.

**TWST: What needs does your firm meet for investors?**

**Mr. Auxier:** Our firm is a little unique. We have a documented record of outperformance that is audited back to 1989. We focus, number one, on the power of compounding. We strive to be an exceptional business analyst and minimize risk through a passionate, persistent daily research effort. Longer term, we want to beat market indexes — and have — but there are times, like 1999 or late 1987 where indexes were so overpriced, that participating threatens to interrupt the compounding process.

Years ago, a wise investor said the key to survival is identifying bubble prices and taking steps to avoid the portfolio torpedo stocks — highly priced businesses with high expectations that disappoint and torpedo the entire portfolio. We like to buy in the hopelessly out of favor and harvest in the euphoric. We constantly look at the downside risk. One out of five firms in America makes it 15 years. We're interested in focusing on businesses that can endure.

Many of our companies we have followed or owned for over 30 years. We see a huge competitive value in cumulative knowledge. Having over 50,000 hours of research since 1982 looking at individual businesses and surviving through numerous market panics helps increase the odds of investment success.

Today, as markets become riskier, the trend is more toward passive investing, but as markets get close to 20 times earnings, current levels, historically, the forward 10-year return on the index is negative. I remember how Japan was the darling in 1989, and the Nikkei traded at 38,800 and then dropped to 7,500 20 years later. Ironically, an active approach to risk mitigation is far more crucial in high markets, but that is precisely the time passive strategies become popular.

Our fund — the Auxier Focus Fund — was started in July 1999 at the height of the tech and indexing frenzy. We have cumulatively outperformed the market by 104.75 percentage points with less than 90% exposure to the market since inception. I have 100% of my retirement committed in the fund. Ten thousand dollars in our fund has grown to $31,950 vs. $21,471 for the S&P 500 and $24,591 for the Dow Jones. Interestingly, $10,000 with Warren Buffett's **Berkshire Hathaway** (NYSE:BRK.A) underperformed our fund with $31,530. **Berkshire's** starting-point price was at one of its lowest price to book ratios in years, as money flooded into tech.

As prices of assets rise, we tend to become more defensive and stay disciplined with more market-agnostic positions and will lag market advances when high prices don't justify the risk. Annually, we individually research over 1,200 companies, and if the risk/reward is not compelling, we will stay in cash. Overpaying and overborrowing are recurring sins to investing and can take you out of the game. Globally, banks have been hit with fines or lawsuits exceeding $160 billion due to excessive leverage against overpriced assets. It is one of the reasons only one in five firms survives 15 years in America.

**TWST: Do the funds have a unique overarching investment philosophy?**

**Mr. Auxier:** We've had the same investment philosophy since 1982. In 1982, I actually called Warren Buffett on a Saturday morning. He took the call at his office and was nice enough to share extremely valuable advice — books and investors he admired. I was absolutely hooked, have been ever since. I liked his two rules to investing: First rule is don't lose your capital, and the second rule is never violate the first rule. I liked the ideas of putting a high priority on the compounding process and focusing on the downside and quantifying risk.

We've pretty much had the same approach, and it's helped us survive through the 1987 stock market crash and the thrift crisis in the early 1990s, the 2000 tech bubble and 2008 housing debacle. It has been a savior. When you focus on compounding, you're looking at the downside risk all the time. A lot of funds that rode the tech telecom media craze doubled in 1999, yet were out of business within three years. The markets come and go, they become overpriced, and people get tied to indexes in high markets, and then, the markets blow up.

**Cisco** (NASDAQ:CSCO), a big tech favorite with a market cap in excess of $600 billion in 1999, dropped from 85 to 15 within 18 months. Yet, the indexes were advertised as low cost. Nothing low cost about a 40% drop in your life savings. High cost is not knowing what you own or what you are doing and having the wrong temperament. Like Peter Lynch says, the most important organ in investing is the stomach. We are constantly working on mastering the skills of capital allocation together with the right temperament so we can endure through any kind of markets.

### Highlights

*J. Jeffrey Auxier discusses Auxier Asset Management LLC. Over the long term, Mr. Auxier aims to beat market indexes, but his first focus is on the power of compounding. Based on this, Mr. Auxier believes it is critical to know the companies he owns. He uses a passionate and persistent daily research effort to mitigate risk. Mr. Auxier is interested in companies with the ability to endure and buys them when they are out of favor. However, if he does not find a compelling risk/reward, Mr. Auxier will remain disciplined to his approach and stay in cash.*

*Companies discussed: Berkshire Hathaway (NYSE:BRK.A); Cisco Systems (NASDAQ:CSCO); Biogen (NASDAQ:BIIB); Valeant Pharmaceuticals International (NYSE:VRX); Gilead Sciences (NASDAQ:GILD); Costco Wholesale Corporation (NASDAQ:COST); LyondellBasell Industries NV (NYSE:LYB); Celanese Corporation (NYSE:CE); Sherwin-Williams Co. (NYSE:SHW); Discovery Communications (NASDAQ:DISCA); Kroger Co. (NYSE:KR) and Wal-Mart Stores (NYSE:WMT).*

**TWST: Do you think that investors understand the concept of compounded return, and do they need to find out more about it?**

**Mr. Auxier:** I think investors generally take too much risk for the potential return. They don't know what they're in or the correct odds. Like Buffett says, risk is not knowing what you are doing, often due to a lack of knowledge. That kind of categorizes many who recently are blindly chasing yield at any price. If you study compounding, you'll focus so much more on accumulating facts, knowledge, and anticipating and reducing risk. If the market goes down, if your stock goes down 50%, you've got to go up 100% to break even. If it goes down 90%, you've got to go up 1,000% just to break even. That is why a tenacious research effort is so critical. Investors need to know what they own. It becomes critical because you can't quantify the downside otherwise.

**TWST: Did you want to highlight a company that you find interesting?**

**Mr. Auxier:** We are always looking for mispriced companies. One we bought recently, in the last quarter, is a stock that dropped from $480 down to $230, biotech leader **Biogen** (NASDAQ:BIIB). They're a major player in multiple sclerosis — MS — drugs and in the Alzheimer's area. This is an excellent, well-run biotech with a strong research culture, and they basically stumbled, and their stock price dropped to 12 times earnings, down from a five-year average in excess of 25. Yet, it has a tremendous high free cash flow yield, triple the 10-year bond yield and also the Alzheimer's drug aducanumab, which seems to have a lead in the $20 billion Alzheimer's space. The market cap of the company is only around $60 billion.

This relative bargain is due to the negative political ramifications of pricing on health care. Many high-quality health care names have recently sold off hard, and yet, many sport very attractive growing high free cash flow yields. While most investors have been chasing after interest or dividend payouts, we are more interested in growing free cash flow yields that in turn can lead to growing dividends. We look carefully at mandatory capital spending on each company. We like companies that are serious about investment in research in order to address real health problems. Obviously, there have been some abuses in the biotech area with poor behavior in companies like **Valeant** (NYSE:VRX), but they kind of sold the whole industry because of a few bad apples, we think.

***"I think investors generally take too much risk for the potential return. They don't know what they're in or the correct odds. Like Buffett says, risk is not knowing what you are doing, often due to a lack of knowledge. That kind of categorizes many who recently are blindly chasing yield at any price."***

**TWST: Do you think that once a new President is sworn in and we know what direction they're going to go in, as far as pricing controls or doing something about prices of drugs, that things will start to get back to normal in the sector?**

**Mr. Auxier:** We did well investing in health care names back in the early 1990s when Hillary Clinton came out strongly against the industry. We are seeing bargains created today on similar concerns. Fundamentally, currently 10,000 people are turning 65 every day, and there has to be some pricing to cover the costs to solve some of these diseases. We've effectively found cures for hepatitis C due to the work of **Gilead Sciences** (NASDAQ:GILD).

**1-Year Daily Chart of Biogen**

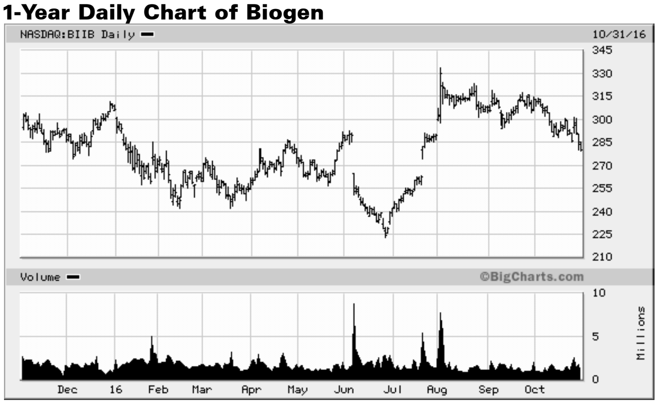


**Chart provided by www.BigCharts.com**

**Mr. Auxier:** A strong management team, very diligent capital allocators. The company has tremendous free cash flow and the kind of a dull business we like. It sells at 10 times earnings, pays over 4%, with an even higher free cash flow yield. It is cyclical, but they know the ethylene space and are in tune with the cycles. Good management becomes much more important in high markets. The bad investments tend to be made in the good times.

**TWST: Do you want to mention another company?**

**Mr. Auxier: Sherwin-Williams** (NYSE:SHW), it's a dominant player in paint and coatings. If painters make $35 an hour, you're not going to skimp on paint; you're going to go for the best quality. Like Peter Lynch used to say, you want the inspired management in the uninspiring industry. Paint is a necessity and very boring — characteristics we seek.

**TWST: With Sherwin-Williams, if you start to see the Millennials buying homes and maybe fixing up, you might see more demand for the Sherwin-Williams products?**

**Mr. Auxier:** Yes, that's exactly right. Generally, if you paint something, the return more than compensates for the cost of the paint, right? **SHW** has outstanding management led by CEO John Morikis. I just met with a lot of housing companies. We can't keep up with the demand for new houses. The supply and demand looks favorable for new housing, given the household formations running over a million, and Millennials are starting to move into that area. We don't have enough skilled labor to build enough houses right now. Conversely, there are many areas that are suffering from overcapacity because we've had eight years of zero interest rates, which leads to sloppy, undisciplined behavior.

***"The pendulum swings. The biotechs were extremely overpriced three years ago. And then, that whole industry corrected. There will be compromises, and the ethical players should prevail, as long as they are not abusive in their pricing. All businesses are being forced to operate with lower prices."***

The pendulum swings. The biotechs were extremely overpriced three years ago. And then, that whole industry corrected. There will be compromises, and the ethical players should prevail, as long as they are not abusive in their pricing. All businesses are being forced to operate with lower prices. We are in more of a **Costco**-type world where **Costco's** (NASDAQ:COST) Jim Sinegal promised he'd never mark up over 14%.

**TWST: Did you want to mention another company you find interesting?**

**Mr. Auxier:** Outside of health care, there are some really solid industrial chemical names like **LyondellBasell** (NYSE:LYB) or **Celanese** (NYSE:CE). These are very dull businesses. **Lyondell**, they're dealing with olefins and polyolefins. I just met with over 50 companies in the industrial space, and it's very difficult now that you've had a strong dollar and you've had some real headwinds, but we do have some tremendous advantages on the cost side for natural gas and a lot of those inputs for chemical businesses. Many of the base industrials are starting to look more attractive on a price-value basis. The fundamentals aren't that strong, but the valuations are interesting.

**TWST: What would investors need to know about LyondellBasell?**

**1-Year Daily Chart of LyondellBasell Industries NV**

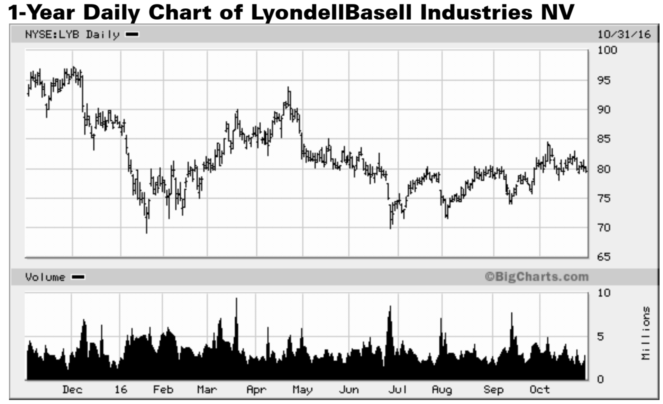


**Chart provided by www.BigCharts.com**

The gluts tend to be more in global goods — areas like global shipping, 33% excess capacity, farm commodities, food, distilled fuel, etc., problems of abundance and the growing efficiencies of data analytics. We have added enormous storage capacity in many industries. Technology advances add to deflationary forces as PC prices are down 99% since 1980. However, in countries where market competition is impeded through socialism like Venezuela, you see 700% inflation this year going to 1,700%. There are extreme shortages in all necessities because the government has been confiscating private property and interrupting the free market. Where free market competition rules — like the U.S. — food deflation in the past eight months is the steepest in over 40 years.

**TWST: Any other companies that come to mind, given the issues you brought up about housing supply, that investors might want to follow?**

**Mr. Auxier:** Yes, another one is **Celanese**. They make acetic acid and glues. And again, these are kind of dull businesses. But they are growing their earnings with consistency, have a low valuation, 9 times earnings, with high free cash flow yield. They have been beaten down; expectations are pretty low and are actually an attractive bargain level given their position as the world's largest producer of acetic acid — raw material for glue.

**TWST: Did you want to mention another company?**

**Mr. Auxier:** One we like is **Discovery Communications** (NASDAQ:DISCA), a media company. They reach 94 million U.S. cable households and 300 million international households. They have strong double-digit earnings growth the next three or four years. The stock's trading maybe 12 to 13 times next year's earnings, and John Malone is the biggest shareholder. They own the number-one cable sports channel in Europe. There is currently a glut of media content, but we see a consolidation coming, orchestrated by John Malone. We'll look at factors that can provide value outside the market like managerial events, split-offs, spinoffs or consolidations. We've been in **Discovery** for several years — original basis is maybe $1 or $2 — and hope to add value to investors with the years of industry study.

**TWST: We talked before about food and prices of food. How might investors take advantage of that now or in the next year?**

**Mr. Auxier:** Well, leading grocer **Kroger** (NYSE:KR) has dropped by a third this year to $29 — 13 times forward earnings. **Kroger** has been the best operator in the industry for the past 50 quarters. The business is suffering from a plethora of entrants. The cost of eating at home has dropped materially in the past year, which is killing the restaurant business. We've oversupplied the restaurants and are seeing more bankruptcies.

In grocery, you have price wars going on now between **Wal-Mart** (NYSE:WMT), **Kroger**, **Aldi** and **Costco**. It's highly competitive, but what's happening is, it's driving compelling value for consumers eating at home. If you look at the food industry, outside the federal government, it's the number-one industry in terms of the overall industry size. People want to eat better, and they are willing to spend more for better ingredients and nutrition. The U.S. leads in food quality.

In addition, meats have really been oversupplied — pork and chicken and beef. Grains, too, have corrected sharply to prices below the cost of production. A strong U.S. dollar has hurt exports. As Russia has had a 40% to 50% devaluation on their currency, they're picking up a lot of market share from our producers.

**TWST: Looking ahead over the next couple of years, with whoever is elected President, do you think there are one or two things that they might want to address that could help the market and the economy?**

**Mr. Auxier:** Yes, I think the big issue is the regulations on small business. Small business provides the majority of new jobs in the U.S. The rule of law is critical as well as is maintaining the integrity of financial markets. Corruption has been the downfall of many countries, and to endure, it is important to have honest and competent leadership.

**TWST: Thank you. (ES)**

**J. JEFFREY AUXIER**
**President**
**Auxier Asset Management LLC**
**5285 Meadows Road**
**Suite 333**
**Lake Oswego, OR 97035**
**(800) 835-9556 — TOLL FREE**
**(503) 885-8607 — FAX**
**www.auxierasset.com**
**e-mail: info@auxierasset.com**