April 11, 2024

Dear Clients and Friends,

We are pleased to share our first quarter letter of our 25th anniversary year. From our humble beginnings, we have grown to a team of 35 dedicated professionals managing approximately $5.5 billion of client assets from our offices in New York, Washington, and West Palm Beach. As we reflect on our progress, we are filled with gratitude for all who have supported us, shared our long-term view, and trusted us as stewards of their capital. Your confidence permits us to do what we are most passionate about, serving as trusted advisors to our clients while working to preserve and grow their assets over time.

In the financial markets, our silver anniversary is off to a strong start. By the end of March, the S&P 500 was up 10.6% year to date, its best first quarter in five years. The current bull market, which started in October of 2022 and was narrowly led by a handful of mega cap technology stocks in 2023, is also broadening. All the sectors except real estate have notched gains this year.[1] Good beginnings have historically portended good years. Since 1950, the S&P 500 has risen 8% or more 16 times in the first quarter, and only once did the index end the year in negative territory.[2]

Bull markets don’t die of old age…

There is a well-known saying on Wall Street that bull markets don’t die of old age, they are killed – when the Federal Reserve raises interest rates. Fortunately, rate increases this year are unlikely. Inflation has steadily cooled from its peak of 9% in June of 2022 thanks to higher rates and improving supply chains. Though prices are still growing at 3.5%, above the Fed’s 2% target, the Fed plans to lower interest rates this year. That should support the value of bonds and improve the outlook for stocks.

…especially in election years.

Absent a sudden spike in inflation or an exogenous event that demands action, the Fed usually treads lightly in election years to avoid charges of political bias. The S&P 500 has not declined during an election year when a sitting president is seeking re-election since 1952 as the party in power usually uses whatever means are at their disposal to paint a rosy economic picture.[3] The reality of the swelling national debt, labor shortages, and volatile geopolitics may eventually limit longer-term returns, but, for now, positive indicators like low unemployment and solid wage growth have investors optimistic that the economy will continue to flourish.

"Grey hair is the crown of the wise" – attributed to King Solomon

Forged over the last 25 years, Douglass Winthrop’s investment team has gained the perspective that comes with stewarding assets over decades. Certain aspects of today’s investing climate take us back to the firm’s early years when the dotcom era was reaching a crescendo and **Cisco Systems (CSCO)** was the one of the world’s most valuable companies.

By the winter of 2000, Cisco’s shares had appreciated nearly 1,000-fold since their debut in 1990. The firm’s networking equipment was critical to the expansion and commercialization of the internet, making it a quintessential

[1] https://www.barrons.com/articles/stock-market-performance-quarter-outlook-0e5168a0?mod=past_editions
[2] https://www.wsj.com/finance/stocks/the-stock-markets-magnificent-seven-is-now-the-fab-four-2dff87ac?st=kvm7xwg2509f21q&reflink=article_email_share
[3] https://money.usnews.com/investing/articles/election-2024-how-stocks-perform-in-election-years

“picks and shovels” play. Like makers of mining equipment that sell tools to prospectors during a gold rush, Cisco seemed less risky than many of the IPO-fueled businesses exploring the internet’s frontier. When the Federal Reserve began tightening monetary policy in the spring of 2000, dotcom companies were suddenly starved of the capital they had previously spent recklessly. At the same time, a next generation of networking routers threatened Cisco’s technical dominance. Growth sputtered and Cisco’s stock lost 80% of its value over the following 12 months. In the 24 years since the dotcom bubble burst, Cisco has morphed into a frumpy old-timer with a market capitalization that is still less than half of its peak in 2000.

“The four most dangerous words in investing are: 'This time it's different.'" – Sir John Templeton

One year ago, our quarterly letter noted the potential for rapid advancements in artificial intelligence (AI) to ignite a market rally. That has come to pass with **Nvidia (NVDA)** leading the pack. Like Cisco in the 1990s, Nvidia is a “picks and shovels” company that holds an impressive lead in a transformative technology – the advanced microprocessors needed to power AI applications. We have held off on chasing Nvidia’s shares during their run up as we believe the AI chip market may mature rapidly which could doom Nvidia to a fate like that of Cisco. AI is indeed transformative technology, but we have ample exposure through **Microsoft (MSFT)**, Google’s parent company **Alphabet (GOOG)**, and **Amazon (AMZN)**. In keeping with our “protect and grow” mantra, these companies also have other profitable core businesses that should insulate them from steep declines if excitement around the pace of AI adoption fades.

AI has captured the headlines, obscuring plenty of unrelated businesses that, in our view, offer attractive prospective returns with lower risk. During the quarter we identified a few such companies and added them to our portfolios.

Becton Dickinson (BDX) makes must-have medical delivery and diagnostics products that touch 90% of hospital patients, giving BDX unmatched scale. The business is recession-resistant; demand for its products does not depend on the state of the economy. Becton’s shares have been stagnant for the past few years while the company was busy hiring new management, digesting a major acquisition, working through pandemic related disruptions, and renewing FDA approval for one of its key products. Over 64% of BDX’s revenues are recurring and come from consumable medical devices including needles, prefilled syringes, IV bags and catheters. BDX manufactures and distributes these critical items at far lower cost than its competitors.[4] These everyday products benefit from growing medical utilization rates globally, driven by aging demographics and increasing health standards in emerging markets. This durable revenue base provides management solid footing to invest with confidence in higher growth areas such as at-home care, diagnostics, and pharmacy automation. Having been battle tested the past few years, the company’s new leadership is prioritizing share repurchases and capping leverage, both of which cement capital allocation discipline that should well serve shareholders.

Anheuser-Busch InBev SA/NV (BUD) holds seven of the top ten most valuable beer brands in the world and the largest share in 28 national beer markets.[5] Through industry-leading scale and distribution, BUD can deliver at high margins while remaining cost competitive for consumers. Management reinvests these steady cash flows into marketing, enhanced production and distribution technologies, and expansion into emerging markets, all of which position BUD to maintain its dominant position. In the US market, the company is working to recover from a painful misstep last year in the form of a Bud Light marketing campaign that was out of tune with its core customer base. We think BUD's emerging market exposure is what makes shares attractive today. The 2016 acquisition of SAB

[4] 42nd Annual J.P. Morgan Healthcare Conference
[5] ABInBev 2023 Investor Day

Miller provided BUD with a near-monopolistic position in Latin America and a strong foothold in Africa. Both regions have above-average population growth and emerging middle classes that stand to propel sales of BUD's venerable beverages used to socialize and celebrate. After eight years of paying down $45B in debt related to the SAB Miller acquisition, management could soon increase capital returns to shareholders in the form of dividends and stock repurchases.[6] Between growth from overseas and swelling free cash flows, investors should soon have a reason to crack a cold one.

Firm Update

Speaking of reasons to celebrate, we are excited to announce that Ted Crawford recently joined Douglass Winthrop as a portfolio manager in our Washington DC office and a member of our Investment Committee. Ted co-founded Sweetbay Capital Management, a value-oriented investment firm, in 2015. Earlier in his career, he worked in New York as an analyst and partner with two hedge funds. In addition to serving his clients at Douglass Winthrop, Ted plans to continue teaching as adjunct professor of value investing at the Georgetown University McDonough School of Business each fall. Having known Ted and admired his love of investing for 10 years, we are thrilled to welcome him and his former Sweetbay clients into our fold.

Later this month we will bid farewell to our colleague, Tom Loizeaux who will be leaving the firm to pursue other opportunities. He will be missed, and we wish him well as he begins his next chapter. As we turn the page from winter to spring, we again note our gratitude to our clients, partners, and friends – old and new. We hope you all enjoy a healthy and happy spring.

Sincerely,

Douglass Winthrop Advisors

[6] Bloomberg