Warnke/Nichols Ltd.
Investment Management

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PORTFOLIO NOTES **AUGUST 2020**

To our Business Partners:

- ***OBSERVATIONS.*** We don't mean to whine, but here are some observations of the financial markets that we find a bit unsettling:

  1. The average holding period for a stock is now 5 1/2 *months*, compared to the previous low of 6 months in 2008. This compares to a holding period of 8 *years* in the late 1950s-early 1960s. Some people actually call this investing, but it is hardly long enough to remember the stock symbol! On a related note, TD Ameritrade reports that, since they cut commission rates to zero, their daily average number of trades has skyrocketed from less than 1 million to close to 3 million! Can you imagine us completely turning over your portfolio more than twice a year?!

  2. With interest rates at all-time lows, many companies have taken on enormous amounts of debt to buy back stock. If a company buys back its own stock for more than the company is worth (a good possibility these days with valuations inflated), it is doing additional damage to its financial condition. Call us old-fashioned, but we prefer to own companies with much more shareholders' equity than debt. We can't see this debt binge working out well long-term, but based on item #1 above, many market participants don't seem to care about financial soundness or valuation.

  3. As some valuations reach stratospheric levels, some beyond the dot-com mania in 1999, market participants go to great lengths to justify such valuations, often creating new metrics. This has happened during every market cycle throughout history. Recently a prominent financial publication justified the richly valued price of one of the market's favored technology stocks by simply comparing it to other even more highly valued stocks.

  4. The five largest companies in the S&P 500 now make up 23% of the market value of the entire index, the highest level in history. High concentrations in the past have ultimately spelled trouble for the financial markets. The combined value of Apple, Amazon, Facebook, Google, and Microsoft is equal to the combined value of the bottom 394 in the S&P 500. If there's any disappointing news in one or more of these, stock index holders ought to look out below.

  5. Public "investor" participation in the marketplace is at historic highs, aided by zero-commission brokers like TD, Schwab, E*Trade, Robinhood, and Fidelity noted in #1 above. Old cynics call this "dumb money," because broad participation by unsophisticated speculators often happens at or near market peaks. Conversely, company insiders (officers and directors – the "smart money") are aggressively selling their company stocks. Who's more likely to be right?

- ***VALUATION.*** Our group* sells at 72 cents on the dollar, a Goldilocks-like not too hot, not too cold.

- ***RECENT RESULTS.*** The stock market gained broadly in July, led by big-cap stocks. The NASDAQ Composite and the S&P 500 gained 6.8% and 5.5%, respectively. Smaller company indexes continued to lag, with gains of only 3-4%. So far in 2020, believe it or not, only the NASDAQ and the S&P 500 are up for the year. Other indexes are down 7-15%. Over the last 12 months, the picture is much the same, with the S&P 500 and NASDAQ showing gains, while small and mid-cap groups are down 5-10%. Our widely held stocks* have tracked the best of the smaller company indexes but, because we don't own the tech heavyweights, we're behind the NASDAQ and S&P 500.

Steve Nichols, CFA   Bill Warnke, CFA

The group of "portfolio stocks" -- our Equity Composite for the purpose of evaluating investment performance -- consists of 18 stocks that are held in our clients' accounts. Portfolios might hold some or all of these stocks, depending on investment guidelines unique to each client, the timing of purchases and sales, and start dates of accounts. The performance of this group of stocks is a good proxy for our equity performance but might vary widely among accounts. Of course, past performance is not necessarily indicative of future results.

Investing with a margin of safety.™

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