



PORTFOLIO NOTES

DECEMBER 2020

To our Business Partners:

- **MARKET MILESTONES.** Investors quite often greet certain round-numbered market levels with much fanfare and optimism. This is true primarily with the popular Dow Jones Industrial Average (DJIA). In modern market history, the numbers have been 1,000, 10,000, 20,000, and now, Dow 30,000. Looking back at how the market performed subsequently suggests this optimism may have been misplaced.

The DJIA first breached the 1,000 level in early 1966 (ancient history, we know!). After bouncing between 600 and just under 1,000, it finally closed again above 1,000 in late 1972. Shortly after, a major bear market commenced, taking the index down nearly 50% to 575 in 1974. The Dow did not cross and stay above 1,000 again *until ten years later in 1982!*

The next Dow milestone, 10,000, was reached in the middle of 1999, only to decline below 8,000 by early 2003. It rose irregularly back to 10,000 by August 2004, continuing upward to around 14,000 in October 2007, only to plummet again 50% to below 7,000 in March of 2009. The Dow did not return permanently above 10,000 until August of 2010, *another 10-year span!*

The 20,000 milestone was reached in early 2017. This time, the index continued upward through that level (interrupted by the pandemic-induced crash this past February-March) to where we are today – 23,000 Dow points above the 2009 lows. This period has been largely accompanied by a generally favorable business environment, and declining interest rates due in part to some US Federal Reserve manipulation. These conditions have carried us for most of the last ten years.

The DJIA closed above 30,000 in late November and is near that level today. Can one look forward to the next round number soon, or will the current milestone spell trouble for markets in the near future as they did at 1,000 and 10,000? Note that current market conditions are similar to those of 1972 and 1999: media fanfare, high public participation in stocks, high valuations, and other very high speculative activity. Interest rates have been in decline since 1982, to the lowest level in history. Thus, it's doubtful falling rates will provide much more stimulus from here. Market history suggests that perhaps the optimism and rampant bullishness is not warranted.

- **VALUATION.** The runup in prices has brought our group* up to 80% of value, which limits upside potential. As an addendum to the discussion above, the denominator below the price (of any index or stock) is extremely important. That prices compared to earnings, dividends, assets, sales, cash flow, GDP, and other economic measures are at or above all-time highs is further evidence that future equity returns could be lower than generally expected.
- **RECENT RESULTS.** Markets recorded significant gains in November. Indexes rose from 11-18%, with the smaller company indexes enjoying the largest increases. This has brought most indexes back into the black for the year, but most only marginally. All indexes have managed to show positive results over the last 12 months, but results are still widely scattered. The S&P 500 is up about 15%, while the S&P 400 (mid-cap) Index is up about 8% and the S&P 600 (small-cap) Index is up about 4%. The median stock on the New York Stock Exchange, remains lower by over 5%. (The median stock is the one in the middle of the list.) Our widely held stocks*, despite a strong November, lags behind the indexes over the last twelve months.

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.

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