Warnke/Nichols Ltd.
Investment Management

William R. Warnke, CFA
Steven R. Nichols, CFA

PORTFOLIO NOTES **March 2021**

To our Business Partners:

- ***BORDERING ON INSANITY.*** What Benjamin Graham wrote 87 years ago in his first edition of *Security Analysis* might just as easily have been written today. In the book's Introduction, Graham recaps the "distinctive character of the 1927-1933 period" during which the stock market rose to speculative heights, followed by a severe crash. "(T)he 'common-stock' insanity was a monumental example of a *sound* principle grievously misapplied. Its history teaches us more about the nature of human beings than the nature of common stocks," said Graham.

  As Santayana famously said, "Those who cannot learn from history are doomed to repeat it." One will never know the timing or extent of any setback in the market, but here is a list of "red flags" that worry us about downside risk from current record levels in 2021:
  - Rampant public participation and widespread bullishness in the markets, with a casino-like feel, and the belief that stock certificates have become lottery tickets (as opposed to ownership interests)
    - Explosion in new accounts and trading activity at zero-commission brokers
    - Optimistic gossip among social media "influencers," most of whom have little investment experience and/or have not lived through a serious market decline
    - Record surge in buying "call" options (stock contracts that bet on rising prices)
    - Record margin debt – money borrowed at low interest rates to buy stocks
    - Widespread sentiment in the investment community that There Is No Alternative ("TINA") to stocks, beset with the Fear Of Missing Out ("FOMO") of big gains
  - Record-high selling by corporate insiders – the so-called "smart money"
  - Surging inflows into index mutual funds, which have become highly concentrated in a few widely held mega-cap companies, mostly tech-related
  - Record low mutual fund cash, and historically low savings rates among individuals
  - Enormous amounts of cash flowing into Initial Public Offerings (IPOs), Special Purpose Acquisition Companies (SPACs), "cryptocurrencies" like bitcoin, and stocks of unprofitable and/or debt-heavy companies
  - Questionable investment analysis to justify high stock prices; astonishingly, it's all about sales growth; earnings (or the lack thereof) don't seem to matter as much anymore
  - Individuals, corporations, and the Federal government hold extremely high levels of debt which, WHEN interest rates rise, is going to cause severe widespread financial hardship
  - "Technical" indicators, based solely on stock prices, are severely "overbought"
  - And last, but certainly not least, warning sign is …

- ***VALUATION.*** … nearly every traditional measure of stock valuation is at or above levels seen prior to price peaks in 1929, 1968, 1972, 1987, 2000, 2007, and 2020, among others.

- ***RECENT RESULTS.*** Markets rose in February, with small and midcap indexes booking the largest gains. Smaller-company indexes gained 6-7%, while the large company indexes rose 1-3%. For the year to date, smaller company indexes have risen 8-12% versus 1-2% for the big-cap indexes. Over the last twelve months all indexes have risen significantly, with the tech-weighted indexes up over 50%, compared to a roughly 20% gain for the average stock. Happily, our group of widely held stocks* has tracked the smaller-company indexes upward so far this year, but still lags the averages over the past year.

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.

We hereby offer to deliver to you without charge a copy of our current Form ADV Part 2, in accordance with the U.S. Securities and Exchange Commission's "Brochure Rule." Please contact us if you would like us to send you a copy.

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417 Genesee Street Delafield, WI 53018 262–303–4113
Fax: 262–303–9035 E-mail: value@warnkenichols.com www.warnkenichols.com