Warnke/Nichols Ltd.
Investment Management

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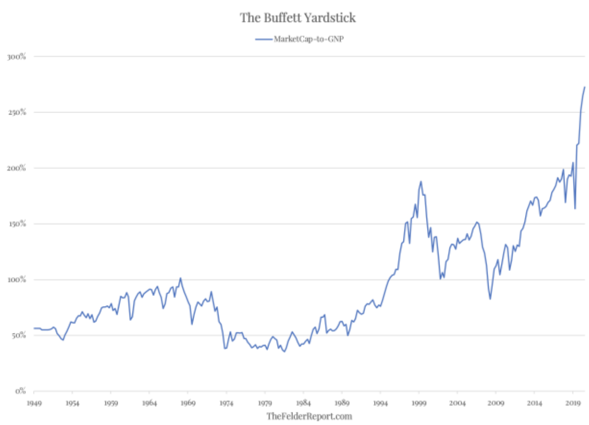
PORTFOLIO NOTES **July 2021**

To our Business Partners:

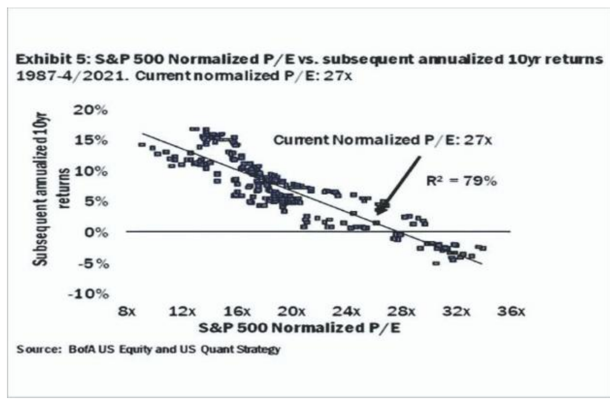
- ***EXPANDING EXPECTATIONS.*** It is human nature to extrapolate recent experience into the future. Stock market returns are no exception. According to blogger Jesse Felder, "… investor expectations have once again soared far beyond any reasonable figure." A recent survey revealed that U.S. "investors" expect long-term returns of 17.5%, after inflation, or over 20% annually before inflation.

  Bullish expectations haven't been this (irrationally) high since 1999. Back then, Warren Buffett famously said that "Investors in stocks these days are expecting far too much. (A survey earlier in the year) shows that the least experienced investors … expect annual returns over the next ten years of 22.6%. Even those who have invested for more than 20 years are expecting 12.9%. Now, continued Buffett, I'd like to argue that we can't come even remotely close to that 12.9%."



  These bullish forecasts exceed long-term historical returns of about 10% annually. How likely is it that we will experience these lofty returns? (Hint: not at all likely!) We can't emphasize enough that the PRICE you pay for an asset determines your rate of return. According to Buffett, the best single measure of where stock valuations stand at any given moment is the value of all publicly-traded securities as a percentage of U.S. GDP – Gross Domestic Product, or the total value of our country's goods and services.

  This ratio has recently vaulted to an all-time high of about 270%, obliterating the previous record of just under 200% in 1999, a market widely thought to be the greatest speculative mania in stock market history. Wow – what does that say about today's market?!



  To illustrate how vitally important price is, note the close correlation between the market price-earnings ratio and future returns. Today's multiplier of S&P 500 earnings certainly paints a bleak picture of future returns. Today's reading of 27 suggests 10-year future stock market returns of 0-5% - quite a bit lower than the survey respondents' hopes cited above. Disappointment is likely to ensue.

- ***VALUATION.*** See beside.

- ***RECENT RESULTS.*** Stock returns were mixed in June, with the Dow Jones Industrials down slightly, the S&P Midcap Index up over 1%, the S&P 500 up less than 2%, and the NASDAQ Composite, rebounding from its decline in May, up over 5%. Smaller company indexes continue to lead the way in the first half of the year, with gains of 17-22%, while big-cap indexes have registered gains of 12-14%. Likewise, smaller company indexes continue to outperform the big three (DJI, S&P, and NASDAQ) over the past year. Depending on the index, year-over-year gains range from 34-65% off the depressed prices last summer. Our group of widely held stocks* continues to perform well versus the indexes over the past month, year-to-date, and 12 months.

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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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