ADKINS SEALE CAPITAL MANAGEMENT, LLC
Investment Commentary
April 8, 2021

Dear Clients:
Facts, Opinions, and the Truth – Disconnects and Intersections. The intersections are welcomed and of little concern. Disconnects are more worrisome and frequently difficult to identify except through the rear view mirror. Bertrand Russell's quote captures this disconnect quite well – "The fact that an opinion has been widely held is no evidence whatever that it is not utterly absurd." Two recent examples from different areas of discourse demonstrate this disconnect quite well.

The common stock of ViacomCBS B (VIAC) was recently quoted in the mid $40's per share, having risen from as low as $11 per share in late March 2020 to a high of $100 in mid-March 2021. Actual execution prices for VIAC contribute to the factual record for this period and speak volumes to the wide disparity in opinion regarding the true enterprise value of this company. This company's business should have benefitted from increased demand for entertainment streaming services as a consequence the "shelter in place" guidance due the pandemic; however, no logical measure of economic value would support such a wide range in valuation. Speculative, or should one say even reckless, trading activities by both sophisticated and novice players were largely behind the wild price pattern. Major banks and investment companies enabled some of this speculation through margin credit facilities and, according to recent reports in the financial press, have suffered multi-billion dollar losses as a result.

There may be no greater disparity between fact and opinion than the public discourse over the economic impact of taxation of US based corporations. Judging from media coverage of this matter, a wide swath of the public believe corporations do not pay a "fair" share of the tax burden required to support government activities. Such a belief also suggests the government can obtain revenues from corporate income taxes without economic cost to individual taxpayers. The principal fact supporting this opinion seems to be that the current tax rate is less than prior higher tax rates. If there is a factual determination of "fair" in this regard, we have not yet seen it. In fact, our view is that corporations do not "pay" income taxes at all but rather simply act as a collection agency for the government for what effectively amounts to a sales tax. Corporations adjust the prices as well the cost of labor and other inputs of goods and services it provides to account for the expected income tax burden. In theory and, in our opinion, in practice, corporate shareholders expect a positive, after-tax return on their investment that is unaffected by the income tax rate on corporate profits. In this framework, corporate income taxes are eventually paid by consumers and workers who coincidently also pay all other income and sales taxes.

What wisdom should investors take from the above disconnects? With respect to investing, buying low and selling high (aka re-balancing) with a reasonable estimation of value based on earnings power remains a simple but often difficult process to follow. Buying low requires conviction in the valuation process since media reports will be focused on selling at the same time. Selling high also requires conviction to go against the media trend and to offset a common aversion to paying capital gains taxes. We think wealth accumulation is enhanced through deferral of income and capital gains taxes over long holding periods, but when the after tax proceeds from a sale exceed a reasonably determined fair value of an asset, selling is the proper action to take.

Since most of the equity (stock) investments in portfolios are in the form of tax-paying corporations, investors should be aware of the impact of income taxes on corporate earnings and resulting equity valuations. We think corporations are dynamic economic organisms that will adjust prices and costs to absorb any net increase in tax burden at least over the longer term. In fact, price declines in the short term may represent a buying opportunity. A much bigger concern for investors is the relative allocation of economic resources between private and public direction. While we think prosperity is optimized through private activities, on this subject abundant opinions vary widely, reported facts frequently contradict, and the truth eventually is revealed but may not get reported. Beware the promise of free lunches from our politicians.

Investment Market Returns as of March 31, 2021

Returns on equity investments continued strong through the first quarter. The broad US stock index returned 6.4% and 62.8%, respectively, for the recent three month and twelve month periods. Smaller US stocks generated even higher returns than the more familiar large cap indices, signaling for at least the time being the benefit of diversification in capitalization. Returns on non-US stocks in US dollar terms were also positive with returns of 3.5% and 49.4%, respectively, for the quarter and trailing twelve months. Of note, weakness in the US dollar exchange rate was additive to the twelve month returns but reversed course in the recent quarter on the strength of higher US bond yields. Investor sentiment has become quite bullish since last summer on a belief that the world economy is on track to recover from the impact of the COVID-19 pandemic. US equities continue to reflect materially higher sales and earnings price multiples compared to non-US equities, seemingly based on the conviction that growth opportunities remain stronger in the US.

Bond returns shifted gears in the first quarter with the broad US investment grade index recording a negative total return of -3.4%. Most of the damage to the index came from the longer duration segments as indicated by a negative return on long term US Treasury bonds of -13.5%. For the trailing twelve month period, the broad US index generated a near breakeven total return of 0.7%, reflecting an average yield of 1.3%. The broad index for non-US bonds behaved similarly for the quarter with a negative total return of -6.4%; however, favorable yield and currency tail winds were evident in a twelve month return of 3.5%. The recent weakness in bond prices across the globe seemingly reflects an increasing concern for future price inflation and the result upward pressure on bond yields. As of this date, concerns for higher credit risk have not yet appeared judging from the very tight yield spreads on lower quality bonds.

Returns on the alternative investments used by our firm were mixed for the quarter and twelve months. Hedged equity strategies generated positive returns that lagged traditional equity returns, as would be expected. Positions in gold bullion etfs lagged the broad commodity index, perhaps signaling higher demand for industrial commodities from improving economic activities and a lower risk of global geo-political instability. Returns on cash remained near 0% with stable nominal value being the only redeeming feature.

Our Look Forward

The margin of safety and forward return expectations in the current prices of marketable securities remain low, which subjects account valuations to higher volatility should investor sentiment turn more bearish. Investors may well consider using higher allocations to both US and non-US equities to achieve desired portfolio returns. Such an approach makes sense where the client has an appropriate time horizon and emotional construct to “stomach” the volatility in market prices and an ability to adjust periodic withdrawals in periods where market values decline significantly. As unappealing as the bond yield may be, bonds continue to have a useful role in a diversified portfolio.

In Closing

We look forward to visiting with each of you about your investment results and expectations for the future and to make sure your portfolios are aligned with your specific circumstances. We greatly appreciate the opportunity to serve as your investment adviser and pledge our best efforts to meet your expectations.

P. Michael Adkins, CFA
mikeadkins@ascm-llc.com

J. Richard Seale, CFA
dickseale@ascm-llc.com

Jay K. Binderim, CFA
jaybinderim@ascm-llc.com

333 Texas Street, Suite 2235 Shreveport, LA 71101 • 318-703-3641 • 800-304-6588 • www.ascm-llc.com