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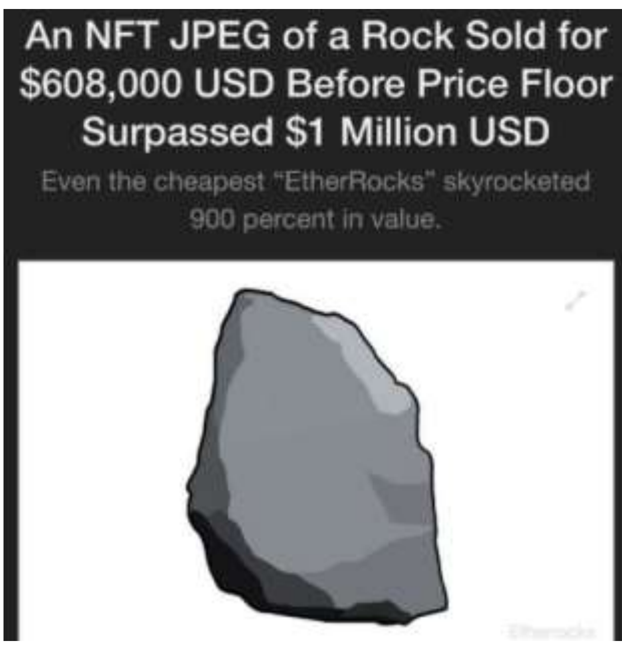
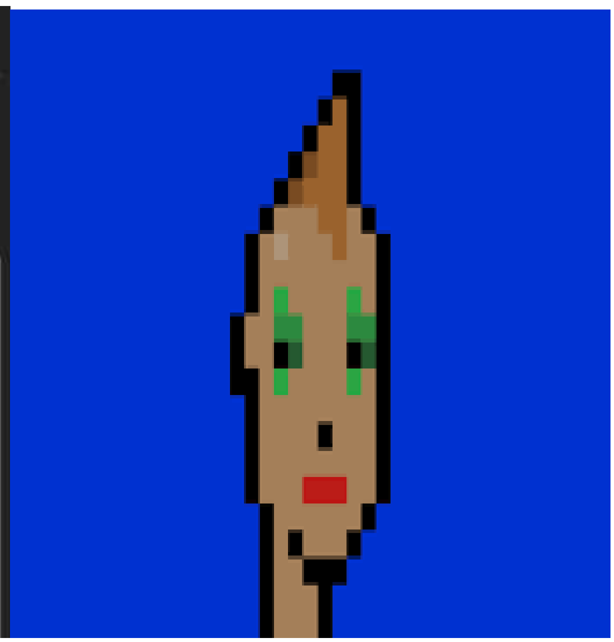
Investor Update

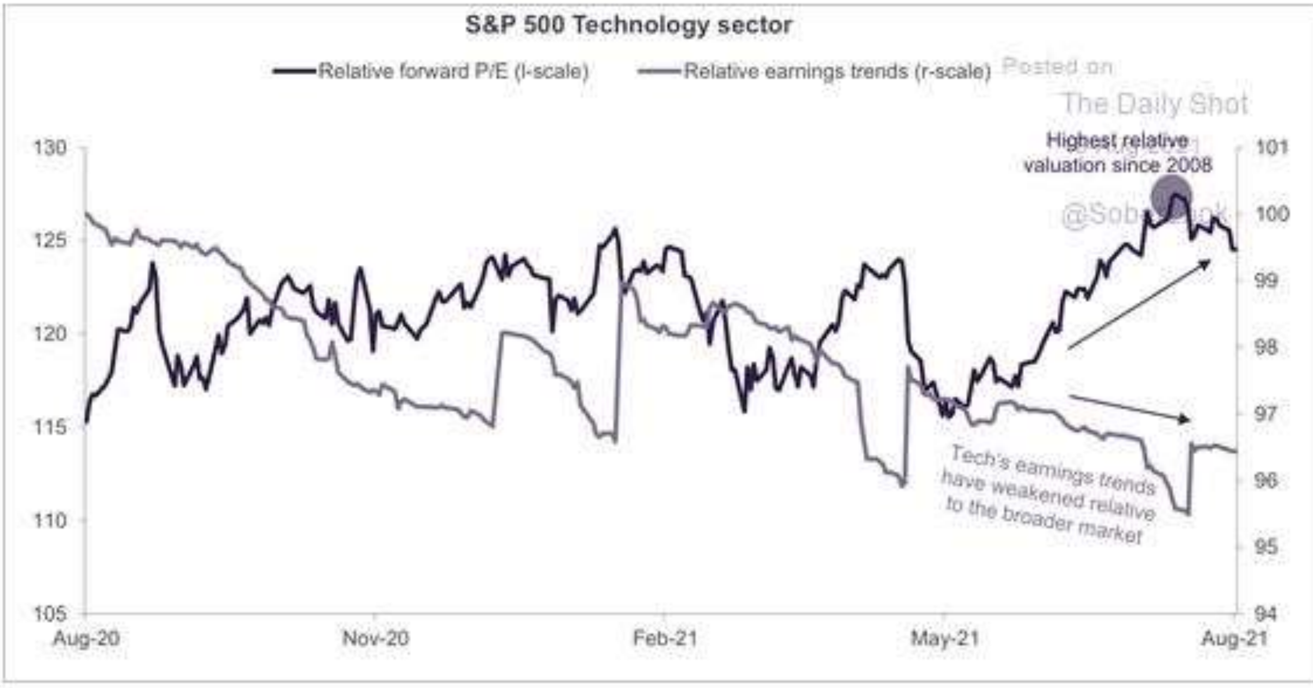
August saw much of the same with a low volume grind with very little movement of the indices while money continued to concentrate in the same areas that are working. Additionally, we saw a return to speculative activity as it continues to move around among different asset classes. In fact, this is the most speculative environment we have ever seen. Right now it is so speculative that the riskier the asset the higher the reward and it is coming at the expense of anything deemed safe.

We are going to take a step back from the analytics to start this letter in order to illustrate the speculative frenzy that we are currently in. People may or may not have heard of NFT's. The definition "An NFT is, in essence, a collectible digital asset, which holds value as a form of cryptocurrency and as a **form of art or culture**." These collections of art are skyrocketing in value. Below is a picture of an NFT rock that went from $608,000 to over $1 million very quickly. Then Visa made headlines when it decided to purchase the next piece of art for $150,000. The announcement of the Visa purchase also propelled the stock higher by over 1% on the day. Greed and speculation are what eventually lead to epic crashes as ever increasing risk is taken until it eventually blows up on itself. This is about as blatant a display of excess that we have ever seen.

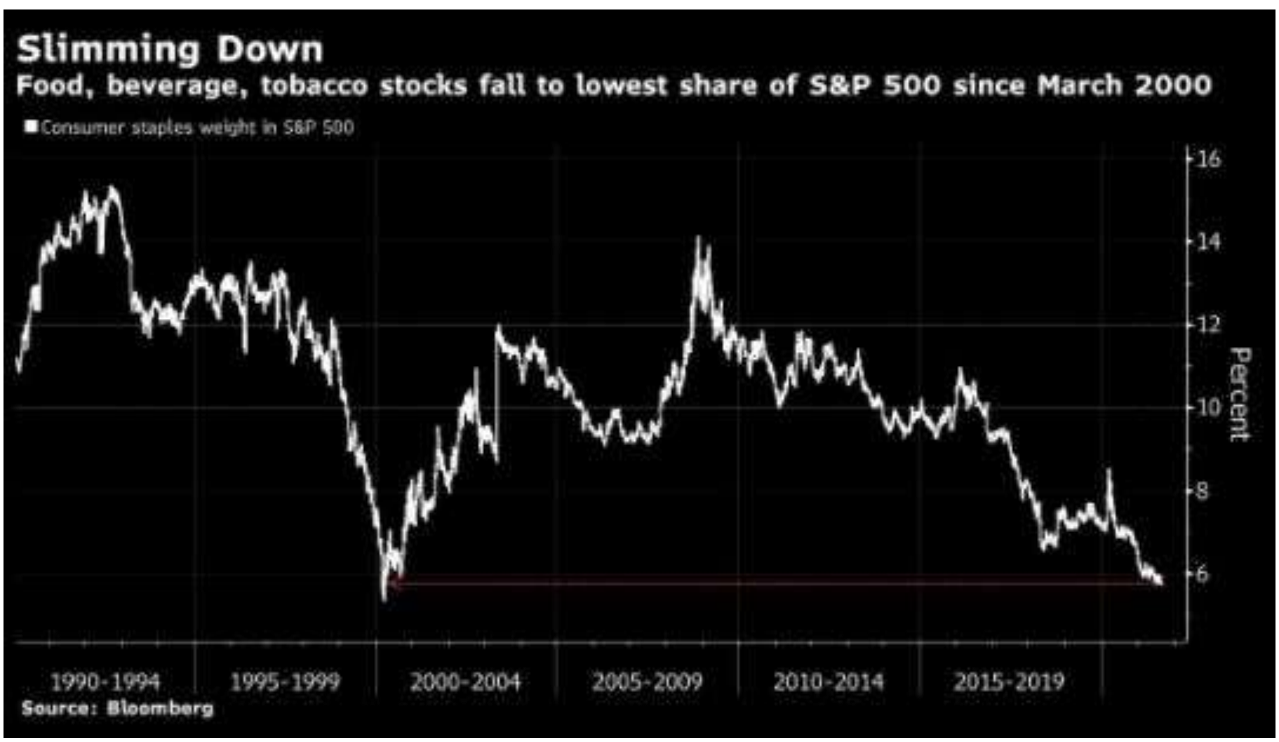




As we come into the last 4 months of the year we want to highlight a few of the narratives in the market. Narratives are a way for market pundits to describe price action. It is a way to explain **WHY** prices are moving the way they are. In reality, there are many factors at work and upon closer inspection the narrative does not match up with reality. As an example, the last few months have seen technology leadership once again and in particular the big 5 names which make up close to 25% of the entire S&P 500 (Apple, Microsoft, Google, Facebook, and Amazon). The general view has been that their earnings power has been spectacular and that they have been a beneficiary of the pandemic. The next chart shows that upon further inspection, tech earnings are actually trending weaker to the overall market while investors are paying the most for those earnings since 2008.



These moves are coming at the expense of boring companies that pay dividends. What is interesting about this is that the narrative surrounding high stock valuations and people owning technology shares is that interest rates are low. The idea is that if investors are not able to get enough return in bonds than they will switch to buy stocks instead in order to generate that required return. Once again this narrative does not hold up. An investor that buys bonds is looking for income and safety. If they are not getting enough income from bonds than theoretically they would switch to dividend paying equities, and in particular those equities whose earnings are not going to fluctuate drastically with changes in the economy (safety). The below chart demonstrates that these particular stocks are underperforming drastically to the point where they have the lowest weighting in the overall market since March 2000. If this was a low interest rate story, as opposed to a speculation story, then the income alternative stocks would be doing well and they simply are not.



Lastly, we wanted to highlight the importance of dividends in total return, especially when we are sitting at extreme valuations. The below chart compares UK stock returns since the mid 1990's until today. For 20 years the only return an investor would have received is solely attributable to dividends being paid. 20 years is a long time to not generate return from investments. In Japan it has been well over 30 years with negative returns. Many people believe this cannot happen here in the United States because of our entrepreneur spirit, hard work, and determination. While we love everything that United States stands for we unfortunately believe we could be looking towards the same fate as other countries, especially when businesses are having a hard time finding workers and fortune 500 companies are using cash to buy digital art pieces instead of spending on capital expenditures to grow the business.

Going forward, the speculative frenzy will continue until it eventually ends in spectacular fashion. While we have no idea what the catalyst will be to start the mean reversion, all of the ingredients are currently in place that it only needs the smallest of sparks. Eventually, money will flow into the defensive sectors and the only form of return will come from dividends for several years. This is where new money should be placed as it is the only place that not only provides relative value (cheap compared to other assets) but is actually cheap relative to history.

If you have any questions or would like to see more charts, please contact me at 908-376-3041 or via email at markpainter@everguidefinancial.com.

Sincerely,

Mark R. Painter, CFA