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CAPITAL MANAGEMENT

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# Year-End Commentary and Outlook for 2024
## Time to be a Contrarian

It is hard to believe that we started 2023 with Wall Street analysts uttering their most negative forecasts in history and ended the year with the market trading near all-time highs! **The result is that the P/E multiple for the stocks with the lowest P/E in the S&P 500 are selling at one of the largest discounts to the highest P/E stocks on record.** The two other extremes occurred in 1980 and 2000. Those two years represented the greatest buying opportunities ever for value stocks measured on both a relative and absolute basis. The "Magnificent Seven" of course had everything to do with what the market did in 2023, with AI enthusiasm giving the seven stocks an additional boost.

**There is always an equivalent of the Magnificent Seven* in every cycle. As we have shown in previous letters, any time the highly priced stocks represent more than 25% of the weighting of the S&P index, which is what we now have, that level tends to mark the peaking of the popular stocks.** In the 1960s there were the conglomerates; in the 1970s, the Nifty Fifty; in the 1990s, the Japanese bubble; and in 2000, the high-tech boom. In each case, the speculative build up was followed by a surprisingly long period of correction - as long as 10 years.

### The Contrarian View

This contrarian result is not unusual. Back in the 1960s and 1970s, brokerage and advisory firms started off the beginning of every year with their top ten stock recommendations. **In my experience, at the end of the year, in almost every case, the firms' selections did worse than the overall market.** The experience for institutional professional investors was not any better. We see, for instance, that the Annual Institutional Investor Conference in 1970 published their best ideas from the brightest analysts from all over the world. Their list also proved to be disastrous. As a result, gradually, many stopped publishing those beginning of the year recommendations. This experience supports the legendary Ben Graham's warning of the danger of getting caught paying too high a price for popularity.

### Performance

One of the biggest ongoing challenges for investors is overcoming the almost irresistible temptation to buy stocks when they are very popular and at their highs and to sell them when they are out of favor and at their lows. The urge to chase performance becomes increasingly compelling as the market goes higher and higher. Today it is easy to see why when seven stocks in the S&P 500 are up more than 70% while the rest of the index is basically flat. The increasing momentum of flows out of the average stock and into the Magnificent Seven has had the value stocks going down not because of fundamentals, but because of flows. **Meanwhile, as the market goes higher, advisors are increasingly under pressure to make changes.** The best example has been the growing popularity of the alternative categories. (i.e., alternatives to equities). Last year, brokerage firms showed liquidations of 15% in common stock mutual funds, while flows into alts have been extraordinary. We see that money going into private equity funds were up 83%, private real estate funds +54%, and private credit and infrastructure +39%. Other popular alternative areas include hedge funds, private properties, private debt, fixed income, global bonds, global property, and venture capital. (*Source: FundFire, July 5, 2023*)

**By the way, it is easy to forget that while the Magnificent Seven were up 77% last year, the year before they were down 44%, resulting in a two-year return of only 5%, which was similar to the average stock mutual fund over that same two-year period. ****

**More on Alternatives**

**Many of these alternatives certainly make a lot of sense, but investors need to be careful because some do not have much of a track record and the risk levels can be more than people realize - and fees are typically higher.** Remember that it was only a year ago that the hottest area was in SPACs (special purpose acquisition companies) and the publicity about them was everywhere in the financial media. This year, at least 21 of these vehicles went bankrupt while there was almost no mention of what happened in the press. A university of Georgia Law Professor, a close student of the alts, believes that blowups are unlikely to be over any time soon and "that many of these companies are ticking time bombs." ***

Some of the early returns for alts are coming in and the results have not been good. According to a recent FundFire article: ***

1. The $700 Billion Singapore Wealth Fund, one of the major alternative investors, pointed out that alts have produced their worst returns in years.
2. The Oregon State Pension Plan pointed out the results for the alternatives have been disastrous.
3. A major report by the chairman and founder of Ennius Knupp, which is now part of AON, focused on the period 2008 – 2021 reported that the alternative strategies have been a drag on portfolio performance for that entire period.
4. The California Pension Fund pointed out that a few of their alternatives are now being classified as zombie holdings.

The investing world has certainly changed, because it used to be that pension and individual allocators would divide their assets into growth funds, value funds and cash equivalents. Today, this is dramatically different. **Looking at pension allocations over the last year shows that**

**there have been almost no searches for allocations to value.** One personal experience is with a large institutional client of ours, overseen by one of the major institution consulting firms. This is a value account and the consultant pointed out that they had not done a value search in 10 years and to monitor our account they had to outsource it to an outside firm because they have no one researching value in-house.

### Alternative to the Alternatives

Our recommendation as an alternative is the value discipline. Below are the rolling 10-year periods of the bottom 20% of stocks by P/E in the S&P 500 annualized. These periods include 12 economic recessions and many more bear markets. What it shows is how the combination of a value discipline plus a long-term period helps smooth the performance. **What we call this is long term value investing.**

**Long Term Value Investing**
**S&P 500 Bottom 20% by P/E – Annualized 10-Year Returns**

| | Bottom 20% by P/E |
|---|---|
| 2013 - 2022 | +11.30% |
| 2012 - 2021 | +13.45% |
| 2011 - 2020 | +10.70% |
| 2010 - 2019 | +13.25% |
| 2009 - 2018 | +15.42% |
| 2008 - 2017 | +11.45% |
| 2007 - 2016 | +9.55% |
| 2006 - 2015 | +9.58% |
| 2005 - 2014 | +11.06% |
| 2004 - 2013 | +12.05% |
| 2003 - 2012 | +11.73% |
| 2002 - 2011 | +9.07% |
| 2001 - 2010 | +10.57% |
| 2000 - 2009 | +10.92% |
| 1999 - 2008 | +7.03% |
| 1998 - 2007 | +12.45% |
| 1997 - 2006 | +16.13% |
| 1996 - 2005 | +16.20% |
| 1995 - 2004 | +18.55% |
| 1994 - 2003 | +16.46% |
| 1993 - 2002 | +14.49% |
| 1992 - 2001 | +17.36% |
| 1991 - 2000 | +20.23% |
| 1990 - 1999 | +15.72% |

| | Bottom 20% by P/E |
|---|---|
| 1989 - 1998 | +17.31% |
| 1988 - 1997 | +20.29% |
| 1987 - 1996 | +15.82% |
| 1986 - 1995 | +17.05% |
| 1985 - 1994 | +16.41% |
| 1984 - 1993 | +17.99% |
| 1983 - 1992 | +19.08% |
| 1982 - 1991 | +20.17% |
| 1981 - 1990 | +17.44% |
| 1980 - 1989 | +22.83% |
| 1979 - 1988 | +23.62% |
| 1978 - 1987 | +22.21% |
| 1977 - 1986 | +24.00% |
| 1976 - 1985 | +25.42% |
| 1975 - 1984 | +27.59% |
| 1974 - 1983 | +24.15% |
| 1973 - 1982 | +19.18% |
| 1972 - 1981 | +17.18% |
| 1971 - 1980 | +16.46% |
| 1970 - 1979 | +14.58% |
| 1969 - 1978 | +9.55% |
| 1968 - 1977 | +11.03% |

*Source: SCCM Research, 2023; S &P Research, 2023*
***Past performance does not guarantee future results. Investors cannot invest directly in an index.***

## Conclusion

**While a contrarian view is always important in investment decision-making, it is especially important in periods like this one where we believe the market has reached an extreme level. A few expensive stocks are selling at extreme multiples while the most conservative sector of the market is the most out of favor – this is the high dividend stock category. Time to be a contrarian.**

Jim Cullen

***Apple (AAPL), Alphabet (GOOGL), Microsoft (MSFT), Amazon.com (AMZN), Meta Platforms (META), Tesla (TSLA) and Nvidia (NVDA)**

****Source: SCCM Research, Bloomberg, 2023**

*****Source: FundFire, December 28, 2023**

**Past performance does not guarantee future results and there is no assurance any trend will continue. Investing in the stock market involves gains and losses and may not be suitable for all investors. Investing in equity securities is speculative and involves risk. Investing in foreign securities involves greater volatility and political, economic and currency risks and differences in accounting methods. Dividends are subject to change and are not guaranteed. Dividend income is just one component of performance and should not be the only consideration for investing.**

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