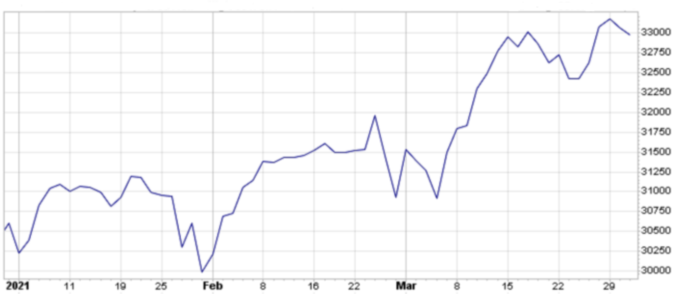
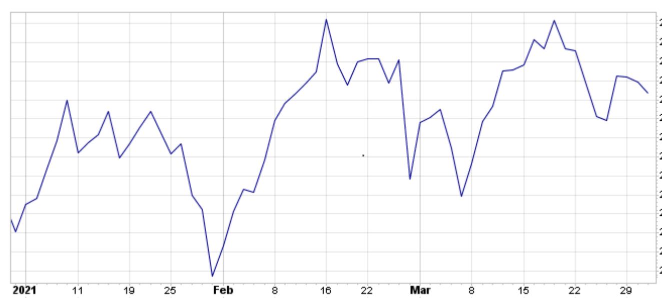
INTELLIGENT INVESTMENT

First Quarter Newsletter, 2021

DOW JONES YTD 8.29%[4]



MSCI ALL WORLD ex US YTD 3.48%[4]



"Keep on Loving You"[1]

"And I'm gonna keep on lovin' you
'Cause it's the only thing I want to do
I don't want to sleep, I just want to keep on lovin' you"[1]

Investors have certainly kept up their love affair with the equity markets in 2021. After the exceptionally volatile year that was 2020, will 2021 bring a more careful, nuanced approach by the masses of investors? Or will everyone "Keep Pushin"[1] these markets ever higher? With the S&P 500 remaining mostly over 22x earnings since May of last year it would appear market participants loved high multiples of earnings and… "They meant every word they said, when they said that they loved high multiples of earnings, they meant they loved high multiples of earnings forever."[1] Meanwhile I can't help to remain concerned the markets are "coiled up and hissin"[1] waiting to strike with a grim reminder of past painful lessons of risk and reward.

Last quarter we began our curriculum under study for 2021; "Risk". We spoke primarily about risk and how investors perceive risk in any given market environment through the metaphor of a pendulum. Let us begin to put 2021 into context with a quote from our favorite Professor Emeritus Mr. Howard Marks "The degree of risk present in a market derives from the behavior of the participants, not from securities, strategies, and institutions".[2]

Behavior… It is the psychology and behavior of market participants that is the core driver for all major market swings up or down, not necessarily fundamental data derived from thorough, thoughtful macroeconomic study. Wait, haven't you been writing for years the market is an economic / earnings anticipation machine? Yes, but it is the irrationality resulting from this information mostly stemming from greed or fear of missing opportunities, to fear of losing money.

Risk appears not in economic and corporate earnings data but the varied reactions to the information that is available in the data. How has this behavior manifested in our markets today? Has this nearly yearlong market exuberance and once in a generation earnings multiples actually equated to overvalued equity market? Or is the economy strong enough to support and sustain these prices?

Let's take a look at the Buffet Indicator, aptly named after its creator Mr. Warren Buffett. "Warren Buffett called this metric "probably the best single measure of where valuations stand at any given moment." The Buffett Indicator measures the ratio of stock market's total value to U.S. economic output. The idea is that abnormally huge valuations relative to GDP cannot remain at those levels, let alone wax from there, if future earnings also soar to devour a much-bigger-than-normal slice of national income. That can happen for a few heady years. But over a longer span, outsized profits trend back to their traditional share of GDP. As the late economist Milton Friedman said, "Over time, corporate earnings can't absorb more than their traditional share of national output in our competitive economy." When that "reversion to the mean" in profits occurs, valuations also drop.

We've witnessed that pattern many times. The difference now is that stocks have never defied the Buffett rule for so long, nor gotten so incredibly out of the whack with this heretofore gravity-like force. Since the S&P 500 companies hold 70% of the value of all U.S. equities, we'll use it as a proxy for the overall market cap. For the past quarter century through the close of 2020, measured at year end, the median S&P market cap to GDP is 85.65%. The number ranges from 54% in 2008 in the depths of the Great Financial Crisis to 131% at the apex of the tech bubble in 1999. From the end of the dot.com craze, the ratio didn't reach 100% again until the close of 2016.

From there, the Buffett Indicator took off, jumping to 122% in 2019, 147% in 2020, and at the end of the first quarter of 2021 with the S&P hovering near 4000 sits at 155% based on the CBO's GDP forecast for this year. Since 2016, the S&P's total valuation has risen 100%, far outstripping the 19% increase in national income projected through the end of this year. The current 155% number is 80% above the quarter century median, and nearly 20% higher than the ratio at the peak of the tech frenzy."[3]

If prices are too high does that mean the market is heading down? ""Prices are too high" is far from synonymous with "the next move will be downward."[1] Things can be overpriced and stay that way for a long time . . . or become far more so." Then what are investors to do with an overpriced market? "Roll with the Changes", "Keep the Fire Burin", "I Do Wanna Know"… as does everyone. Attempting to predict future market moves is a difficult if not impossible task, furthermore over time those predictions and market proselytization's prove to be of no utility whatsoever. What is of use to market participants is knowledge markets at some point will revert to a more traditional relationship with Gross Domestic Product regardless of what everyone may be buying or selling in the moment. The best question anyone can pose is "Where is the pendulum today?"

When there is a popular stock or investment mania said to be providing some market advantage, then by definition of its own popularity cannot provide any advantage. If everyone is buying, selling, shorting, etc… any type of security then the price will reflect its popularity. If you don't believe me, "I heard it from a friend who… heard it from a friend who"[1]… said to buy Game Stop!… "There's only one form of intelligent investing, and that's figuring out what something's worth and buying it for that price or less. You can't have intelligent investing in the absence of quantification of value and insistence on an attractive purchase price. Any investment movement that's built around a concept other than the relationship between price and value is irrational."[2]

Spring has sprung! Get a cold beverage, go outside and enjoy the lovely weather or "Take it on the Run". No matter the headline or market risk du jour, ARPG will continue to practice our approach to value investing. "Intelligent Investment is Investment on Value"[5]. This is what sets American Retirement Planning Group apart from the rest. As always, we thank you for your confidence and are humbled by your trust. Please feel free to contact us at any time.

INTELLIGENT INVESTMENT

Sincerely,
Matthew D. Dahl
Chief Investment Officer

1. REO Speedwagon
2. Howard Marks, The Most Important Thing
3. Forbes
4. ARPG / Stockcharts.com
5. Matthew Dahl