# INTELLIGENT INVESTMENT

*Second Quarter Newsletter, 2021*

*DOW JONES YTD 12.73%*[4]


*MSCI ALL WORLD ex US YTD 8.36%*[4]


## "Much Too Young To Feel This Damn Old"[1]

"The ol' highways getting longer
Seems there ain't no end in sight"[1]

Has Garth Brooks become a stock market commentator? It sort of sounds that way with the markets growing like they have these last 15 months. There must be wisdom in that 10-gallon hat. I suppose with the second quarter of 2021 coming to a close and equity markets at all-time highs, (well above any previous year's levels) 2020's soul wrenching market crash feels like nothing "More Than Just a Memory"[1]. But still I see no reason to continue to ponder on what caused the crash or what provided the catalyst for the subsequent market mega rally. Let's go ahead and plan on this bull market raging on like there's no tomorrow! Sound familiar? Does this remind you of most, if not all stock market punditry?

"If Tomorrow Never Comes"[1] I suppose the talking heads will be correct. Unfortunately for them "tomorrow" always shows up. Sometimes a little early, sometimes a little late, sometimes just a trickle, sometimes it becomes "The River"[1] that no one expected. In any event you can be certain it will appear… and may be here sooner than some reckon, I reckon.

The S&P 500 and Dow Jones have enjoyed a fantastic year so far with the indices up 14.41% and 12.73% respectively. The S&P 500 has not had a first half as good as this year since 1998. With markets doing so well perhaps our old, clandestine friend "risk" is simply on a well-deserved vacation after being locked down for a year. Ha, very funny! As much as one might think anthropomorphizing risk as a silly, "Shameless"[1] exercise, this is actually the proper prism in which to look at risk.

As we continue this years in depth study of risk; let's remember from last quarter "Risk appears not in economic and corporate earnings data but the varied reactions to the information that is available in the data… 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."[5] Market risk IS the varied reactions of market participants, i.e. people. Risk is people's behaviors and deserves to be studied through human its characteristics.

Equipped with an understanding of risk's true origins, we can more plainly see "The biggest investing errors (i.e. buying or selling at the wrong time) come not from factors that are informational or analytical, but from those that are psychological."[2] And "the key to understanding risk: it's largely a matter of opinion."[2] These two factors describes almost perfectly why equity markets "Ain't Goin Down til the Sun Comes Up"[1]. Market psychology has moved our risk pendulum into a place where risk has become more an afterthought then a centerpiece of consideration. The opinion of market participants these days seem to be that equity market gains will be wonderful and remain so ad infinitum. These opinions will likely become "Unanswered Prayers"[1] sometime in the future.

Elevated market prices coupled with little to no caution among participants equates to vast quantities of risk for those who are unable or unwilling to consider "tomorrow". Let's look at valuation levels beyond the typical markets price to earnings ratios. According to commonwealth.com "When it comes to assessing valuations, we find longer-term metrics—particularly the cyclically adjusted Shiller P/E ratio, which looks at average earnings over the past 10 years—to be the most useful in determining overall risk. Looking at this metric, valuations continued to rise in June, as the CAPE Shiller ratio rose from 36.76 in May to 37 in June. This marks four consecutive months with rising equity market valuations, and it left the Shiller CAPE ratio at its highest level since late 2000."[3]

The elevated Shiller P/E in concert with ARPG's favorite metric to study; the S&P 500 to GDP ratio, known better as "The Buffet Indicator" being 240% above its historical average should be a warning sign to anyone willing to participate in critical thinking. Our Professor Emeritus, Howard Marks speaking about the 2008-2009 market crisis "Everything you needed to know in the years leading up to the crash could be discerned through awareness of what was going on in the present."[2] Hear hear Professor Marks!

What's in store for the remainder of 2021? Are these heightened levels of valuations steering equities inevitably toward a major and sustained bear market? As much as a 20 plus percent long-term market crash seems unlikely given the current strength of the economy and demographics, we know attempting to forecast future market direction IS a silly and "Shameless"[1] exercise, so let's leave that to the clowns. However, remaining cognizant of where valuations are now is essential when making decisions on the optimum places in which to deploy capital for growth as well as areas that need to steered clear of in an effort to avoid "capital punishment". Who wants "Friends in Low Places"[1] anyway"?

Summer is here and it's a hot one. Grab "Two Pina Coladas"[1] and hope "The Thunder Rolls"[1] in and brings some rain and cooler temperatures to a great many regions these days. ARPG will continue to practice our approach to value investing. "Intelligent Investment is Investment on Value"[5]. This is what sets ARPG 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.

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Sincerely,
Matthew D. Dahl
Chief Investment Officer

1. Garth Brooks
2. Howard Marks, The Most Important Thing
3. Commonwealth.com
4. ARPG / Stockcharts.com
5. Matthew Dahl