December 4th, 2024

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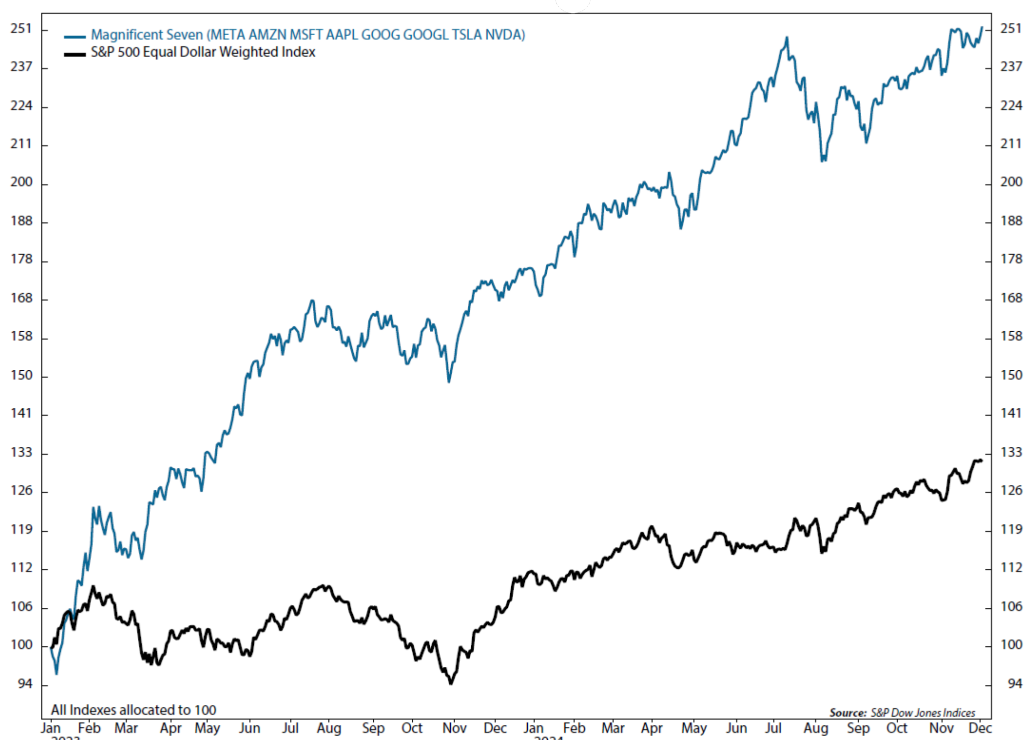
Chairman & CEO

2024 Year-End Comments

The Melt Up Continues And Two Surprises

In the beginning of 2024, almost all financial analysts and the general public were expecting a recession during the year. Instead, the market is up 27% (S&P 500) for the last 12 months as of mid-November and the market hit 6,000 for the first time, making new highs an amazing 51 times during the year. Much of this explosive strength has to do with a combination of the Magnificent Seven and AI excitement. **As a result, the market is now selling at a historic, very expensive 24x earnings, with the top seven stocks accounting for 37% of the S&P, a higher percentage than in past speculative cycles*.** The chart below shows how the Magnificent Seven has dramatically outperformed the rest of the market.

Magnificent Seven (Cap Weighted) vs. S&P 500 Index
01/01/2023 to 12/02/2024

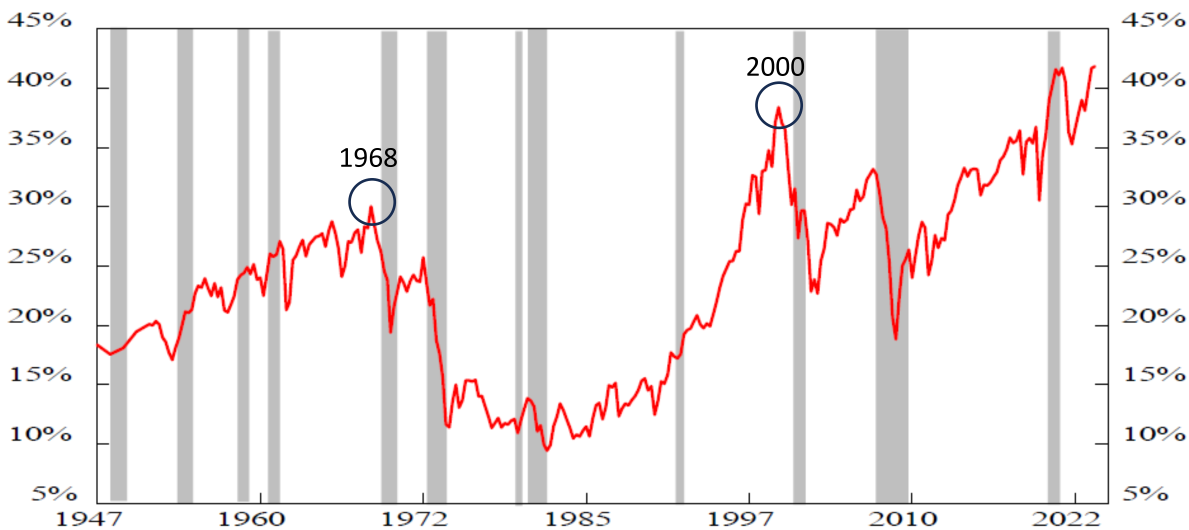


Source: S&P Dow Jones Indices.

All Aboard!

Melt-up markets, like this one, usually don't end until almost everyone is on board. **A recent survey by Morgan Stanley pointed out that we are getting close, as only 15 percent of those surveyed are now looking for a recession in 2025.** Also, public stock ownership is at a record high (see chart below) and higher than past cyclical highs.

<u>Household Corporate Equities Ownership</u>
Last Point 2Q 2024: 41.8%



Source: Federal Reserve

Is This Time Different?

The publicity, enthusiasm, and momentum surrounding this market has sparked talk that maybe this time is different from past melt-ups. **That may very well be the case, but there is an old saying on Wall Street that the four most dangerous words in investing are "THIS TIME IS DIFFERENT."** With this in mind, it may be worth looking at the experience of the last 100 years. As we have discussed in past market letters, there have been two melt-up periods like the present, when a select group of stocks has convinced investors that these stocks will outperform everything as far as the eye can see. We list the two periods below.

<u>The Nifty Fifty</u>

In the mid-1970s the high-quality growth stocks (IBM, Eastman Kodak, Xerox, Polaroid, etc.) became labeled the *Nifty Fifty*. **They were considered "deserted island" stocks, meaning that one could go to a deserted island for five or ten years, and when one came back, the prices of these stocks would always be higher, because their earnings and fundamentals were so strong.** This was half right. The earnings for the companies continued to be strong over the next ten years, but, in every case, the stock prices were down an average of 50 percent over the same ten-year period.

The Tech Bubble

The tech bubble of 2000 is the more recent example of a select number of stocks (Microsoft, Apple, Intel, Cisco, etc.) having such a major impact on the market. **During this time, a new term was coined, "new paradigm," meaning that these select companies would have a lasting impact on the world.** They certainly have. However, much like the Nifty Fifty, earnings were strong over the next 10 years, but the stocks also were down fifty percent over those same 10 years.

The Two Surprises

In reviewing the history of these past bubbles, there are two surprises.

1. **Surprise Number 1:** We have done studies over time pointing out how the highly favored stocks of an era finally correct, and how long that correction lasts. The table below appeared in our letter of October 15, 2002. **The surprise was that with the considerable correction in the two years after the highs, one would have thought that this drop had corrected the excess.** That was not the case. 10 years later, these major stocks were 50% lower.

   In 2002 when we did the report, we did not know where Microsoft's P/E would bottom. In the initial drop of 2002, the P/E multiple fell to 27x from 75x in 2000. **Ten years later, as in the earlier example, Microsoft's stock was selling at 10x earnings with a 5% dividend yield.**

MARKET COMMENTS
October 15, 2002

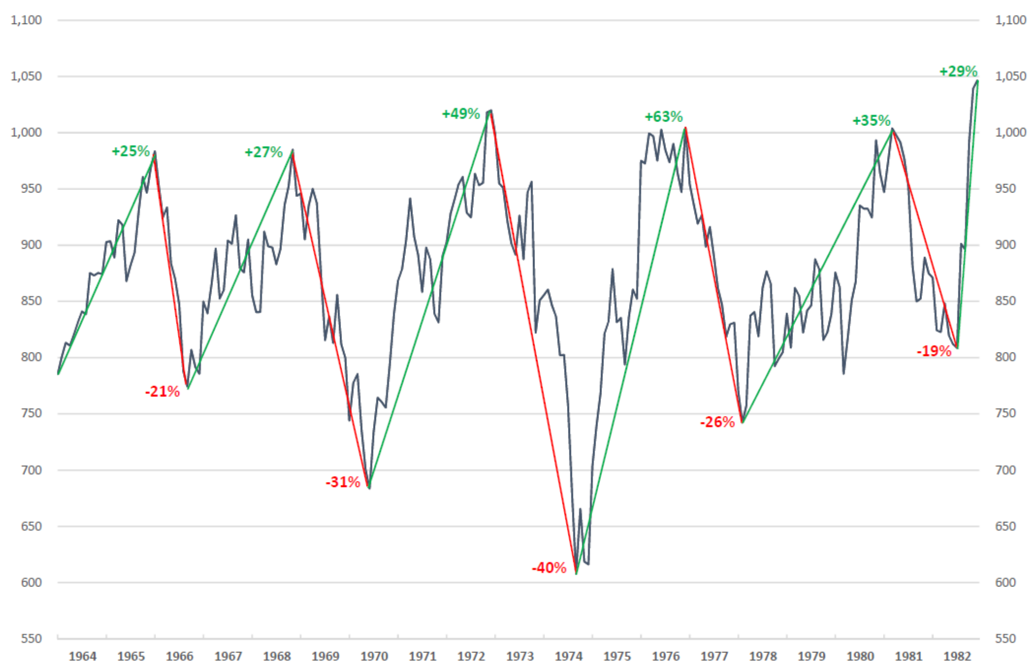
Major Technology Leaders

The Tech Stochs As Bubble Leaders	P/E at the Bubble High	P/E at Collapse	Time It Took for a Sustainable Recovery to Start (Peak to Bottom) and P/E Ratio at the Turn
RCA	75x in 1929	10x in 1932	12 Years and 4x in 1942
IBM	35xin 1973	12x in 1975	8 Years and 8x in 1981
Microsoft	75x in 2000	27x in 2002	?

Source: SCCM Market Comments; October 15, 2002

2. **<u>Surprise Number 2:</u>** In the mid-1960s, the market was in a very speculative period, as it kept making new highs and ran up to 1,000 for the first time. Over the next 15 years, the market was never able to break through the 1,000 barrier again and instead had big swings between 700 and 1,000, as you can see from the table below. It wasn't until 1982 when the market finally broke through 1,000 once more. **The surprise was that if one had bought the bottom 20% of stocks on a P/E basis in 1965, and each year until 1982, the return would not have been flat, like the DOW, but instead up 1,000%.** Of course, none of us realized this at the time but this experience is the main reason for us becoming value investors.

<u>Dow Jones Industrial Average (1964-1982) – Anything but Flat!</u>

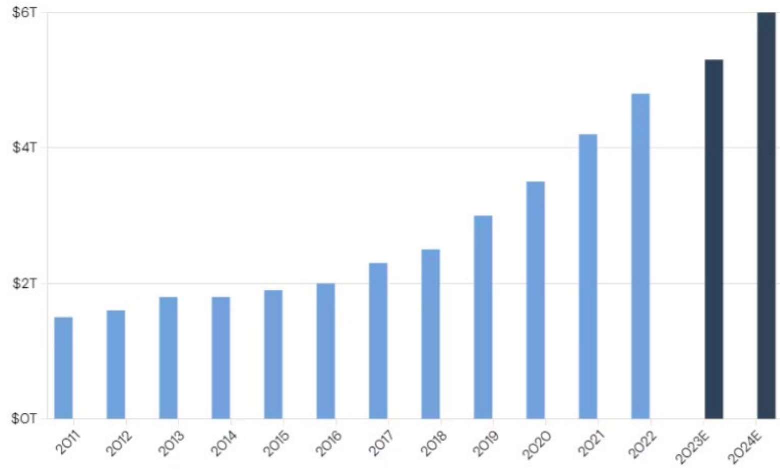


Source: Bloomberg; SCCM Research

Where is the Money Going Now?

In the past, like the present, a point is reached where due to extremely high valuations, investors desperately start looking for new strategies. In the last few years, private equity has had good returns for investors and the result is that the strategy has become increasingly popular, as you can see in the table below. **While the sector has produced good returns in a low-interest rate environment and a generally stable market, many experts in this area have pointed out that in a more difficult economic climate, it will be challenging. An example is the head of capital markets at Callan Capital who said "we haven't really had a good test of private equity in a down market." ****

Private Equity AUM ($trillions)



Source: Preqin as of 04/09/2024

Our Alternative Strategy

The below academic study is the annualized 10-year performance of the bottom 20% of the S&P 500 by P/E for every period dating back to 1968. Private equity has limited experience with down markets; on the other hand, the value strategy has experienced 12 economic recessions and bear markets during this time. Flows have been extremely positive for private equity as seen above; meanwhile, flows for value have been just the opposite despite its proven history.

S&P 500 Bottom 20% by P/E – Annualized 10-Year Returns

2014-2023	8.61%	1990-1999	15.72%
2013-2022	11.14%	1989-1998	17.31%
2012-2021	13.44%	1988-1997	20.29%
2011-2020	10.70%	1987-1996	15.82%
2010-2019	13.25%	1986-1995	17.04%
2009-2018	15.42%	1985-1994	16.41%
2008-2017	11.45%	1984-1993	17.99%
2007-2016	9.55%	1983-1992	19.08%
2006-2015	9.58%	1982-1991	20.17%
2005-2014	11.06%	1981-1990	17.44%
2004-2013	12.05%	1980-1989	22.83%
2003-2012	11.73%	1979-1988	23.62%
2002-2011	9.07%	1978-1987	22.21%
2001-2010	10.57%	1977-1986	24.00%
2000-2009	10.92%	1976-1985	25.42%
1999-2008	7.03%	1975-1984	27.59%
1998-2007	12.45%	1974-1983	24.15%
1997-2006	16.13%	1973-1982	19.18%
1996-2005	16.20%	1972-1981	17.18%
1995-2004	18.55%	1971-1980	16.46%
1994-2003	16.46%	1970-1979	14.58%
1993-2002	14.49%	1969-1978	9.55%
1992-2001	17.36%	1968-1977	11.03%
1991-2000	20.23%		

Source: S&P 500, SCCM Market Comments, June 27th, 2024

Conclusion

With investors confronted with so many uncertainties, especially very high valuations, investing could be more challenging than normal. **The message continues to be: stay focused on a valuation discipline and investing for the long term, ignoring the distractions.**

Jim Cullen

P.S. We often get asked if we ever buy the popular growth stocks. The answer is yes, when they meet our value criteria. **A perfect example is Microsoft, mentioned earlier (Surprise Number 1), which we first bought in 2009 at 9.5x earnings. Since then, Microsoft's stock price increased by over 1,900%.**

***Magnificent Seven are Apple, Microsoft, Alphabet, Amazon, Meta Platforms, Nvidia, and Tesla.**

****FundFire; October 15, 2024**

All charts included are for illustrative purposes only and not any recommendation to buy or sell a security.

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The **S&P 500 Index** is a market capitalization-weighted index of 500 companies in leading industries of the US economy. The **Dow Jones Industrial Average**, simply the Dow, is a stock market index of 30 prominent companies listed on stock exchanges in the US. Indices are unmanaged and have no fees. An individual cannot invest directly in an index.

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