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Chairman & CEO

Mid-Year Outlook

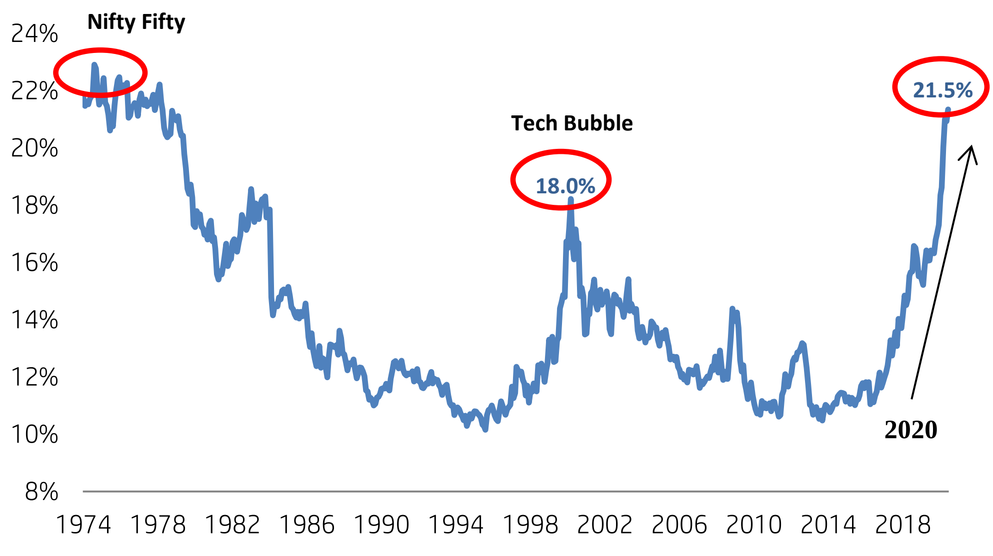
Look Out!

As the country went into lockdown, the lion's share of consumer sales was captured by Amazon, Wal-Mart, Netflix and similar companies. So many investors concluded: Why not just buy the stocks of these companies? Which sounds reasonable, but market history says, LOOK OUT.

After a long market advance like we just had, history shows that speculation builds and money tends to flow into fewer and fewer stocks, a concentration that coincides with major market tops. The chart below compares what's happening now with the Tech Bubble of 2000 and the Nifty Fifty bubble of 1975.

Record Concentration of Market Cap in 5 Largest Stocks

5 stocks account for 21.5% of S&P 500 equity cap: MSFT, AAPL, AMZN, GOOGL, FB



Source: Morgan Stanley Research, June 2020

A recent Barron's article* pointed out that the concentration in the NASDAQ is even more extreme. Its ten largest issues, led by the FANG stocks - Facebook, Amazon, Netflix and Google - are up $900 billion this year, while the other 2600 or so stocks in the index are down $300 billion. This is the new NASDAQ. After the 2000 peak, the old NASDAQ dropped 80% from its highs.

Past Market Extremes

Every cycle is slightly different, but each was preceded by a long bull market at the end of which momentum and speculation reached an extreme.

Tech Bubble - 2000

Most investors remember the bubble, which was fueled by investors finally coming back into the market after the Nifty Fifty collapse of the 1970s. **There was talk of a new paradigm created by new tech companies that would reshape the world far into the future. Also, a common theme during the bubble was that value investing was dead forever.** Technology certainly has been a factor in the world, but abandoning an investment discipline and chasing technology stocks was a mistake. When the market finally rolled over, the technology stocks, led by NASDAQ, went down about 80% over the next ten years. The chart below shows what happened to a few of the tech leaders.

Major Expansion	Top Stock	P/E Multiple at Peak	Return 5 Years Later (2005)	Return 10 Years Later (2010)
Tech Bubble				
	Cisco	230x	-78%	-67%
	Intel	50x	-66%	-76%
	Microsoft	79x	-55%	-48%
	Oracle	60x	-71%	-41%

Source: SCCM, 2020. For illustrative purposes only. This is not a recommendation to buy or sell the stocks shown.

The Nifty Fifty Bubble: 1973-1975

Most investors are probably not familiar with this bubble, which developed when I started in the investment business with Merrill Lynch. For many years there had not been much interest in the stock market, thanks to the 1929 stock market crash and the Depression of the 1930s that followed. However, interest returned to stocks as the economy started getting better after World War II. **Slowly, interest and speculation started coming back into the market and by the 1960s, both had become extreme.** Merrill Lynch and other major brokerage firms opened up offices all over the country and the offices were packed every day with new investors.

A recession in 1970 killed a lot of the interest and wiped out many of the speculators and speculative stocks. **Meanwhile, institutional investors developed a strong interest in the stock market because they were impressed with the quality and long term prospects of some of the major companies- these market favorites became known as the "Nifty Fifty".**

About them, one of Wall Street's most highly regarded investors made the following statement: ***"All these great stocks could be considered deserted island stocks, meaning that you could go on a deserted island for the next five years and when you come back, no matter what price you paid for the stocks they would always be higher."*** It turned out that this was not the case. Despite the good fundamentals, these great companies suffered major stock declines over the next ten years. See the sample below.

Major Expansion	Top Stock	P/E Multiple at Peak	Return 5 Years Later (1980)	Return 10 Years Later (1985)
Nifty Fifty				
	Avon Products	63x	-58%	-66%
	Xerox	254x	-70%	-83%
	Polaroid	26x	-79%	-87%
	Eastman Kodak	24x	-66%	-42%

Source: SCCM, 2020 For illustrative purposes only. This is not a recommendation to buy or sell the stocks shown.

Dealing with Momentum and Melt-up Markets

Because markets can stay overpriced and overbought for longer than many expect, the question becomes: how does the investor deal with extended and volatile markets?

Our solution and the cornerstone of our investment strategy is to invest with a value discipline and to invest on a five year basis. Our experience has shown that this combination tends to help smooth out performance even in the worst markets. The table on the next page, one that we have presented before, shows how the bottom 20% of the stocks by P/E in the S&P 500 performed in all the sequential five-year periods dating back to 1968. Next to the performance we show all the recessions and bear markets with the percentage drops for all the five-year periods.

Long-Term Investing

Consecutive 5-Year Periods 1968 – 2017

	Bottom 20% Stocks by P/E	Recessions	Bear Markets	
1968 – 1972	8.0%	1969 – 1970	2/1968 - 5/1970	**-36%**
1973 – 1977	14.2%	1974 – 1975	1/1973 - 2/1974	**-46%**
1978 – 1982	24.4%	1979 1981 – 1982	4/1981 - 8/1982	**-24%**
1983 – 1987	20.1%		8/1987 - 10/1987	**-33%**
1988 – 1992	18.1%	1990 – 1991	7/1990 - 10/1990	**-20%**
1993 – 1997	22.5%			
1998 – 2002	7.0%	2000 – 2001	7/1998 - 8/1998 1/2000 - 9/2001 3/2002 - 10/2002	**-19%** **-34%** **-34%**
2003 – 2007	18.2%		10/2007 - 3/2009	**-56%**
2008 – 2012	5.6%	2008 – 2010	4/2011 - 10/2011	**-19%**
2013 – 2017	18.0%			
Annualized Average:	**15.4%**	**1968 – 2017 ($1 million)**	**$1,307 million**	

**Annualized Returns. Source: SCCM Research, 2018 Past performance does not guarantee future results. Investors cannot invest directly in an index.*

Conclusion

Rather than trying to time the market, invest with a discipline and for the longterm.

Jim P. Cullen, CEO

Additional Comments

In recent market letters, we have commented extensively about the election cycle and the coronavirus, but brief comments about both might be appropriate here. As for the election cycle, we know that historically the stock market in a presidential election year usually does fairly well, especially when an incumbent president is aggressively looking to get re-elected. However, history also shows that the year after the election tends to be a tough one for the market, regardless of who gets elected.

In the short term, the coronavirus will continue to be a major market factor. But few college American history books make any mention of the Spanish Flu, which was dramatically worse than the present coronavirus – an estimated 675,000 deaths in the US versus the 115,000 to date for the current outbreak. The sole focus of the history books was World War I, where a fraction died compared to the Spanish Flu. The stock market then as now had a v-shaped recovery, discounting the present and looking to the future. In 1920-1921, there was a recession and a bear market that lasted 18 months, and again there was no mention of the Spanish Flu affecting the recession. The main focus was the inflation caused by the post-war buildup. The reason for the recession was blamed on the inexperienced new Federal Reserve (founded in 1914), which pushed rates aggressively higher, causing a recession.

These additional comments are keeping with the message of this market letter. That is, invest with a price discipline and invest for the long term, and that tends to digest all of the various shocks and crises, no matter how serious.

*Source: *A Few Big Stocks Are Driving the Market's Gains. That's an Opportunity.* May 22, 2020.

The **S&P 500 Index** is an unmanaged index of 500 large-capitalization publicly traded U.S. stocks representing a variety of industries. Investors cannot invest directly in an index.

There is no guarantee that any historical trend illustrated in this report will be repeated in the future, and there is no way to predict precisely when such a trend might begin.

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