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JIM CULLEN'S NEW BOOK URGES INVESTORS TO THINK LONG-TERM

THE CASE FOR VALUE INVESTING

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AT THE END OF THE DAY, THE MESSAGE IS CLEAR. BE DISCIPLINED ABOUT PRICE, DON’T OVERREACT TO HEADLINE NEWS AND BE A LONG-TERM INVESTOR.

VALUE INVESTING: THE DATA DOESN'T LIE

WHEN IT COMES TO THE BIG PICTURE, HE WROTE THE BOOK

BY HOLT HACKNEY

WALL STREET legend Jim Cullen's career began at Merrill Lynch in 1964. A stint at a research firm specializing in P/E research then pushed him to branch out on his own.

In 1983, he co-founded Schafer Cullen, his own research boutique, with a focus on buying stocks for the long-term with a price discipline. The firm's approach provided downside short-term protection and long-term growth, helping it attract over $20b in assets.

His new book *The Case for Long-Term Value Investing* merges six decades of investing experience with some eye-opening data, to make a strong argument for value investing. We caught up with him in his office to unpack his experiences and get some of his best advice for advisors, clients and investors.

T.S. You graduated from Seton Hall – Finance in 1961, and before starting your firm served in the U.S. Navy on the U.S.S. Essex. What lessons from the Navy are still with you today?

J.C. The Essex was an aircraft carrier that traveled all over the world; that experience made me more interested in international stocks. For example, one of the first stocks we bought was Jaguar, which was the British auto company. Because many of the international stocks were much cheaper than the U.S. companies, we started using a small percentage of ADRs in all our portfolios.

Then, eventually, because performance was so good in that area, we started an all-international portfolio, and then from that an all-emerging market portfolio.

T.S. You have over 5 decades of investment experience, and recently published *The Case for Long Term Value Investing*.Timely, given the recent rotation from growth to value. What period reminds you most of where we find ourselves today?

J.C. There were two distinct periods of the rotation from growth to value. First was the 1968 period, where the market approached 1000 for the first time and didn't penetrate that level until 1982. During that 14-year period, the Dow Jones was flat, and value stocks (bottom 20% on a P/E basis of the S&P 500) were up over 1000%. Another major period was 2000. Following the tech collapse there was a 10-year period where the S&P 500, driven by the tech stocks, experienced a negative return. Over that same period, value stocks doubled.

In both cases, there was a preceding pivotal year where the growth stocks were up, and the value stocks were down. During the present period, 2022 was a pivotal year where value stocks were down 5% and the growth-led S&P 500 was up 20%. Since then, value stocks have dramatically outperformed.

T.S. In the book you cover 'the value disciplines' and some of the lessons from Ben Graham at his final speech given in 1975. Are these disciplines still the core of your investment philosophy today?

J.C. Yes, we still follow the same disciplines, which are price to earnings, price to book and dividend yield. We are also interested in dividend growth. Another important piece of advice from Graham was to invest for the long term, another feature of our own philosophy, though what we have done to make that less vague is to focus on a five-year time horizon. This dramatically smooths out the performance for long-term investors.

In the table below, we have included a study of all the rolling 5-year periods of the bottom 20% of the S&P 500 dating back to 1968.

Bottom 20% Stocks by P/E Annualized Return	
1968-1975	↑8.0%
1973-1977	↑14.2%
1978-1982	↑24.4%
1983-1987	↑20.1%
1988-1992	↑18.1%
1993-1997	↑22.5%
1998-2002	↑7.0%
2003-2007	↑18.2%
2008-2012	↑5.6%
2013-2017	↑17.6%

Annualized returns.
Source: SCCM Research, 2022

Recessions	Bear Markets	Bear Mkt Drop
1969-1970	Feb 1968-May 1970	↓36%
1974-1975	Jan 1973-Feb 1974	↓46%
1979 1981-1982	Apr 1987-Aug 1982	↓24%
	Aug 1987-Oct 1987	↓33%
1990-1991	Jul 1990-Oct 1990	↓20%
	Jul 1998-Aug1998	↓19%
2000-2001	Jan 2000-Sep 2001	↓34%
	Mar 2002-Oct 2002	↓34%
	Oct 2007-Mar 2009	↓56%
2008-2010	Apr 2001-Oct 2001	↓19%

Performance of Low P/E Stocks in Five-Year Periods (1968-2021)

Period	S&P 500 Bottom 20% by P/E	Period	S&P 500 Bottom 20% by P/E	Period	S&P 500 Bottom 20% by P/E
1968-1972	8.00%	1985-1989	21.20%	2002-2006	16.20%
1969-1973	↓0.90%	1986-1990	10.50%	2003-2007	18.20%
1970-1974	0.40%	1987-1991	13.10%	2004-2008	0.20%
1971-1975	7.60%	1988-1992	18.10%	2005-2009	4.80%
1972-1976	14.10%	1989-1993	16.00%	2006-2010	5.60%
1973-1977	14.20%	1990-1994	11.90%	2007-2011	2.40%
1974-1978	21.10%	1991-1995	23.90%	2008-2012	5.60%
1975-1979	30.70%	1992-1996	18.60%	2009-2013	25.30%
1976-1980	26.10%	1993-1997	22.50%	2010-2014	17.70%
1977-1981	20.40%	1994-1998	18.70%	2011-2015	13.70%
1978-1982	24.40%	1995-1999	19.70%	2012-2016	17.20%
1979-1983	27.30%	1996-2000	16.60%	2013-2017	17.60%
1980-1984	24.50%	1997-2001	16.10%	2014-2018	6.40%
1981-1985	24.80%	1998-2002	7.00%	2015-2019	9.00%
1982-1986	27.70%	1999-2003	14.30%	2016-2020	7.80%
1983-1987	20.10%	2000-2004	17.40%	2017-2021	9.84%
1984-1988	20.00%	2001-2005	15.80%		

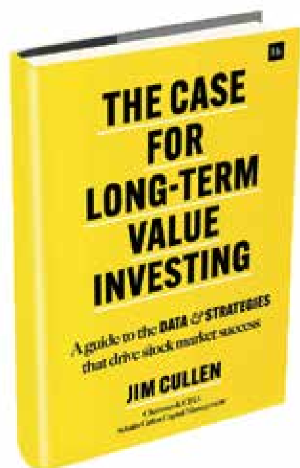
Source: SCCM Research, 2022

T.S. You describe the Achilles heel of investors as greatly overpaying for future growth. This was a characteristic of the FAANG era, which lasted nearly a decade. Do you think we are early in the rotation toward value stocks?

J.C. In the book, we discuss how once the major growth stocks represent more than 25% of the S&P 500, historically, that has been a warning sign that the market is overpriced. In the past, the shift out of those stocks has been long and dramatic.

Whether that applies in the present case depends a lot on the price of the individual tech or growth stocks. An example is what we saw during the Nifty Fifty period when IBM was the invincible leader during that era. It peaked in 1973 and even though business was good over the next 10 years, by 1984 the stock sold off to where it was a value name at 10x earnings with a 5% dividend yield.

The same thing with Microsoft, which we discussed in the book. During the Tech Bubble, the stock peaked in 2000, and value investors were able to buy the stock 14 years later at 10x earnings. This is despite the fact that like IBM, Microsoft's business was fine during that entire time. How this all plays out in the present market is not clear, but it is certainly worth noting.



T.S. What about recessions? You have amazing data in the book on 12-13 previous recessions, in which dividends increased. Any similarities between those periods and today?

J.C. We were shocked how dividends went up during all the recessions over the last 50 years. To illustrate this, we show, in the chart above, how during the 1973-1974 recession, one of the worst of all time, stocks went down about 50%, earnings also dropped almost 50%, and at the same time, dividends went higher.

T.S. You write in your book about the importance of company management and management teams. Are you concerned that today's leaders haven't experienced this type of inflation or economic downturn?

J.C. What we have seen over history is that management and companies are extremely motivated, incentivized and pressured to grow their earnings. They do everything in their power to increase earnings, such as cutting costs, making acquisitions, selling parts of their business, etc. Today, nothing has changed, management will figure it out.

T.S. In Chapter 28 of your book, you state "bear markets and recessions are where most investment mistakes are made." Any advice on how to avoid these mistakes, given the market we are currently living through?

J.C. Our conclusion on bear markets and recessions is explained in a study we have done dating back to 1968. Here we measure all the bear markets and recessions in every five-year period over the last 50+ years. At the same time, we list the rolling five-year performance for the value stocks. What we see is that no matter how bad things get, investing with a discipline and for the long term (5+ years), makes worrying about recessions and bear markets somewhat of a waste of time.

T.S. Ok Jim, we're in an elevator, what's the one thing I need to know about Schafer Cullen?

J.C. Be invested, be disciplined, be a long-term investor, and don't be distracted by all the noise. ■

INVESTING WITH A DISCIPLINE AND FOR THE LONG TERM, MAKES WORRYING ABOUT RECESSIONS AND BEAR MARKETS SOMEWHAT OF A WASTE OF TIME.

"History shows that it doesn't pay to try to time the stock market, but there are times when risk levels have increased to a point where it is wise to have a safety net – like dividends."

- Jim Cullen, Chairman & CEO

High Dividend Equity

Enhanced Equity Income

Value Equity

Small Cap Value

International High Dividend

Emerging Markets High Dividend

Water Impact

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For further information, please contact Cullen Capital Management

212.644.1800 • info@cullenfunds.com • www.cullenfunds.com

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