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DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: Mid-Year Reflections + Becoming Superhuman? – June 23rd, 2023

Good Morning, #TGICF

Mid-Year Reflections...
Investment dichotomy leaves openings for those willing to remain disciplined. Many investors are enticed by the allure of chasing what's hot, while others embrace the power of patience and foresight. We choose the latter, recognizing that true wealth is not built overnight. It's built on a steadfast commitment and process extending far beyond the day-to-day market noise.

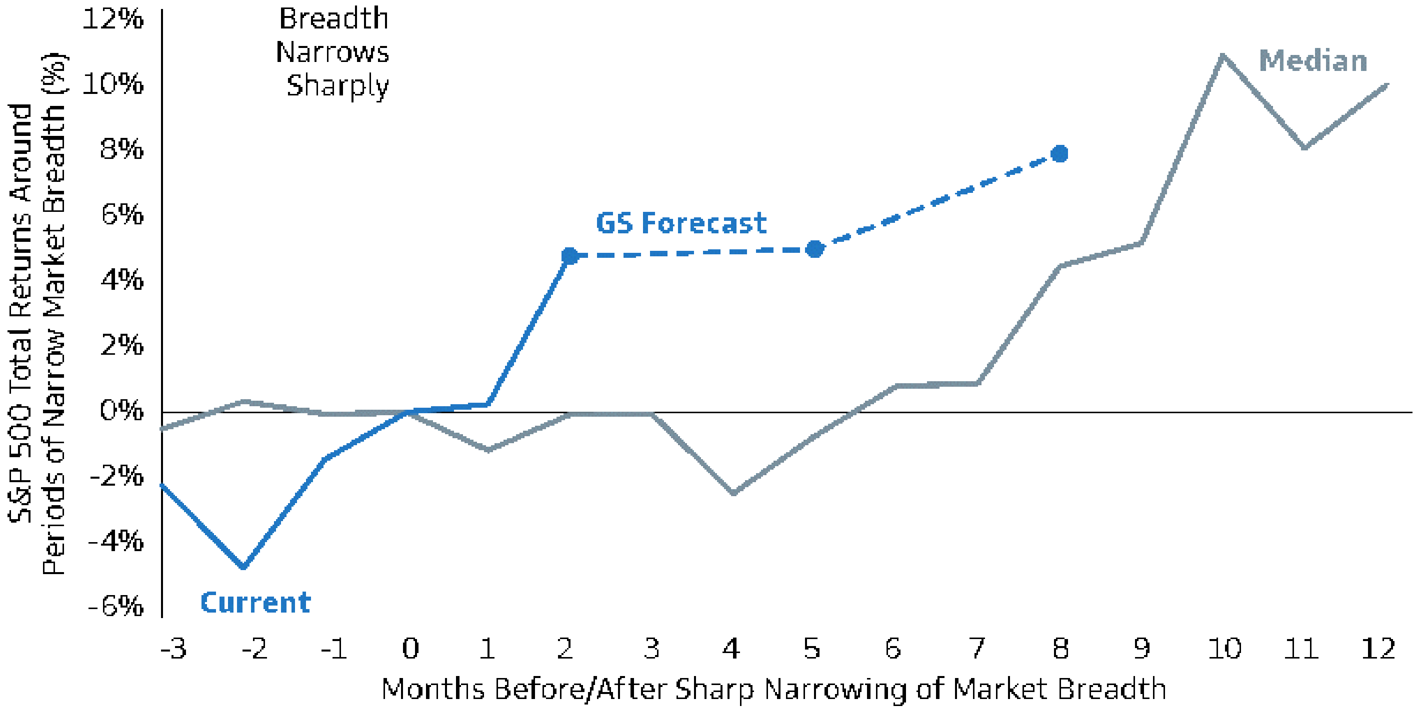
We identify; however, recent and dramatic performance dispersions in investing styles may challenge investor patience. For example, 2022 was a notable year for dividend and value strategies. In fact, most dividend indices were roughly flat, while the S&P 500 languished, down nearly 20%. Growth and momentum as factors got smoked, while dividends, value and profitability held up much better. Now, midway through 2023, "equal and opposite" forces shape YTD performance. Dividends, value and profitability are all negative factors and they seem to be defining returns YTD. On the other side of the performance spectrum, familiar faces sit near the top… Seven stocks, (Facebook, Amazon, Apple, Microsoft, Google, Tesla, and Nvidia), are now up over 80% on average and have driven nearly the ENTIRE performance of the S&P 500 YTD. These names are contributing to record levels of concentration in the S&P500 and Russell 1000 Growth indices.

We believe these 7 are great companies; they have superior balance sheets, strong earnings, cash flow, and dominant businesses. The issue is valuation, which to say the least, is extended. For example, Nvidia, an artificial intelligence and gaming chip maker, trades for approx. 40 times trailing SALES. Meta, up over 120% this year, has lackluster growth but still trades at 19 times earnings.

So the big question is – "Will this narrow performance persist?"

Perhaps, but be mindful that the risk of whiplash appears very high at the moment. Value vs growth had massive performance dispersions over the past number of years. Selling value to chase growth in late 2021 or throwing in the "growth towel" to buy value late last year would have crushed relative client performance. We never know the length of these trends, but we're certain, giving clients "performance whiplash" can jeopardize an otherwise healthy relationship. We recognize disciplines move in and out of favor, but we've found sticking to cogent long-term investment processes and patience tend to be more successful than darting in and out of markets -- portfolio balance aligned with investor goals is always a good idea. We do however suspect the market regains balance in the not-so-distant future. (Source: Bloomberg)

"Past episodes of similar breadth have delivered lackluster short-term performance, but returns have historically surged a median 10% in the 12 months following. A "catch-up" effect from remaining index constituents reflects a key catalyst sustaining this rally."



Source: Bloomberg, GS GIR, and GS Asset Management. As of June 14, 2023.

AI Breakthrough?

We suspect the AI investing mindset is behind some of the "market narrowness". Flashbacks of 99' surface as investors are clamoring to "get in". Similar to AI today, in 99', the internet seemingly permeated every investor's mind. Market pundits squawked about the haves and have-nots. Microsoft, Cisco, Intel, Oracle, GE and IBM were all "market darlings" of the dot-com era and surged in value and market cap, creating concentration in the indices -- much like today. In fact, many of these stocks went up 10x in just a few years and valuations were pushed to extreme levels.

2 observations/lessons feel comparable today:

1. **Valuation does matter:** Similar to the dot.com era stocks, AI investors appear to be paying huge premiums for this "feel good" trade. In hindsight, those who paid premiums for the market darlings during the dot.com era ended up with abysmal returns over the next decade. These companies weren't bad businesses, they were just way too expensive.
    - Returns for "Market Darlings": 3/31/2000 - 3/31/2010

  - Microsoft (MSFT) (-32.39%), General Electric (GE) (-52.85%), Cisco (CSCO) (-66.33%), Intel (INTC) (-61.15%), Oracle (ORCL) (-33.51%), IBM (IBM) +20.84
  - Furthermore, for every name on this list, there were dozens more “dot.com darlings” that no longer exist.

2. **Companies are adaptive:** Every company became an internet company. Yes, the internet paradigm didn’t just benefit a handful of early pioneers… the technology broadened out and all or most companies figured out how to adapt and best leverage. This technology shift led to increased productivity across the broader economy and created secular tailwinds for the following decades. We envision a very similar path for AI. The handful of companies grouped in the AI trade are not the only ones that will likely benefit… Business leaders across the globe are exploring AI business applications. And just like the internet, AI will likely permeate all sectors of the economy and provide tailwinds for the decade ahead.

(Source: Bloomberg)

Company's Earnings Recap
The Fed, mini banking crisis, recession fears, higher rates, commercial real estate, etc… there’s plenty of concern on investors’ minds. Sorting through these macro cross-currents using top-down methods is difficult, to say the least. Instead, our discipline is to focus from the bottom up -- pouring over company data generates thoughtful and bigger picture insights. On average, most of our companies delivered positive earnings or sales surprises and upbeat guidance. This seems to provide a stark contrast to what the average investor thinks is going on in the economy.

- Financials: generally navigating the environment well – we own very large regionals (PNC, MTB) or megabanks (JPM, BAC). But the stocks are still down and this has been a drag on performance YTD.
- Industrial-oriented companies: demand still remains pretty brisk for many. Let’s hope they are saying the same 2 quarters from now.
- Consumer & drug companies: less cyclical companies, a potential haven also posted solid results.

Net / Net? Company earnings across a range of industries are holding up well, despite constant recession chatter.

Becoming Superhuman
Looking to juice up productivity in your practice? Dr. Sahar Yousef and Professor Lucas Miller unveil the science behind optimizing human productivity and performance. The program is a course at Berkeley Haas and was redesigned for busy executives. Check it out!

https://www.becomingsuperhuman.science/

Have a great weekend!

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