FRIDAY, SEPTEMBER 30, 2022

Well, hello and welcome to the weekly Dividend Cafe Podcast. I am your host of the weekly Dividend Cafe David Bahnsen. And I say "weekly" Dividend Cafe because I've been doing it every week since September of 2008. And the topic that catalyzed this weekly market commentary is the topic I will talk about today. Now, it's not exactly the same; some areas are quite significantly different. But the historical context of what created this weekly communication was the implosion of our nation's financial system that resulted in an equity bear market in September of 2008, the equity bear market, the history of bear markets, and what investors need to do about entering bear markets. That's what we're going to talk about today. September 2008 was different. We were in an equity bear market.

But within 10 days, you had seen the implosion of Fanny and Freddie, the bankruptcy of Lehman Brothers, the saving from the collapse of Merrill Lynch and AIG, and a lot of vulnerability that I have written about, talked about, spoken about, thought about a great deal over the years. But back in September 2008, I started doing this weekly writing, and there was no podcast. There was no subscriber list. There was no video. And the name in Dividend Cafe wasn't yet relevant. I just wrote an email and Microsoft Outlook, and I sent it each week to the clients I thought would like and need and benefit from hearing appropriate information and counsel. So, we're in another bear market right now. We're not facing the implosion of the world's financial system, the violence of everything both macroeconomically, you know, unemployment then was getting to 10%.

It's right now, three and a half percent there. There is simply no comparison between the Great Recession and some of the conditions we are presently in. And yet, bear markets are just hard for investors. I understandably feel angst to see the value of underlying investments decline. And I think I sometimes take the risk of sounding callous, even though my life's mission, our company's entire purpose, is to counsel, hold hands, provide empathy, and most importantly, actual direction, guidance, and advice through these times. But I may sometimes sound a bit less empathetic than I thought because my conviction is so high about what people ought to do and ought not to do. And it is incumbent upon me and the advisors of the Bahnsen Group and the team of the Bahnsen Group to never take for granted that we're dealing with humans and that human beings have emotions, have fears, have vulnerabilities.

So, we produced this information we did back in oh eight, and here we are today with Dividend Cafe. We produce it to bridge that gap between the information necessary for good activity and behavior and the emotional starting place that is so natural and human. Okay? It's human not to like seeing the value of one's assets decline, but that humanity and that reality cannot be an excuse to do something totally counterproductive to one's own goals. So, how do I define productive and counterproductive? What is it I'm talking about? I can't answer that without going back to the basics of why people invest in equities. We're talking about a bear market as a

period of time when stocks drop over 20%. TheS&P is now down over 23% of the year. The NASDAQ's down 35%. And look, we're not NASDAQ investors.

I didn't put this in the written Dividend Cafe. I'll put it in DC Today on Monday. But you podcast, and video listeners are getting a little bonus right now. You know the compounded annual growth rate from March of 2000 to now of the NASDAQ over 22 years. A significant portion of us is really, really, big up years. It's 3.5%. Now look, I'm totally cherry-picking timing because the NASDAQs in the middle of a 35% drawdown, and it was at the peak of a bubble in March of 2000. So, my starting in ending points are, are admittedly, you know, what, what they are. I mean, math is math, but you get my point. You then had a 70% drop before a significant recovery, before another big drop, before a considerable recovery. And this drop we're in now. But my point is we're not long-term investors in the Nasdaq. And even though I'm going to use the S&P for many of the points I'm going to make, just to provide some historical context, we're not, we're not S&P investors either. Now, look at the three indexes. I'm recording in the middle of the market day on Friday, September 30th. And so, things may get a little bit worse. The next few hours are a little bit better, but in one month, the Dows are down seven, and the NASDAQ and S&P are both down more than that in one month. But my point is that the NASDAQ's buy-and-hold approach is not what we believe in. And even the S&P's buy and hold approach is not what we believe in as dividend growth investors. But a buy-and-hold approach for the S&P has been far better than it would've been for the Nasdaq, based on my point.

But why do you forgive the almost three-minute tangent? Why do investors buy stocks at all? It is to capture a risk premium, that is to say, a premium in return they'd get because of the risk they're taking; You can go into cash, which for many periods of the last 20 years was paying 0%. At, at over a hundred years has paid about 2%. And after inflation essentially has averaged a negative rate of return, a negative real rate for most of history. And so not only do people need more than a negative rate with inflation, but they also probably need a higher premium just to accumulate the capital necessary for many of their long-term financial goals. So, the risk premium I talk about what does that mean? It does not mean trying to get seven, but then there's a chance you'll lose your money.

It is a reference to volatility. The premium comes from having to suffer through volatility. And that is a two-way street. Investors won't invest in the asset class if they must suffer through volatility. If the return it generates isn't going to compensate them for that cost, the volatility cost and the volatility cost are necessary to rationalize the return. Okay? That, that return that we talk about of what's called it 10% a year, the average stocks are 50, 60, 70, a hundred years. It isn't going to happen without a cost to it. It would get priced away, and the expected rate of return would decline. The volatility is what keeps us coming back. On the return side, the pain

side, rinse, and repeat. It cuts both ways. Now, I want to be precise. This is a byproduct of basic economics. The price of a stock is a reflection of two things.

The companies' earnings and the price relative to the earnings, meaning the multiple, the valuation of those earnings. And those are the two things one has is taking a risk on when they buy stocks. The earnings can come down the, let's say, you buy one company, not 500 companies. The company could fail. It could, could suffer an unexpected setback. Competition could hurt it, and consumers could not like the product or service of a company. Costs could go higher than expected. You diversify away from the company-specific risk. But earnings are the least speculative part of what we're engaged in when we're buying public equities in a diversified and professionally managed context because capitalism works for enterprise works, and the profit motive works. The natural process of goods and services being produced to meet the needs of humanity, even in all the complexity and, frankly, the wondering glory of the modern market economy, that this growth of earnings is the rule, not the exception.

There have been very few years where aggregate earnings for diversified public equity investors were not higher than the year before. And in fact, the earnings when you go back since World War II are up thousands of percentage points relative to where they started. And yet we've had 13 bear markets. The 13th is the one we're in now since World War ii. Bear markets are very common. Profit growth is widespread, but it is the second component that I think provides more lumpiness to that experience, that volatility of an investor. And that's the price-to-earnings ratio, the valuation, the multiple, there are different synonyms, and I use all of them, and I just want to make sure you know what I'm referring to. And so I've made a kind of investing career out of trying to minimize my reliance on the second one and focus more on the first one.

I believe we can fundamentally analyze and understand earnings and that there can be mistakes and setbacks. But I think PE ratios are blowing in the wind. I have never known anybody that is able to calculate effectively when PE ratios will go higher and lower. They are driven by certain degrees of fundamentals in interest rates, inflation expectations, growth expectations, ma currency, macroeconomic circumstances, and geopolitics can all impact PE ratios. Those are pretty hard things to factor in, but they are in the fundamental range. But seeing all of them put together doesn't impact PE ratios as much as the thing that is totally unreliable and predictable. And forecastable unanalyzable, that is sentiment, that is public mood.

There's a company called Beyond Meat, and I don't have any opinions on the company. I don't have any opinions on the product, although I guess I do, but I won't share those.

But the back to the matter is that it was a company trading at 940 times earnings three years ago. Okay? Something like a 16 billion market cap on a company that that year made 17 million of profits. Now 940 times earnings, the stock price is down 94%. What am I referring to? I'm referring to public sentiment driving something very, very high and public sentiment driving something very low. And those are extreme examples up and down of valuation being entirely about a sentiment driven dynamic. I don't believe that we can time game or forecast sentiment, but sentiment is what pushed up the stocks of March and April 2020, the covid moment where people thought that everyone would behave that way and shop that way forever. That the dynamics of what you're doing when you've walked in your home were going to be the same as when you weren't walked in your home, as if somehow, we were never going to recover our freedom.

So, there were two mistakes made. There was running it up, and then there was now I suppose in some of those cases, the possibility that some have been overrun down. Still, because the valuation is disconnected from the reality up and down, movements become impossible to calculate. And it isn't something I have to worry about getting caught in one way or the other because it's just not what we do and not what we believe in doing. The difference in the bear market we're in right now as we come upon the end of the third quarter is different than where we were in the year when I was obsessing over shiny objects. There was a sentiment-driven correction of stuff that was excessively and euphorically priced coming back to reality through investment gravity. Right now, the bear market is impacted. Now everything the Dow may not be down 20% yet, but the Dow was down four 5%.

It's now down. I think 17, 18 at S&P, which is far more than just shiny objects, has come down a lot. Even some of the big tech names, there were a couple that were down a lot, but a couple that weren't. Now those have gotten hit hard. So, there has been a very significant democratization of the pain in markets and that's what a bear market does. Eventually, it brings down everything, but some things are less than others. And I think that's very important. But the reason I bring all this up is to say that the bare market volatility, which is generally what happens either in evaluation correction or a recession or both, is the name of the game in equity investing. That by accepting the possibility of downside volatility, one generates longer-term returns. So, you say, Well, look, okay, but there are fundamental things.

We know the feds raise rates. We know recessions are either here or coming. Why not just get in the fun, go to the sideline, and come back in? And I think that sounds like a great idea other than this little problem. Markets have never, first of all, given you or me an instinct or information that it didn't give everybody else. So, what one does in those cases is try to invest with the herd and not against it, and that has never ended well. And then the fact of the matter is that markets can find people trying to be their most intelligent pessimistic selves by rallying

far in advance of actual improvement because they price in what will end up being the corrective mechanism. The eventual fed reversal policy, the eventual reversal of underlying conditions, how high prices solve for high prices or low prices solve for low prices or valuations got too high.

So, they came down, but they also got too low. So, they come up. A number of these factors happen in the real world and occur in a certain real-time, but markets are not going to respond to the real-time markets are discounting mechanisms. And this is the painful reality that, first of all, those trying to cheat the rules of the game of bear markets by being in and out miss the recoveries that, mathematically, a significant portion of which comes very quickly. And so you effectively try to miss 10% of a 20% downside can miss 50, 60, 70% of a hundred percent upside. It happens over and over and over again. So, you say, Okay, well you're just telling me I have to ride it all out then. But see, I'm not even really telling you that. I have more stories to tell than you would even believe.

I do think index investors have chosen for themselves a life of riding these things up or down, and things get too expensive and they're in them, and they can get too they can come way down, and they have to write it out and that's fine. It's, it's, but to me, I'm saying something different when it comes to dividend growth investing is that you're benefiting from it. You're benefiting if you're an accumulator of capital, these bear markets in which certain companies are continuing to grow their dividend. And when you're reinvesting those dividends in the accumulation of more shares, you are genuinely going the compounding of long-term returns. It's mathematical and glorious and doesn't feel like it when it's happening other than you genuinely intellectualizing what is happening. It is challenging for humans because we are more feeling creatures than thinking creatures.

And we're all guilty of that. And, I don't even know if I should use the word guilty because it implies something bad. It's just what it is. It's how we're wired. It's human nature. But no, intellectually, what I'm saying is true, that for one who doesn't need the money in the short term and one should not be in these assets, if they do need the principle money in the short term that long term, you are significantly increasing your expected rates of return through the reinvestment of dividends through these periods of time. Now you say, okay, but I'm not an accumulator capital. I don't have long-term debt, and I'm now withdrawing from my capital. I need it for retirement or this or that or the other. And in that scenario, I would say your dividend withdrawals are not going down. They are going up. So, you are actually not being jeopardized in your financial goals through the change in the price of underlying investments.
I don't, and I don't know that this needs to be just a general commercial for dividend growth investing. I do that exhaustively. I make the case sometimes with much more granularity, sometimes at a higher level. But my point is because my clients are dividend growth investors,

our clients have our firm that the bear market is actually not only something that I want everyone to have a historical understanding of and appreciation for. There have been 13 of them. The averages lasted 367 days. So, last I checked, that's a year. The averages lasted a year, but the one that last started in March of 2000, and when I was in a younger stage of my professional investing life, lasted almost three years; the covid bear market lasted 33 days. Okay? So, when I say the mean that the median rather than the average that we're referring to is a year, they can be much longer, much shorter.

And that's why the mean and the median are a little different here. Okay? I want you to understand that the bear market we're in now could last longer and very well end quicker than people think because the whole thing catalyzing this bear market is riddled with uncertainty. There is no clarity on the depth of where the economic distress will go. One does not have to say, Well, if you're telling me to guess if we're going to be in recession or not, I know we're going to be in one. So, no, it's bad that the problem is, that's not what I'm saying. I think most everyone believes that we're going into some form of a recession if we're not in one. Now, the question is the depth of it, length, and the level of pricing for it that has already taken place. And I'm sorry, but no one knows any of those three and certainly not the last one. And therefore the upside risk, especially when one attaches to the current bear market, is the reality of the US dollar. And I put a chart in Dividend Cafe today. When you see how overstretched the dollar is and what that has meant, people generally flee to dollars when they're going to cash and they're going into treasuries and things as a safety escape. And when it has gotten overstretched, what that has meant, when the dollar reverts to the mean, and what kind of equity recovery you generally see very quickly, it's something else. So, I just hope that the broad-based understanding of bear markets, why they happen, and what they mean to investors who are just playing in the game's rules but trying to capture risk premium in exchange for volatility.

I hope you will understand that within dividend growth, there's an opportunity to benefit within dividend growth. There is the ability for a withdrawal to be totally insulated from an actual functional material practical pain that you can simply maintain your financial objectives, quality of life, and cash flow needs regardless of the underlying asset. And that this too will pass. That you are dealing with markets that are up thousands of percentage points and earnings underlying those markets up thousands of percentage points despite not one and not two, but 13 bear markets in my professional investment career, not just merely as an adult and as an investor and as a human, but in the time that I, I have been paid to manage other people's money. This is now the fourth bear market I've lived through, along with many other corrections and downtimes.

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And like all of them, we will look back on this, and some will say, Wow, I really made a lot of money out of that bear market. And some will say, Wow, I didn't make money out of the bear market, but I really did the right thing by not letting it hurt me worse. Others still listening to this or willing not clients of ours may come out of it with a lot of regret. I'm asking you not to come out of this bear market with regret. It's difficult to go through while you're going through it. Still, I will say that the hindsight of bear markets has been overwhelmingly positive when we put these things into practice, implement them, and execute them correctly. Thanks for listening to this message. Reach out with any questions. I hope that you will feel free if you're a client of our firm to take advantage of your advisor as a sounding board. Get the information you need, get the perspective, get the support, empathy, and hand holding, and whether it be on the emotional or intellectual side, I don't care. This is what we're here for. Thank you for listening to and watching the Dividend Cafe of the Bahnsen Group. We're going to keep doing what we're doing. I guess I'm tired—time to get back to work. Take care.

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