FRIDAY, NOVEMBER 11, 2022

Well, hello and welcome to the Dividend Cafe from Nashville, Tennessee. I arrived very late on Tuesday night. The entire team arrived on Wednesday afternoon, and we have just been having an incredibly productive time out here in Nashville. We are in meetings all day on Thursday and have a big day of meetings ahead here Friday. Plenty of fun with the team at night and all that good stuff. Enjoying our office out here and really great discussions, conversations about our business. In the meantime, a few other things have happened around the world. We did write in the DC Today on Wednesday, a kind of recap from some of the election coverage. Obviously a lot of big surprises in that, and I've written plenty about it elsewhere this week as well. The major market event that I suppose would've become a good subject for Dividend Cafe had I known it was going to take place on that third on Thursday was that market rally was the biggest day in the market and over two years, it was the biggest day in the bond market that I remember seeing in my career.

The 10 year yield coming down 33 basis points, mostly about 30 to 35 basis points down across the whole term structure. So a massive violent rally in the bond market. And rather than really get into that right now and start talking about what the CPI report said, what is being implied in the Fed funds and future Fed policy decisions, why markets are responding that way, the NASDAQ going up over 7% yesterday alone. I'm going to do that in Monday's, DC today, and in fact, this morning began working on a lot of that already, but because this week's Dividend Cafe is a bit shorter, just because of our time constraints with the week, there's a lot more charts and I'm going to just sort of stick to that topic and get to the rest in Mondays, DC today. As far as the major theme we want to cover today, it has to do with the state of technology stocks, the tech sector overall, and much of what has happened in the marketplace over the last couple years.

And then just kind of where the lay of the land is now. And this is one where I say it all the time, I always believe Dividend Cafe written provides some charts that are necessary to your experience. This week though is basically what the whole Dividend Cafe is. Oh, I think I have something like eight or nine charts in there with commentary, but it's all kind of in sequence to build up, to make an underlying point that the first thing I want to say is that the energy sector, which we're very heavily invested in at the Bahnsen group, we've done very well there, as many of you know was from 2015ish through the Covid moment in a secular down trend for a lot of different reasons that have also written about extensively in the past. And at the same time, the technology sector was in a secular up trend for other reasons I've written on some, but maybe not totally cohesively but it was definitely a fundamental story of growing revenues, expanding profit margins, and certainly that happening in a backdrop of rising multiples rising valuations.

Then the covid moment comes and you actually end up after the initial downturn in markets when the world seemed to be ending really as things kind of recalibrated, the tech sector did quite well. There were fundamental reasons for that. People assume that folks would stay at home ordering stuff on e-commerce at a heavier clip, which they obviously did. And people would be utilizing cloud-based software, people would be utilizing streaming services. There was a lot of aspects of software as a service cloud, social media, e-commerce, streaming. These are different sectors, but they're connected to a technology apparatus that perform very well during Covid. The big problem was in some cases, forward projections that were just preposterous about what that would look like. And then the biggest was the way the valuations exploded. There was nothing wrong with tech going higher in that period on fundamentals, but it went too much higher because of the immutable law of nature human nature that is to overdo the good times and overdo the bad times.

And so at the same time that was happening in Energy was let's say, facing some challenges. Saudi Arabia and Russia conspired together in March of 2020 to flood the world with oil. And then we shut down all consumption of oil essentially with no travel, the vast majority of oil being utilized in air, in automobile travel. There's a lot of other industrial uses and a lot of other consumption uses that were all pretty much brought down to stasis as well. But either way, demand evaporates in a period of excess supply and oil prices collapse and profits evaporated and losses went through the roof is one of the great ironies and I think offenses of current administration talking about excess profits in the oil sector when if there is such a thing as excess profits, that's for economists to debate, and I'm in that debate myself but I'll save that for another time.

But if you think there's excess profits, you must think there's such thing as excess losses and obviously 2020 would fit that bill if such a preposterous idea was even in reality. But then the phase two of this after secular increase in tech and secular decline in energy was beginning in about November of 2020, energy bottomed and it bottomed with force. The bounce off of it was quite severe, but that wasn't now a divergence where wow, energy's coming up and now tech's coming down because from November of '20 until the end of 2021, tech was doing quite fine as well. It was extending its rally from the covid moment and energy was reversing its downturn from the covid moment. So they were both correlated up together. So you have a period of one up, one down, then a period of both up. Now you have beginning at the beginning of 2022, another period of one up, one down, but it's changed.

The hat's reversed. So the chart of all this in Dividend Cafe is worth the price of admission. But now of course energy has just had a violent move, higher tech the other way. But even saying tech is down a lot doesn't really tell the story. First of all, we had a big long period of unprofitable tech companies outperforming profitable tech companies

that is totally reversed. So in other words, profitable tech companies are down, but they're not down nearly as much as unprofitable ones. There was a lot of just utter insanity where things like so-called 'Web 3.0', crypto nonsense, tokens, if there's that stuff that got killed, and I'm not referring right now for our purposes as much to cool tech, that was small tech, but cool tech that was big tech, and these are our big companies, brand names. They have very strong monopolistic advantages.

So I put a chart of even how all the different constituents of Big Tech have done and they're all down. My point is that a lot of it was valuation re-pricing where there were excess evaluations, but then it has become a fundamental story for a lot of the sector. Not just that PE ratios were too high, but that margins have started to come down. They were really enjoying a period of growing revenues and not growing expenses at a pace that was unsustainable. They still have very attractive profit margins.

It's not a very capital intensive sector. That's always been my whole career. The big advantage is 'made technology' such a uniquely investible space when it doesn't get overpriced is it's It's very 'capital white' as we call it. And there's a lot of capacity for scale. You don't need a lot of people and you don't need a lot of equipment to be very, very profitable, but you have a lot of death. You have a lot of companies that die that don't make it. Then you have companies that succeed a lot but become a victim of their own success because they reach an unsustainable evaluation. And if you're continue buying at those levels, you might face a decade of negative returns. Entry point in something like that becomes very important. The entry point in a lot of stock

investing is not nearly as important when you're talking about things like where somebody may bought Salesforce. Okay, Salesforce is a great company, we use their product at the Bahnsen Group, but that entry point for CRM for cloud-based software could very well make the difference between making money or not making money over a five or 10 year period of time. And so I think you're dealing with valuations, but then you're dealing with fundamentals and then you look at this decline and you realize, well, valuations are largely correlated to bond yields. And I'm of the opinion that you could get a position, this is actually what I think will happen. Bond yields won't keep going higher, and PE ratios may or may not keep going lower, but I still don't see a scenario by which PE ratios can go higher. Not going lower is good, but going higher. I don't believe it. I don't see it as a sustainable secular theme from 2023 to 2027 the way it was from 2013 to 2019, 2021, et cetera.

And so then you say, "Oh, if you get kind of choppy, flatlined, very tight range of multiples, do the fundamentals give you those returns?" And I would be more skeptical there. I think it would be a higher dispersion of results. Some companies might do better than others, so forth and so on. But as a secular theme, another chart we have today is showing that historically when you look at big, massive ratings re-pricing, that what Japan had to become as a percentage of the world's stock market, what the financial sector had to become as a percentage of the US stock market after 2008, what tech became after '.com', what natural resources have become and the commodity within a relative world that repricing has a certain range of downturn when things have to kind of normalize. And I'm sorry, but Big Tech has not done that yet. So I would not argue that there's a lot of more downside for big tech, but I wouldn't argue that there isn't.

I think on the basis of fundamental questions, valuation potential and that kind of relative, I would make an argument that there is some risk reward levels here that are tricky. And in the meantime, as I write every

other week, the macro environment calls for a bias into quality, into 'known knowns' and dependability, particularly around cash flows, particularly around return of cash flows. So that's sort of the take today it, it's a shorter message, but there's some real great charts to help pull it all together for you. The largest divergence between the best performing sector and the worst performing sector we had seen in a long time was 2020 when tech was on fire and energy was getting what handed to it. Now that record was broken in 2022 by the two same sectors wearing different hats. The divergence this year between the top performing energy and bottom performing tech communication services has been unbelievable.

So this is, again, not that indexing moment where you just want to buy everything and it all goes up together. There's a high dispersion, a big divergence amongst certain sectors, certain aspects of the marketplace, and we will see where some of this goes. There's going to be rallies. I mean, certainly a day like yesterday feels really good, but you're investing for more than one day, one month, one quarter. And this is kind of the lay of the land I would see, and I want to be very objective, very data oriented, but provide actionable perspective to the way we think about and act upon these things.

I think I'm going to sum it up this way, that 2022 is going to prove to be a wonderful year for a lot of investors. And you go, What are you talking about? It's been a bloodbath and bonds besides you dividend guys and energy people. There hasn't been really a lot of great opportunity. It's not been a good year for investors. What I mean is that a generation of people got '.com'ed in the late '90s and into 2000 and learned lessons from that experience that provided them 20 plus years of investing acumen and superior wisdom to what they had before better decision making. Some are individual retail private investors, some are professional investors. So I say this from testimony from personal experience having been '.com'ed 23 years ago. I know as a fact that in

my career, the things I learned in that experience have been million dollar decision type things for clients. And I believe there are a lot of other people out there this year learning things that I learned in difficult ways over 20 years ago. That's what I mean, that to the extent some people, not all will learn. Evaluations matter. Some people will learn, not all, not to chase the crowd. Some people, some people will learn. Not all that. Behavioral decisions are very vital in how you go about investing. That's what I mean. And tech energy, contrarianism cash flows, all these things. They're kind of what the subject of today's Dividend Cafe has been. look at dividendcafe.com, check out the charts. Thanks for listening. Thank you for watching. We're back in our California office on Monday and looking forward to what's going to, I happen to know. Be a pretty full DC today, on Monday, and we hope you all have a wonderful weekend. Look it. I said yeah. Oh, I guess Nashville's rubbing off on me. Thanks for listening to and watching the Dividend Cafe.

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