FRIDAY, NOVEMBER 17, 2023

Hello and welcome to the Dividend Cafe. I am very happy to be back here in Newport Beach getting ready to enjoy Thanksgiving week. Next week we will have a Dividend Cafe on Wednesday as we always do, dedicated to some Thanksgiving reflections more than a normal economic commentary. I had, this is the second time now that I've said the week prior, I am doing this dividend cafe next week on a full study about artificial intelligence and comparisons to past market moments and technology and what this means for investors.

It's something I've been working on now for months, and then I decided to call an audible yet again. because I don't want to publish this edition I've been working on until I feel that it's done, and I don't feel it's done till I feel it's ready. I don't feel it's ready. This was a pretty insane week.

And I really like the message I have for you today. I think it's very appropriate building off what we talked about last week. And yet the aforementioned topic around artificial intelligence and this AI moment, investor wisdom around all that. It's coming, but we'll wait till the week after Thanksgiving.

For that, unless I break my promise for the third time which I don't intend to do. I want to talk to you right now about the 2010s. As a decade and the two thousand twenties as a decade. And I believe that in this contrast lies what is really playing out is perhaps the most important lesson for investors right now could be one of those important lessons they'll learn in their lifetime, but it is this needed lesson that is going to get taught one way or the other.

And I hope with as little pain as possible. But I remain certain that whether it requires little pain or more than little pain this lesson will be taught. And that is that the 2010s were an exception, not the rule. And I think if people heard that and didn't listen to the rest or didn't have a full context, they could assume that all I was saying or going to say was, Oh the market went up a lot in 2010s and it's not going to do that anymore.

That is not what I'm saying. Now, I could be saying the 2010s went up a lot, but the volatility was just so low and it was so easy and there won't be such an easy period of returns. I'm saying a lot more than that, but let's be clear, the 2010s had volatility. We were down almost 20 percent in the summer of 2011.

We were down almost 20 percent in the fall of 2018. We dropped, I think, 9 percent in one day in the middle of a day of in May of 2010, the flash crash. You had a two year period, but it doesn't coincide with the calendar years, but a kind of middle of 2014 to middle of 2016, that was basically flat, no real good returns, even though 14, 15, 16 were all up as full calendar years, but a two year, 24 month period, it was dead flat.

Yeah, maybe I'm stretching a little, but there, it wasn't totally Easy or free of any kind of ride, but every year was up. Now you say 2018 was down, but it was down 4. 3%. So I barely even count that. And then that 4. 3 percent was made up in a few minutes into 2019. Literally. By before the end of January the whopping down 4 percent of all 2018 had been made back in just days into 2019.

The standard deviation, which is the measurement of the variance or the volatility around the mean, the average return. I, there's a, that's a pretty good technical definition, but you can just call it the volatility. The volatility of the return of the S& P 500 was significantly lower than its average in the 2010s, and the return itself was significantly higher.

You ended up being close to 14 percent compounded annual returns with reinvested dividends in the S& P for 10 years. It had averaged, about 3 percent a year less than that for 70 years before that, with a few points more in volatility for the 70 years prior. So it was a significantly better decade with far less year by year volatility and bonds were up each year, averaging 3.

65 percent for the 10 years, the short dated bonds were up every year. Long dated bonds are up every year, but one corporate bonds are up every year, but one 60 40 investor was up 9. 7 percent with with the almost all up years and bonds, almost all up years and stocks. What? It was just, it doesn't get much better than that.

Easier than that. And I truly believe we're living through a period now where A lesson is going to be taught about what is normal, what isn't, what was an aberration and what wasn't. And the 2010s were an aberration. And I want to go back in time a little bit. If you don't mind to the beginning of the 2010s, and I want you to remember something really quite interesting.

Where were U. S. household balance sheets coming out of the financial crisis? Tattered, bruised, beaten, maybe way too nice of a way to say it. Leverage was huge, debt was huge, assets were low, savings was low home prices had fallen. Household balance sheets had nowhere to go but up after a couple years of liquidation.

Where was new investment entering 2010? Macroeconomically, new investment was dead. CapEx was dead. Non residential fixed investment was zero. Where was growth? It was hyper muted. We could barely get to 1 percent real GDP growth coming out of the GFC. We never did get to 2 percent real GDP growth for that whole decade.

You, you were you basically We're running up the sovereign wealth excuse me, the sovereign balance sheet. Debt was skyrocketing at the federal government level. And wages were not growing, which is really where all the populist angst started to come from, both left wing and right wing, but both domestic and international populism housing was massively unfathomably oversupplied.

There were so many people about homes they couldn't afford. You had a lot of people having foreclosures, workouts. Sales and an awful lot more homes on the market than qualified home owners. Significant oversupply coming into the 2010s in housing. Low growth, very high unemployment. It started the decade up around 10%.

Low wage growth, low investment. So just a brutal economic macro backdrop. But... You also had a decade of pretty benign environment geopolitically. What was the major bad incident of the 2010 to 2019 period? 9 11 was in the decade prior, the great, the global financial crisis was in the decade prior. This new decade kicked off with COVID.

But 2010 to 2019... You had Brexit, or what is, you had the Arab Spring. There, there are a few things here and there but it wasn't a decade that had significant global or geopolitical melodrama, it just wasn't. So you had a a troubled economic backdrop to enter a decade and then what about the investment backdrop?

Just tell me how it could get better than this to start a decade. PE ratios had gone low. They were around 13 earnings had gone very low. They were around 60. They would end the decade the PE near 20 and the earnings themselves are 200. So 13 X on 60 versus 20 X on 200. That, that, those are two pretty good data points to, to move in the right direction for risk investors.

The 10 year, it started at 4%. It ended at 1%. Pretty good movement for bond yields. I would say you had a pretty negative correlation through most of the decade with stocks and bonds, the way they're supposed to work. You got zigs and zags and a benefit of asset allocation that attracted capital from into both major asset classes.

You just, you really had a very benign environment for investing macro and a very troubled environment for economic macro. And then Really, we entered the new decade and immediately COVID happens. Now, I don't want to do this whole div in cafe about COVID because that isn't the defining moment. I think we're now resetting expectations and remembrance and reality and data points to a pre COVID world.

I think COVID is in the rear view mirror so much so that the, we can now talk about this in a sense of where I believe we are in the global cycle. We're trying to re anchor ourselves to not just a pre COVID reality, but to a pre GFC reality where wages are growing over 4%. There is a lot of talk about a resurgence of investment business investment, CapEx.

Some of it is government subsidized. But my point is there is a lot of discussion about onshoring, reshoring, nearshoring. The 2010s were and started off heavily favorable to globalization. 2020s start off with deep skepticism about globalization. You started the decade, let's move from the economic macro to the investing.

You started the decade with a 20 times multiple, not a 13 times. You started the decade. At over 200 earnings, not 60 earnings. You started the decade at a 1 percent bond yield that has now come up to four or five, not starting at four or five coming down to one polar opposite decade in the 2020s in the economic macro and in investing macro relative to last decade, the strategic asset allocation decisions of the 2010s, the total return expectation of the 2010s, the behavioral realities of the 2010s.

are no more. Now, what is still the same? Muted economic growth, but muted economic growth with some changing paradigms that create changing investment landscape. A different bond deal environment at the moment. Wage growth is better. Household balance sheets that now went from, they basically went from bad to good.

Now, perhaps they go from good to bad or good to not as good. So you have a lot of factors that would be different. Does this mean, oh, now this, that last decade was good, this decade is bad? It does not mean that. It means that stocks and bonds are very positively correlated. Last decade they were negatively correlated.

It means investors are absolutely underweighted to alternatives. And that the expectations of returns, getting 14 percent per annum in S& P is not going to happen. Getting almost 4 percent per annum in the bond market is not going to happen for this full decade. What you are probably looking at is a need to have a lower expectation for equity returns.

A definite change in expectation of how many years in a decade will be up versus down. You can have a very good decade with six or seven up years and three or four down years. Instead of ten up years or what was it? Eleven out of twelve up years. All I can tell you is that return expectations will be different.

Volatility expectations are different. The economic backdrop and macro from a starting point, midpoint, and end point are and will be different. And that the reality of 2010s being an aberration, not the norm, will have to settle in for a lot of investors. And that the Bahnsen Group's approach, principles we believed in well before all this and during and now, cash flow generative investments being a much wiser way to go as risk asset investors, coupling it with assets that are non correlated to smooth that return.

Not an entirely pot 6040, a stock bond mix where there's high positive correlation. You could end up getting a good return when both are working well together, but you don't get the same smoothness that asset allocations intended to deliver. And candidly, that's the case. It makes sense to simply default to the higher return asset class and accept the higher volatility that goes with it if you're not going to get the smoothing effect, the zig zag asset allocation objective that modern portfolio theory has written around.

I believe that the next decade is not going to be the 2010s and I do not believe that means this decade is going to be a horrible one. It mean, it doesn't mean. that we can look at it as the rear view, excuse me the mirror image the opposite. It means that prior to the 2010s you had decades that had some up years and some down years, some good decades, some bad decades.

You had volatility that was normal and embedded and inerrant to the asset class in equities that didn't usually call for things like 2017 where you had basically barely any down days. The worst drawdown being 2. 9 percent all year. You will have a more normalized volatility environment in the years ahead.

You will have periods. I got asked by a media outlet this week. What do you make of stocks being up, excuse me, being down in October, but now being up in November and I just thought, what an odd question that someone would care what October and November had did, had done differently when, if they were to just go back to the October and November of last year and the October and November of the year before that we have gone actually 24 months and the market hasn't moved.

Same place. It's 24 months ago. The S& P in 21 and 22 put together averaged 5%, not the 14 percent of last decade. Now, If you count 2020 where FANG drove a lot, it's up to 9%. So 2020 ended up being a good year for cap weighted, FANG dependent. But my point being the returns already are far lower than last decade.

And the volatility is already far higher than last decade. And bonds have a negative return on the decade after the 20. 22 year. I don't expect, I think you're going to have very good returns for bonds going forward until rates end up going low again. But my point is that already we're in a completely different environment and there's a lot of economic macro difference, a lot of investing macro difference.

But this notion of being surprised at up down moments in a two year period of flat return, I expect a five year potential period of flat return or maybe muted returns. I don't mean necessarily the exact same level in five years, but the index could be up on an average basis of three to 5 percent compounded, which would be a third of what it had been last decade.

And that would be very normal historically coming off of a bull market like that. Cashflow growth, the compounding of cashflow and greater waiting to alternatives. I just think this is the norm and the best practice in the decade we're about to face. I'm going to leave it there. I'm so excited to give you some Thanksgiving reflections next Wednesday.

I will have a special DC today that I'll do from my desert house on Monday. There'll be no DC today, Tuesday, and then we'll close out the holiday week on Wednesday with the Thanksgiving dividend cafe. I'm going to leave it there. Thanks for listening. Thanks for watching. And of course, thank you for reading the dividend cafe.

Have a wonderful weekend.

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DIVIDENDCAFE | PODCAST TRANSCRIPTION

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Due to the publishing time constraints for us to produce our daily missive, podcast, and video, the best we can offer at this time is a machine-generated transcription which contains errors. We will continue to work to improve this service and appreciate your patience with us.