FRIDAY, DECEMBER 22, 2023

Well, hello and welcome to the final Dividend Cafe of 2023. I am I guess it's sort of bittersweet, you know, you're saying goodbye to one year getting ready to welcome in another year I am going to give everybody the week off next week. We will celebrate the Christmas holiday early in the week and we're gonna go this final week of the year without DC Today and a Dividend Cafe on Friday. You know, I don't believe a lot of you will want to read it or need it I want the production team to get a little time off and then of course somewhere in that list of priorities I'm going to be taking it off myself, which I'm sure my family will appreciate We will be out of the country and in a very cold place.

So in the meantime, today's Dividend Cafe is going to kind of unpack I think what might be one of the most important ivesting messages you will hear this year. In a way you could say I've saved the best for last but in another way, you could say you've talked about this stuff for you know decades and that is correct and this will be 20 plus more years to come I want to talk about the current lay of the land and where dividend growth investing fits in.

We're talking about another year there is after I am done recording this, you will still have five market days remaining this year the Friday and then four days next week because Monday is the Christmas holiday and then we're done with 2023 so with the caveat that we can't know what these five trading days will bring we essentially know that 2023 is going to be another big year for the stock market and 2021 was a big year for the stock

market and 2019 was a big year for the stock market and since 2009, out of what is essentially now 15 market years, only two of them had a negative return 13 had a positive return at a compounded annual growth rate for the S&P 500 of 13.9 percent over a 15 year period.

So that is what we call a bull market and I make the point in Dividend Cafe this morning in the written version, that you know life is pretty much a bull market history. It's pretty much a bull market that may not be very useful to people that go through a real bear market a prolonged bear market. But when you're talking about 20 year 50 year 75 year 100 year 200 years because of my beliefs about the nature of the free enterprise system and then of course the testimony of history itself around market reality, this is all a bull market. But but we don't usually talk about it in terms of 20 or 50 or 70 year period we can narrow it down and and in this 15 year period 13 out of 15 positive years with a 13.9 compound. That's a bull market and I want to make the point that particularly like let's say since 2017. That's a more recent period of time, as the clock strikes midnight and the ball drops here in about a week.

It'll be seven years since January of 2017 and and one of the marks just to kind of give you a reference point no significance in it. I'm just trying to bring it to a time stamp. That's when President Trump was getting ready to be inaugurated. He had been elected and he was getting ready to start his first term. So that's a you know that wasn't yesterday, but it was an ancient history and you're talking about in the period of time a president

Excuse me, President Trump's term in office Covid and now this three years of President Biden's term so far in that period of time the S&P has exactly doubled, basically it was at about I want to get this right 2350 January of ‘17. It's a 4700 now and and then I wanted you go my gosh the markets have a hundred percent seven years, that's a big number but much like the point I made about housing that's 10% a year now housing numbers over a long period of time are much lower.

But the rule is 72 you divide The number you know into the the number 72 how many years that's the percentage to double if you've doubled in seven years, then you've been up 10% a year. It's back of napkin math close enough. Okay, 10% a year not bad, so a 15 year bull market since financial crisis a Seven-year doubling of the market what could go wrong? The only thing I'd say again depending on time perspective is If you go back two years from right now December of 2021 to December 2023 going into Christmas weekend. You're down not by much anymore The kind of 12%, 11% run in markets here over the last seven weeks has helped. But you're still not quite back to where you were in December of 2021. So somebody put money in in 2021 two years later They're down a little bit if they bought the entire index not a big deal. It's only two years. But let's say That you look at the S&P right now and it's trading at 21 times earnings, you think it's gonna get 11 for you to get another year of 15 to 20 percent returns in the S&P, you're gonna have to if you meet 11 percent earnings growth if you get to this $252 of earnings that are currently the projection, you're gonna need a

23 or 24 times multiple to get that 15 to 20 percent return next year.

I mean, I suppose it could happen. I wouldn't bet on it now. Let's say for a second, okay, so we're gonna end up being down 5% or up 5% some kind of boring return around the zero, give or take 5% next year now of a sudden you're talking about compounding over three years at about two to three percent a year less than the return on cash. And that's not a short period of time now. It's becoming longer and you and so that's where this this belief system I have that historically the periods following robust bull markets and mathematically where we are in the cycle now I think we're in a extended period of a choppy flattish market and a choppy flattish market can be up 20 in a year like this year just as it was down 20 in a year like the one before and then if you have another year, you're up big and you're down big and then you're you're up a tiny bit or down tiny bit all of a sudden three four years go by and you're getting maybe a positive return a very very modest one a very sub-historical return. That's the type of market that I think we're in now. Here's the thing I throw out there, what if you do get another 15 to 20 percent year in the market next year? That means you've ended up at 24 times earnings What happens then? Maybe it's a month later. Maybe it's a year later. These are not timing things, but a hundred percent of the time in history when markets get overstretched you go through a mean reversion and that Reversion to the mean of something resembling a historical average of historical valuation now you're talking about being down 40 percent really significant

deterioration of value as hyper overstretched becomes, just normally stretched let alone going to below average returns remember a below average valuations remember you can't have an average valuation when the average is the floor and Everything above it is above it by definition That would mean it wasn't the average an average becomes an average because it's right in the middle of numbers above and numbers below You know I can repeat that if it's Confusing or anything so I hopefully follow what I'm saying here I don't think people should be rooting for a 20% return of the market next year and getting to a 24 times multiple Knowing that basically it just simply means we end up setting ourselves up for a far more violent bust and I think at whatever level you're talking there is a mathematical reality that is problematic and Yet I look at dividend growth investing and I think I see something that is Insulated in a much different way than an index investor could be and you get back to the kind of point of what brought me

Evangelistically into dividend growth investing, you know when we were at 29 times in the S&P in 1999

And you know You can make up whatever multiple you want for the NASDAQ because there were barely any companies that made money. So the PE ratio was negative to the power of infinity and It went down 80% and stayed down 16 years the

S&P went down roughly 50% was down for almost three years These are real big deals I remember them well and I do not believe we are imminently facing something like that if We were to go up another 20% from here with the same number of with the same level of earnings. I Think you set the table for a pretty substantial correction. Yeah, but I don't know that we will do that I would be surprised if you got that kind of price appreciation from this level knowing what it would mean to Evaluations to get there. And so my argument is Rather than be exposed to these booms bust booms and bust.

Let's consider something that doesn't require periods of hyper Extension and valuation and let's think about the reality of a withdrawal That point I've been trying to make to people for many many many years Is that if a portfolio itself averages 8% a year the real underlying investment itself not your dollars But the investment averages 8% a year But in the periods where it's down 10 or 15 or 20 you're withdrawing from it Your investment can't earn 8% the way the market earned 8% because you deteriorate the value that then Experiences the recovery. So whatever the return is That gets to an 8% average return for the market It's doing so with less dollars in your portfolio because by withdrawing during periods of a drawdown You permanently erode the capital base Dividend growth by nature of taking what is only positive a dividend and and again the idea being only growing You leave the share count in place You don't erode the principal value by getting rid of the the tree that is bearing the fruited dividends.

This is one of the most powerful anti negative compounding stories in the history of capital Enabling somebody to withdraw from a portfolio without suffering permanent damage, even if the value of the portfolio is down.

And that is a major mechanical Benefit in a period like this where people need to withdraw from a portfolio that might very well go Down 20 up 20 down 5 up 5 for several years to come. I Think that it's very likely to happen in markets. They have some form of Flatish return from a point a to a point B and that in that period of time It doesn't feel like it's flat at all because there's a lot of ups and downs and yet withdrawing from a growing dividend base provides an amazing mathematical insulation and Then for those accumulators those other 50% of investors that don't need to withdraw from the portfolio They want to grow the capital base in this case You actually turn the negative of a volatile range-bound Flattish market to a positive as you monetize that this is the concept of anti fragility You're not just defensive or insulated or immune you benefit Become stronger from such environment as you inevitably have periods in which dividends which by the way they're all paid yearly It isn't like the market is at a certain level flat all year that it has one date that it's down ten And that's where you get a down ten year or vice versa one day where it's up 20 and that's where you get up 20 year It's quarter by quarter volatility and guess what? Dividends are paid quarterly for the most part So you're actually building in an embedded mechanism that is automatically reinvesting dividends at periods of lower prices Causing you to get a lower average cost For the same securities that you're getting a higher

share count in that are one day bearing the fruit you will live off of This compounding is a miracle and it's a miracle made more magnificent.

By these types of markets the longer the better one two three years You're gonna get a little period of time of this Accumulation benefit with reinvestment of dividend four five six seven years even longer significant opportunity for accumulators withdrawers and accumulators alike United around a superior investment strategy of fundamentally better businesses with cash flows With a balance sheet that enables them to get through hard times with management aligned with shareholders all subject to fallibility all subject to challenges and execution all subject to extraneous shocks to the system from cyber attacks to consumer preference changes to very to higher interest rates to various changes in fiscal policy and Yet nevertheless able to weather through those things and continue this Escalating dividend payment. I believe that the market we've been in Illustrates the point of why I want dividend growth for the market. We're gonna be in That it is a strategy for withdrawers of capital and accumulators of capital both That truly meets the moment meets the challenge that we face Today in investing so I don't know what 2024 holds for index investors. I'm not rooting against the index I never have I know the math of what it will take this at numbers And I know what probably follows in the chapter after that if you do hit certain numbers What I also know is that for dividend growth investors Whether it comes to monetary policy excess fiscal policy geopolitical risk there is a better Defensiveness in place for the

drawdowns the risk of significant deterioration of capital and there is a benefit Mechanically on both withdrawing and accumulating capital the dividend growth provides That's a benefit that we have built our business around I believe in with every ounce of breath in my body.

I'm gonna leave it there By it I mean not just this Dividend Cafe, but 2023 I wish you and yours a very Merry Christmas because I won't be here to say it next week I wish you all a very happy new year and we will be rejoining you in January look forward to bringing you our next Dividend Cafe on Monday January 8th the year behind Year ahead special edition and of course you'll have DC Today and all that good stuff the week before as well So for the last time of 2023, thanks for listening. Thanks for watching and thank you for reading the Dividend Cafe

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