FRIDAY, JANUARY 19, 2024

Well, hello and welcome to the Dividend Cafe, and I am recording this week from the... for the very first time, most certainly will not be the last, from the Bahnsen Group's beautiful offices in Phoenix, Arizona, where I came out for some client meetings and a dinner event on Thursday night. Now headed back to New York City shortly, but in the meantime, want to record for you. And I will say that this is one of my favorite formats for Dividend Cafe. I don't really know why, I just love it. Where we end up getting an excess amount of questions that come in, sometimes some really, really good ones. And we turn Dividend Cafe into kind of an online fireside chat. And so we're going to go through a handful of those questions that came in, and it covers a multitude of topics. And so as much as I love the deep dive singular topic, weekly Dividend Cafe, sometimes I think these multiple subjects can be quite fun as well. So I'm going to get right into it, and I, as always, encourage you to look at the written Dividend Cafe. It's particularly where some of the charts and things can be very reinforcing. But for those of you that are listening on podcasts or watching the video, we hope that this will scratch a lot of itches for you.

I'm going to start with a really thoughtful question about pricing things in. I use the expression that's priced into market or the market is trying to price that in. And the question is, how do I know if or when the market is already accounted for an event, especially when that event's only a possibility?

And I think that it is worth pointing out that this is sort of the whole point. You don't know, but what you do know is the only

thing that matters, which is that markets are always trying to. Their market's ability to price things in is as good as the market's knowledge. So the greater uncertainty, the less pricing in and the more knowledge, the more pricing in. So let's take the obvious example. What is fully priced into market? Something that just got done happening. What is not at all priced into markets, things that have almost no chance of happening, like UCLA winning a national football championship. Markets can't price that in because they can't even comprehend the possibility of it. But something that's sort of in between the market conditions, economic possibilities. This is what I mean. And so all one needs to know to factor this into portfolio understanding is the nature of markets. So they're discounting mechanisms and that they are imperfect and that circumstances can change. But the price discovery is dynamic. But why do we believe markets are pricing things in? It is like I believe in gravity. It is what it is a law of nature. And so the second to that markets know of a storm coming, it impacts the cost of transportation and trade. And then the greater clarity can move prices up or down. It's a process of price discovery. And when you apply it into the price of an asset, a risk asset, that's what we mean. But we never mean the markets could perfectly price it in. And so there's variance. And the sentiment beyond the question is exactly right. Markets try to price in. They move in a direction, but they can't perfectly capture something. But they try to price in the risk of various probabilities. Great, great question.

The article I wrote last week for Dividend Cafe about government debt and its impact. The question here is why I

excluded intergovernmental debt when I talked about the debt to GDP ratio. They are referred to the public debt ratio of the money the government, the federal government owes to people who own its bonds, but not the money it owes to itself. Like, for example, when the Treasury Department borrows from the Social Security Trust Fund. So of our roughly $33, $34 trillion of debt, roughly 7 trillion of it is intergovernmental. And the question is, well, does intergovernmental debt not matter? Why not include it? And it's a good question. I believe, first of all, the most important thing is to be consistent and fair. I look at the debt to GDP with only public debt and with all debt. And I look at the dollar amount with public debt and without. So the $33, $34 and the $26, the 125 percent ratio and the 108 percent ratio, all data points are relevant and known and understood. But when you're doing comparisons, you just have to compare apples to apples. So you can't look at the public debt of one country and compare it to the total debt of another. It needs to be understood in a relative basis with consistency. Ultimately, the government's intergovernmental debt matters at the point of some action. They forgive the debt. They just say we're not going to pay it back. Well, then that means the things that was spent on, OK, have to be accounted for. The point at which it is paid back, it lowers the amount of cash resources available. There is not the same obligation because of the internal flexibilities that exist. And yet it is untrue that it's immaterial. So it just has to be nuanced in that way. I hope that's helpful. There's a chart, by the way, at Dividend Cafe showing what I think is the big point, which is that intergovernmental debt doesn't grow. Over 10 years, it's grown 40 percent, where the

public debt has over 10 years grown 108 percent. So there's a real relevance around the trajectory of the two different categories of debt as well.

Do stop losses, our third question today, do stop losses factor into your portfolio management? Or are they less relevant in the context of dividend growth investing? Stop losses absolutely emphatically do not play in. And I want all people to understand that they do not work for anybody. That if someone is just at home day trading and they want to try to pick up some free gains of a stock and they think they'll put a loss in so if it drops, they won't lose that much. It's all well and good with little tiny increments, not at any size, not any scale. But most importantly, for long term investors who believe in the fundamentals of a company, you put a stop loss in, you have a magical way of getting stopped out all the time. And if you put a stop loss in and you think, well, I want to avoid a lot of excess downside, you have an incredible propensity to take on excess downside because so much of stocks' losses do not come during trading hours. A stock is at 60, you put a stop loss at 50, the stock's at 52, bad news comes out overnight, and it wakes up the next day at 42. If you had a stop loss at 50, and the next tick of the stock is 42, where are you getting sold out at? It's not 50, it's 42. So stop losses can't account for where so much of market downside violence happens, which is in the after hours, pre-market, post-market, overnight, etc. And fundamentally, it goes against the whole premise of the development of investing, which is during down times to not go sell a stock at a loss or sell a stock at a limited amount of gain, but as it's in a decline to be

buying more. If you want to sell a stock, sell it. If you've lost the conviction, sell it. But using a stop loss is a fictional way to try to have cake and eat it too.

Moving on. Should we buy gold? I've covered gold so many times over the years, but it does come up from time to time and needs to be readdressed. I just start off with the premise as to why people buy gold. Well, because I believe it's going to go higher. Why do you believe it's going to go higher? Maybe it will, maybe it won't. But I only have the ability to value assets on an internal rate of return, and gold doesn't have one. So it isn't that I don't think it can go up or don't think it can go down. I think it can do either, is that I don't have a way to measure it or value it or predict it or do proper analysis because there's not an earning stream. There's not a coupon or a yield, like a bond or debt instrument. And when people say, okay, fine, but it's like a substitute currency, it will help you mitigate the risk of something going on that is problematic with monetary policy or with inflation. Then I just look empirically to the facts and I say, well, gold is still down over a 40-year-plus period. Over 20% from the rate of inflation alone. Just to break even with inflation, gold is down 20%, 25% over a 40-year period. And you say, okay, well, one of the things that we're crazy at monetary policy, well, like you mean years and years of zero interest rates, years and years of trillions of dollars of quantitative easing? Yeah, we had that for the last 10 years, and gold hasn't moved. It started here, ended here, flat line. There's a chart to that effect. So gold by its own standards, no pun intended, has not done what advocates say it will. Now maybe it will in the future. Maybe

things change. But it's too speculative for me to consider it viable in that context.

Okay, next question. Since dividends are paid out on a share basis and not on a value basis, rebalancing the portfolio may have a disproportionate effect on dividend income. Is the target weighting used by TBG based on value only, or do you consider the weighting of the dividends as well? I'm pretty sure I had to read it a few times. I'm pretty sure I understand what this individual is trying to ask. But there's a misunderstanding here. Yes, dividends are based on share basis. So the company will say it's $100 stock, and they go, we're going to pay $5 per share. And of course, the stock prices go up or down. But at the end of the day, the yield becomes just a function of the math. Per share you own is at a certain price. You're going to receive another amount of dividend, and that divided by the other becomes the yield. The fact of the matter is, by definition, it is based on value when it's based on shares because it's just one extra step of multiplication. You're just simply multiplying the shares by the value of the stock. And so we have target weightings that factor in what those dividend yields are. So we're kind of doing the math for you and doing it for ourselves. And then when we decide we want to reweight a company, the dividend that's coming from that company is being reweighted. But then the dividend from the company we're moving into, if we're rebalancing, meaning we're selling one stock lower and buying another stock higher, we're simply swapping the level of dividend income to the portfolio from one to the other. So I think that the question is overthinking it a little by definition through

mathematics. But if the question is just simply, are we asking about a particular company's yield in the way we're weighting the stocks? That we most certainly are. But no, across the whole portfolio, the fact that dividends are paid on shares versus dollars is totally immaterial.

Do you think China's upside down demographic position will have an even greater impact on its economic situation this year? And can that be quantified? My answer is no. I am very bearish on China's demography, but it's a multi-decade phenomena. It's not one I would isolate into a single year. Their demographic trend is negative, but that's not a 2024 story and most certainly not a quantifiable one.

David, I agree with you wholeheartedly in your analysis of the lack of interest by either political party in cutting spending or dealing with the tough financial problems when they're in power. But that said, how should that knowledge guide our equity and bond investments going forward? Well, obviously, it's kind of teeing me up because this is sort of what we do. It's what I believe in, largely a big portion of what I dedicated my life to. And I believe that what we're trying to do through that period is expect that greater indebtedness to create greater fiscal and monetary instability and essentially lead to a declining growth environment that puts a premium on high quality equity, puts a premium on well run companies and causes us to value balance, strength and of course cash flow to make cash flow primacy a driver in our decision making and then the return of cash flow to

shareholders. It should also on the bond market side lead to an expectation long term or lower bond yields, not higher ones.

All right. Probably one of the most interesting questions that came in this week that I'll try to go through quickly, but I think it's very important. The example of Apple's debt, because I had made the analogy to how Apple has a ton of debt, but relative to its assets and cash flows, it's just not significant. And that's my comparison when I brought it up was to a person with a lot of credit card debt with a ton of income and assets versus someone with a very small credit card debt, but no income and assets, which one's really worse. But the person said is it's given me a chance to kind of connect dots that I'm struggling with regarding Japanification thesis. If over indebtedness as a nation is bad because of the law diminishing returns and diverting resources to pay debt that could be more productively used elsewhere, but how does that impact Apple? If what can increase economic growth is a capex cycle that increases productivity, then when that investment in new factories and automation come from various big companies, successful companies, leading companies, cash flow and private or public debt that the company issues, how does the government's debt impact the capex cycle and investment decisions of private companies that drive economic growth? And this is the very important thing. I'm actually giving you in the podcast and video even more of the answer than I did in the written, because you have to understand that theoretically, we believe debt issued by private companies is often, but not always, but is intended to be productively deployed. And the debt issued by federal

government is often not. And so the debt is not created equal. I very much believe in the productive use of debt. But when you get into the realm of federal government and a misallocation of capital, you generally will get an unproductive use of debt. And even if there's a certain productive debt, like when we build the Hoover Dam, there are only so many Hoover Damns. And eventually you get to a point where the Pentagon is buying toilet seats for ten thousand dollars, things like that. So, yeah, there is a higher propensity for unproductive use of debt from government than private business. I sure hope that's not a controversial statement. But the point I want to make about verification is in the mathematical realm. National savings, which includes all resources, and national debt, what do you know about the publicly held debt and private. At the end of the day, every dollar that is used in national debt, that has to be diverted to go to national debt, is a dollar that comes out of the private sector. The Apples and Fords and, you know, various private companies of the world have less money to go into productive deployment when the government has more debt because the national savings has declined. And this is just a tautology that as you have more strain on national income, there is less ability to put it into productive use. And fundamentally, I think that nobody would disagree with the fact that investment comes from savings and you have less money and then from investment comes productive outcomes. You have less money in savings when you have more money having to service governmental debt. So in the total of economic resources, excessive government debt on this takes away from the productive side of the economy.

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All right. There is a chart in the dividend cafe dealing with dividend growers in the market and talking about the strong benefits of active dividend growth management versus passive. And then even passive dividend growth and how it is done versus the S&P over the years on a relative basis.

There are certain years where the S&P can really outperform the dividend growers. And then there tends to be a significant multiyear outcome. And we put a chart in to make the point. And that is that we believe dividend growth over the long term does better than the total market. We believe that active dividend growth is paramount over passive dividend growth. So I'm going to go and leave it there. I'll leave you with the quote of the week from Morgan Housl's brand new book, which is outstanding. Every investment price, every market valuation is just a number from today multiplied by a story from tomorrow. Thank you so much for listening to reading and watching the dividend cafe. We're forward to being with you again next week. Take care.

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