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.

Well, hello and welcome to this week's edition of Dividend Cafe. I am actually recording in my apartment here in New York City. I just arrived after a middle of the night flight here into New York and getting ready to head out for a whole lot of things that have to be done over the next several days. And I will say that this was a very interesting Dividend Cafe to write. Covered a lot of ground. I meant to go through a lot of different topics today, but I'm going to focus primarily on one that I think ended up getting a lot of the attention in Dividend Cafe, but is also likely the one that is on so many people's minds. And it has to do with the top heavy nature of the market right now. The valuations in the market. Some sort of odd and different things that are happening within the weightings of the market, the risk exposures that exist, just how the market is made up these days. And then applying all that to one particular company, which is the company known as NVIDIA.

And so I'm going to spend a little time on that, but then we'll cover here if we have time on this recording, a few of the other topics that the written Dividend Cafe went through.

Let me share with you a couple of just data points that I think may be of interest right now. I've talked a lot about, okay, the trailing 12, meaning the last 12 months earnings, when you look at the price of the market, now the market's at 25 times. Those

earnings. When you look to what forward projections are, it's trading in between 21 and 22 times. And I think that it's a very important point to make that's where expensive, it's extremely expensive and I do consider it problematically expensive, but then the nuances come and nuances, the enemy.

Clear communication, soundbites, social media TV hits, all of these things, frankly, it's nuances. The enemy of the. But then nuance is the great friend of good investors who can get through the simplicity of one or two sentence summaries and look into unpacking something with a little bit more depth.

Allow me to walk through some numbers that have blown me away this week. Yes, 25 times trailing earnings, 22 times forward. The median PE for the S&P is 18 times forward earnings. Now that's not cheap either, but it's just obviously nowhere near the level of frothy excess of the overall index. So how do you get such a distinction between the way the market cap weighted S&P trades and the median PE?

It's because the five largest stocks in the S&P are 28 percent of the index, so 1 percent of the companies are 28 percent of the weighting and the impact in the index, and their forward PE is 31. 5 times. So you have an index that five companies make up 28 percent of the index and are trading at 31.5 times earnings. Where the median of the whole index is at 18 times. Now, again, when you buy the S& 500, you're not buying the median PE. You're buying a cap weighted, a market cap weighted index, and that has this, 20 something price to earnings ratio. But the

distribution of valuation excess is highly skewed, if not exclusively skewed, to the very top of the index.

You could argue three companies. You could more plausibly argue ten. I don't mind if you want to say five. We used to talk about mag seven. And then very candidly, you could even talk about one. But there is a significant value throughout much of the market It actually pays nice dividends and increases them every year trades at a significantly more rational multiple.

Now let's talk about this Nvidia name because it's obviously one of the most successful companies in human history. The returns are utterly staggering. The growth of revenues and the market share they have in powering a AI is significant. Okay, but we're really not talking about a Mag 7 anymore. 33 percent of the return of the market.

The market's up about 12.4 percent of the 12 is from one company, one out of 500 indexing right now has become essentially a levered play on a very few companies. And right now the impact of one of them is something we've never seen before. Now the top three companies, so I talk about the mag seven being 28%, three, excuse me the top 10 being 28%.

Three companies represent 20 percent of the index. In 2017, you were coming off of eight years in a row of very strong market. You are already well into the Fang revolution. There was no a historical traumatic event to have skewed things. In 2017, the top three companies were 8 percent of the index.

They're now 20. I did read this week, a report from Larry McDonald analyst to bear trap support, which I've learned a lot from over the years. And video was 0. 35 percent of the S&P 500 in 2019. And it became over 2 percent of the index by 2021. It is six and a half percent. One out of 500 companies is six and a half percent of the market now. And that company. is trading 89 percent above its 200 day moving average. So you take this very high stock that has gone much higher and that gets captured into what a 200 day moving average is, by definition of the math, and it's trading at 89 percent above that number. So Larry provided this historical context I want to share with you.

Microsoft, which I think many will recall in the 1990s, went up a lot and was a sort of big deal. Windows and all that stuff. It got to be 54 percent above its 200 day moving average one time. 89 percent above your 200 day moving average is unheard of in human history for the greatest and most successful of companies. Apple never even close. There was one 24 hour period where it was 64 percent above its 200 day moving average a couple of years ago. 89 percent though that Nvidia currently trades above its moving average. It's unfathomable, but here's another way to look at this, to go up 1 percent from here, a 3 trillion valuation, the value of the equity has to go up 30 billion dollars. So, in other words, the entire 7 Eleven food chain, worldwide, is worth 30 billion dollars. To go up 1 percent from this level. NVIDIA has to go up the value of the entire 7 Eleven food chain or the entire amount of DuPont or the entire

amount of Delta Airlines, the entire amount of Consolidated Edison, the entire amount of the Hartford Insurance Group to go up 1%.

You get the idea. The value right now is greater than all of Amazon, Walmart, and Netflix put together. It is greater than all of Google, Disney, and Home Depot put together. That, those, that last data point thank you Josh Brown and Michael Batnick. The prior on 7 Eleven and so forth was something I came up with on my own.

I like to give credit where it's due just in case I ever get asked to be the president of Harvard. The top five companies in the S and P 500 from 2000 to 2019, a 20 year period, the top five companies were somewhere between 14 and 18 percent of the index. And again, they're over 27 percent now. So I know there's a lot of data points here and comparisons and maybe your eyes start to glaze over. I'm not saying anything whatsoever because I don't have anything to say whatsoever about what any of these very large companies, let alone NVIDIA do from here. I have something to say about the sustainability of these numbers. And to the extent that people will say, well, this time is different. I have a very long history of studying what happens. When people say this time it's different.

Let's talk about China for a little bit. Just it worth pointing out. It's tough to imagine things having gone worse. When you look at their stock market, having dropped 65% a really significant property bubble burst, something in the range of 40 percent of

property values down largest property developer in the country going through a bankruptcy.

Bond holders getting wiped out, all of these different things. And yet they have not gone to monetary accommodation. They have not gone to bond buying. They have not manipulated the cost of funds and their currency did drop against the dollar modestly over the last several months. But it's right now where it was in 2019 their bond market has had a 30 percent better return than the U.S., a 50 percent better return than Germany. And so how do you uphold the value of your bond market and your currency, how China has in the midst of a lot of real big problems, one of them being a statist Marxian political and economic framework by avoiding monetary intervention. By avoiding monetary policy as a tool that addresses Japanification facilitates Japanification.

I'm constantly worried that I'm going to wake up one day and find that I was premature in giving credit, but my belief that they will fiddle with the fiscal side of Japan, Japanification in their own Chinification, but avoid the monetary side is still far is so far still holding up. Quick lesson in humility for everyone who believe fancies themselves as good market timers.

The weekend of April 13th, we're aware of 300 drones launched from Iran to attack Israel on Israel soil. It was largely foiled. There was significant talk of retaliation, massive vulnerability, volatility, and questions over that weekend as to where things would go. That was April 13th since then. The dollar is up against emerging market currencies.

The NASDAQ is higher. The VIX, the volatility of the market is lower. Oil prices are lower, substantially lower. So if someone was predicting all four of those things in the aftermath of what some were then talking about, Oh, are we about to head to world war three? I'd like to know who they were. Interesting data point here speaks to how spreads have moved around in corporate credit markets.

Two years ago, it cost 8 percent to borrow in the high yield bond market. Today, it's 8%. The Fed's raised rates a gazillion times. Cost of funds for high yield has not moved higher. It was about five and a half, it was about 5 percent two years ago in investment grade bond market, those that were, had ratings higher quality credit ratings.

There's about 5 percent two years ago. It was 5.5 percent one year ago. It's 5.5 percent today. So spreads tightened even as rates themselves have moved higher. It speaks a lot to why credit has held in there and therefore a lot of economic conditions. What sectors have higher yields in the equity side?

Then they did pre COVID. This is interesting. Real estate, utilities, and consumer staples. Two reasons. One, the organic dividend growth embodied in a lot of those the names in those sectors. And then also those sectors have not screamed higher in price as much. The most dramatically lower dividend yield is of course in technology and consumer discretionary, but not only is

dividend growth almost non existent in a lot of those spaces it started very low as well and just simply hasn't grown.

I think I'm going to leave it there. Just my two cents on the second half of the year, do I think a bank failure could happen? Yes, but it's not top of the list of concerns. Do I think some kind of volatility from The election could happen. Sure. And I expect there will be volatility, but I don't think the outcome.

I, what I know is there's a hundred percent chance that someone's going to be elected at the end of the year, the 50 percent of the country hates. So that's baked in, Middle East escalations are out there. There's a number of things. I don't think many of them are much different than always is the case.

But the one thing I would throw out when I look at the way so much of the top heavy part of the market, and this is where I want to come back to where we started, is so based on high corporate spending and technology investment right now. Do I believe that there is some risk of that, those technology orders dropping, neutralizing, muting to some degree?

I do. I do. So, so I guess the way I'd sum this up is that I think there's a consensus view out there that I'm sharing though. There's a big risk that this could be catalytic to problems in the market if it were to happen. But where the consensus view may be different than mine is that the consensus view is not expecting it in the next six months where I think it's entirely possible, but I wouldn't I would be much more agnostic.

Not saying one, but not confident in it happening. I am very confident it's going to happen. And the timing of it is all we're really talking about. Okay. So with that said, what do I think in the current market environment? If that were to happen, if you get slower growth, if you get some form of. Goldilocks situation where we don't go into recession, but the kind of higher growth of the second half of 2023 reverses, which it appears to be doing.

I think economic growth is definitely slowing from where it was, but not facing contraction. This becomes that environment, in my opinion. Again, not that I would really care to try to forecast this for a three or six month period, but this becomes environment. where cyclicals get hit, disappointing growth, even if it's positive growth affects those high PE names and the defensive sectors, the higher yielding sectors, the more value and just put differently, high quality does very well.

That's an economic environment. I consider people to think about how they want to be positioned for. I wouldn't care to predict it because I really like to invest for all weather. And all weather to me is found in companies growing free cash flow where the folly of trying to time and predict these things is removed from our calculus.

Thank you very much for listening. I hope you got a little information out of this current market in this week's Dividend Cafe. Always appreciate watching, listening and reading. And I'll

close you with our quote of the week. It is impossible for anyone to begin to learn that which he thinks he already knows. Have a wonderful weekend. Thanks for watching the Dividend Cafe