DIVIDENDCAFE | PODCAST TRANSCRIPTION

FRIDAY, July 12, 2024

Well, hello and welcome to the Dividend Cafe. It has been a very interesting week in markets. We're going to talk about a really short term story with a little bit more medium term story, and then expand it into a very, very Long term story. And so there's a little bit of something for everybody this week.

It's very, very rare that I care at all to talk about in the dividing cafe, something that happened in markets on a given day, or even really a given week. Sometimes I might anecdotally mentioned some drama in markets on the week we just had, but it's generally not really all that relevant.

to, to what we're doing and the way we manage money for our clients at the Bonson group. And it's not generally relevant to the types of things I want to teach in the dividend cafe in terms of sharing our perspective on how Investment markets ought to be managed and thought about. And we just generally have a much longer than one day or five day perspective.

That hasn't changed this week, but there's a kind of opportunity to mention something as well as then dive into. A few other stories. So I'm going to go all over the map of this week here and I will say what I like to say quite often. For those of you listening to the podcast or watching the video this week's written dividend cafe has how many?

One, It's just two, I believe. Yeah, two charts, but I think it will be impossible, impossible for me to capture what I want to say without you viewing those charts. So hopefully you'll have a chance to jump in at

DividendCafe. com as well, but we'll get into it. You tell me what you make of this. I've talked over and over and over again about the top heaviness in markets and the a historical reality of what's taking place right now with the concentration in return from one company, three companies, five companies, seven, 10, et cetera.

And then one particular sector, two sectors. There's just been. A consistent theme of a lot of top heaviness in markets for some time. Now, the reason I bring that up right now is that it is incredibly rare for an even weighted S&P 500, where all 500 companies have the same waiting. You can hopefully do the math of what that would be to, just in terms of divided by a hundred for an even waiting company by company.

And then also, of course. The cap weighted, which is almost entirely how people own an index, not universally, but by a large move, the cap weighted indices have a lot more assets than even weighted. And what I mean by cap weighted is. That the market capitalization indicates how big of a company or small of a company it will represent in the index.

And so if you take the total capitalization of the S& P 500 and one company is 3 trillion divided by capitalization, they're going to be a lot bigger in the index. In this particular case, six or 7%, then a company that their capitalization is, let's say only 0. 1 percent of the index. And so we have a lot of that right now in cap weighted where those larger capitalizations are moving the needle a lot more.

Okay. Why do I bring this up? The even weighted index year to date versus the S&P cap weighted has an 11 percent Delta between the two. Okay. Oh, they have the exact same stocks in them. But one is up 11 percent more than the other in six months We have never had that kind of a delta and the last time we had a delta this close in a quarter So you know the quarter two of 2024 was the highest outperformance of a cap weighted index versus an even weighted index.

That again, two indexes that hold the exact same stocks. It was the largest outperformance since Q1 of the year 2000. I think most of you know what happened in March of 2000 and why I'm bringing that up. It is not predictive to the extent that history has to exactly repeat that way, but the, Dynamics and the math and the economics that are at play are most certainly similar and it's worth pointing out.

Now I had talked about that and set it up in Dividend Cafe before Thursday of this week. And then on Thursday we had another individual event and that's why I bring up, the year to date issue with the market for six months and then now a ultra short term thing of just one day. And one day is one day.

I don't have any idea, nor do I care to have any idea as to whether or not it's predictive of something to come. But I do want to point out that the small cap index, the Russell 2000 on Thursday was up 3. 6 percent in one day. The NASDAQ was down 2. 2%. That's the largest single day Delta ever in history by a wide margin.

There's never been a day where those two were 5 percent apart and a 5. 8 percent Delta between the rest of 2000 and the NASDAQ in one day is absolutely stunning. But all of the things that have been laggards this year, maybe they've been up most cases they have been, but just up a little. The regional banks the Russell 2000, REITs, the Yen long duration bonds, treasuries, they were all up huge on Thursday.

And then the winners of 2024, semiconductors were down three and a half percent in one day. Tesla was down 8% in one day. It's been all over the map, and video was down almost 6%. Big cap growth was down big over 2%. Big tech was down about 3%. So you just had one of these days where the big winners fell a lot.

The big losers went up a lot. Is this predictive? No, I couldn't care less about that. The reason I'm explaining it is because I think that there are theories about whether or not big cap growth just runs on forever. That would not be my view. Whether or not everything tanks together. That's certainly possible.

Not my view, but it's possible or a rotation takes place, a shift of leadership. And that has historically been very common and given valuations, what we might expect this year. Now, some are saying, Hey, maybe things are about to rock and roll because the fed's about to cut rates. And so this is where a chart comes in that I.

Put together myself, by the way, which is never a very good idea on the design side, but nevertheless I took two charts from original sources and blended them together myself with our design team out today, but here's the thing. You've had you started the year with an expectation of six rate cuts and in the actual chart of the fed funds market You go down down down down down.

We're right now expecting two cuts. We were planning on 175 basis points of rates coming out From six cuts at the beginning of the year. It's now down to 50 And yet inversely the s& p going higher and higher as rate cut expectations came down s& p went up Now do I think that means that the market? Wants rates to go higher?

Of course not. But there is no basis for believing that there are some big, huge hedge funds out there that are thinking, Whoa, the Fed just cut rates. We better get going on this. We we were not expecting that. Let's check out this Nvidia thing. I've heard it's doing well. It's just not true. Markets are discounting mechanisms.

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Is it possible that the big market action was in anticipation of something and that when the thing happens, markets respond differently? Of course it's possible. Happens all the time. Check out the chart. Okay. The quick update on the Fed now after the very benign CPI report this week, 94 percent chance priced into Fed Funds futures about a September rate cut.

I think I'm gonna end up being wrong on that one that they wouldn't cut till after the election. It certainly appears, although there are still two months to go, that they will end up cutting once before the election. It's a 96 percent is it? Let me look at it. No, 99 percent chance by November and 100 percent by December in the futures market.

So these rate cuts by all indications are coming. And apparently very likely to be starting even a little earlier than expected. Okay. There's some information on China that I want you to get out of divingcafe. com that I got to skip through here. And then I want to quickly say I used Germany and Switzerland to make an analogy about growth.

Because you have the German stock market, the MSCI index of Germany, which is 57 companies that is trading right now at half of the value of Apple. And it's, it is generating in aggregate, all 57 companies, 10 percent more free cashflow than Apple. But is worth 50 percent that of Apple, then you have Switzerland, which is, maybe about a point about 60 percent of Apple, a little bit more than Germany, and yet is 10 percent less than free cash flow than Apple.

So you have 90 percent of the free cash flow of Apple. Worth 60 percent of Apple in Switzerland. That's 45 companies, by the way. But you have 57 companies in the German index that are trading at half of the value of Apple with 110 percent of the free cashflow. But this is not totally irrational.

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It's a little irrational, but it's not totally irrational at the end of the day. The more interesting factor to me than why Germany and Switzerland trade the way they do versus Apple. Which is clearly part of just the Colt stock reality of Apple part of it. And again, I hat tip to Alexander Einheiken, one of my very favorite economist analyst in the world who I've been reading now for almost 25 years.

This has everything to do with the Delta between Germany and Switzerland. How does Germany trade at 11 or 12 times earnings and Switzerland trades at 17 times earnings. Well, very simply put Switzerland is number six in the world. In GDP per capita, economic growth per citizen, Germany is barely in the top 30 Switzerland has a 38 percent debt to GDP ratio.

Germany's is almost double that. And that's better than most of Germans, Germany's European neighboring countries, by the way, debt represents a drain on future economic activity. And so all of these things come together for a purpose that. Marked into expectation is some growth expectation and the way that Germany trades to Apple or Switzerland trades to Apple or Germany and Switzerland trade to one another, there's a big takeaway there.

So then let me get to the bottom line thing I want to conclude with today, which does have everything to do with this economic growth. At the end of the day, I've talked over and over about the tautology of economic growth. We care about economic growth to the extent that it is a condition for a better quality of life, that you are creating the necessary soil for people to have a higher standard of living with better economic growth.

And that economic growth is effectively. And this is tautologically true, the combination of population growth and productivity growth. And so when I think about productivity growth, a lot of it is because population growth right now is impeded in the West by a pretty low view of fertility and a pretty low view of immigration.

And as long as most Western countries, if not all Western countries, have essentially zero population growth or even negative population growth, it puts a far bigger burden on productivity growth to drive economic growth if we are to create a higher standard of living across Western nations, including our very own U.S. of A. And so, my friend Louie Gov had written a piece a few weeks ago that I got around to reading this week that was very interesting to me. And In talking about what we know about countries that do take on this burden of greater innovation, I write a lot about the impediments to productivity growth.

The excessive government indebtedness being the secular, structural, systemic impediment that it is across any nation that gets into a position of excessive indebtedness, how that necessarily and I, again, to not to be fancy or algebraic, algebraically, excuse me, takes away from economic growth. But, and then there's, causation around this high marginal tax rates, excessive regulation that go even above and beyond what the role of excessive indebtedness plays in putting downward pressure on productivity growth.

But what are the conditions for productivity growth that are positive? What is it we want to see to generate more besides not having some of the negatives? What are some of the positives? And Louie talks about education, and I think he's really onto something there, but the caveat in one he acknowledges is very important, necessary, but not sufficient.

There are no, Countries that have dynamic economic growth that don't have a top tier education system But there are plenty of countries that have a top tier university system that don't have dynamic economic growth Number two again the rule of law this one is also necessary, but not sufficient. And even what it means to have rule of law is often graded on a curve.

Number three, a strong military capacity. And again, people can debate what's correlation and causation, but you look at the great innovative countries and you look at the highest military budgets per capita United States, Israel, South Korea, Taiwan spending a lot in defense and having a lot of innovation relative to where the rest of the world is number four entrepreneurial ism.

That's the term I'm using. Louie referred to it as an acceptance of failure, and I think he would agree that this is what I mean by entrepreneurial ism, acceptance of failure, meaning a culture of risk of risk taking and where there is not risk taking. Japan over the last 30 years and where there is risk taking United States, Silicon Valley, these things that have gone on, you can get significant.

And it's not by the way, just the risk taking of big tech and Silicon Valley, and that's more exciting and venture capital plays in, but just the entrepreneurial culture that permeates the U S with small business, family, business, private business, et cetera and then number five Louie talked about ecosystems.

And I think this is essentially describing the network effect and he's just completely spot on here that countries that have the conditions of innovation have strong ecosystems for innovation, Silicon Valley, by the way, being a great example of one. And then the final one I'm going to add that wasn't in Louie's list is capital formation.

I don't think societies can innovate without robust capital markets. And then, and this essentially means where there's innovation in capital markets, there's innovation possible in the economy. The United States has done this very, very well. And when people sit around talking negatively about capital markets, they are talking negatively about capital.

about free enterprise. They are talking negatively about innovation across the economy. Capital formation is a wildly important element. Check out the chart of the week at Dividend Cafe where you will see in very visual form, the top heaviness of the S& P. I started off our discussion today talking about the equal weight versus cap weighted index.

And I will tell you that the chart of the week shows. 73 percent excuse me, 78 percent of the stocks in the S&P 500 are performing less than the S&P 500 highest in history. Do with that what you will. Thank you as always for listening, watching and reading the Dividend Cafe. Look forward to being with you again next week.

Take care.