DIVIDENDCAFE | PODCAST TRANSCRIPTION

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Well, hello and welcome to this week's Dividend Cafe. I am David Bahnsen. I am the managing partner of the Bahnsen Group. I am sitting in our conference room in New York City and I am excited to talk to you today about something that I think is a very interesting topic for all investors and it has to do with the way investors think about what they're trying to get done and the way money managers, portfolio managers and even Financial advisors think about what they're trying to get done after I get done kind of going through this topic.

There's a couple other supplemental things we may have time to cover a little bit as always I want to direct you to dividendcafe.com for the written version where the charts are and where my real passion of the written word can be found, but I continue to do this video and podcast because I know that is a preferred method of delivery for many of you, even though I have a face for radio.

I had a rendezvous yesterday with a money manager I've known for about 15 years who is a very prominent growth manager in our business. And I've known him from his old firm. He's now left and started his own firm and we use them at the Bahnsen Group for merging markets, growth, investing, which is

a strategy we import within what we call our growth enhancement sleeve. He manages many billions of dollars outside of emerging markets growth including us and international developed just general global growth. That's sort of their their specialty. But there was a small, gathering of a few portfolio managers investment professionals and whatnot here in Midtown Manhattan yesterday and we just kind of did a little roundtable discussion.

And the reason I tee it up this way is because there was a question asked that his answer perfectly encapsulated something that I feel so strongly about. And so I want to set the table for you a little. He as a growth manager had a very large weighting in technology as many growth managers have, and certainly as I talk about all the time in Dividend Cafe, as the index itself has in fact, right now, the top 10 companies in the S&P 500 represent 36 percent of the index. 2 percent of the companies are 36 percent of the index's weighting. And, as I've talked about, tech has been about 31 percent and communication services another 10%. So, you're really dealing with a very top heavy market from a sector standpoint, and there's no way a growth manager like him can go five minutes without someone talking about this.

The question that was asked to him, as he has significantly down weighted their exposure to tech, particularly to big tech and to the semiconductor space, and some of these real popular mag seven names as they've significantly down weighted their

exposure to well less than half of what the index would have in technology.

The well meaning question was when you own a lot of these big top 10 most popular names and they go down it seems that most investors won't care because they understand, well, everybody saw those things go down, but when you don't own them. And the index goes way up, then people do get upset that you don't own them. How do you expect to outperform the index when you don't own these things that are such a large contribution to the index? And you might be thinking right now, Prima Facie, that's an okay question. Maybe it kind of makes sense. It seems like a reasonable argument. Assumption and then a question you'd want to get answered.

He said, while this is a very philosophical question requiring a philosophical answer, that first, let's just start with the fact that mentality that's embedded in the question, that reasoning, is why most managers are doomed to being closet indexers. That essentially, while it seems as if you're asking about something that could help you outperform, you're basically taking for granted something that by definition means you cannot. How can you outperform something when the presupposition is you need to do your best to make sure you're right in line with it? In other words, if one has a conviction that they want to have a much lower weighting in technology, that conviction could be wrong, could be right, but to not act on that conviction because you want to be hugging and sticking close to what the actual

benchmark itself is doing, effectively makes you a benchmark investor or something very adjacent to it.

And I believe that is what most money managers have done. And as he was saying this, it occurred to me, I wrote a Dividend Cafe about this, not three months ago, the business model of how so many managers think about this question almost gave away the whole issue in saying, look, from a career standpoint, if the tech stuff you own drops a lot and you own it at the same level as the market.

Clients aren't going to like that they're down a lot, but they're not going to fire you because they won't blame you for it being down because everyone's down. These things were so popular. We all suffered through it together. But if you don't own it and they keep going up, then you have the risk of really under-performing.

Now, of course, what's missing is the possibility that they do drop. And by not owning, it creates outperformance by not owning. But we had the point being. I think a legitimate one that if one is a portfolio manager, selfishly, just trying to think about what will not get them fired, they probably are best off to just follow the crowd in that same capacity and his answer was filled with moral authority, but also pragmatic conviction about managing money, and this doesn't speak to whether or not someone's right or wrong.

To believe that owning the technology sector at its current valuation, at its current weighting with its current fundamentals, let alone technicals, et cetera, that could be a good idea or a bad idea. I've obviously spoken plenty about what I think in terms of the valuation, both relative and absolute.

And so forth but the issue right now is not whether or not managers that feel the tech is frothy or that they want to be underweight, or even managers like us at the Bahnsen Group that have a very strong philosophical commitment to dividend growth. As our driver of investment thesis, it isn't even about whether or not those things will prove to be right or wrong in the next three months, six months, 12 months, what have you.

The point is that to do something different than you believe is right, than where your convictions lie, simply based on popularity and size, is immoral. And it is anti fiduciary, and I believe it is unprofessional. And I think it is a horrifically bad idea. And yet I think that's what a lot of people are expecting.

And therefore, when they wonder why there's so many managers that are just right around the index, you say, well, wait a sec, this is be a self created dynamic because too many are unwilling to take the conviction. and apply their own investment thesis with conviction into how they execute in the way they manage money.

So I think that there is a great moral authority and a profound mathematical truth in what is being expressed here. And I felt it

worth repeating. The concentration reality is what it is, 36%. Like I mentioned, you, you could say, I want to outperform The market for whatever reason, that's my goal. And when 10 companies are 36%, keep in mind at the point of dotcom and the big tech and the tech crash at March of 2000, the top 10 companies were 26 percent of the S&P they're now 36%.

Okay. Highest in history. But how do you then outperform? Well, there's three possibilities. You can make those top 10 companies 50 percent and then if they go up, you'll own more of them than the index and if they go up more than the rest of the market does, you'll very likely mathematically create an outperformance.

You could do something much lower than 36 percent including 0 percent and if they go down, then you're very likely going to outperform because you don't own this thing that has really dragged the market because it's 10 companies that are such a high weighting. Or you could own exactly 36%. And so you're in line with the S& P on these 10 companies.

And then with the other 64 percent of the portfolio, do something very different. And if it does better than the S& P, you'll outperform. And if it doesn't, you won't. That's obviously not going to be what a lot of people are going to do. I want to read to you how I answered this question because I not only rejected the notion that I'm supposed to care at all about this question.

That I don't believe it matters to any real person in a given quarter or given year what their performance number is relative to some arbitrary benchmark that doesn't even represent their actual portfolio or goals or income or liquidity or risk tolerance or timeline, what have you. But regardless, even if I pretend is someone serving their clients by saying, you know what, I'm going for this outperformance thing, I'm going to go 50 percent with 10 companies that are already highly overvalued.

Maybe that's what they're supposed to do. I don't think so. It strikes me as outside their fiduciary obligation. Doesn't sound prudent, doesn't sound smart, but let me tell you my answer as to the way I think about this. I believe in dividend, and I'm reading straight from dividendcafe.com this week.

I believe in dividend growing companies that will sustainably grow their dividends over time and believe that some years, things like popularity and size will do better than cash flow profits and value. And over time, I believe that cash flow profits and value will deliver the outcome that we're committed to providing for clients.

The raindrop race along the way runs counter to fiduciary duty. And I will not be sucked into it by a culture that's frankly lost its mind on a whole lot of things. Why should this be any different? I think there's an important mentality. I don't believe that investor needs are met by people. that want to give the culture what it wants even if they don't think it is the best thing for the culture because it's popular.

Size investing speaks to popularity. Popularity does not necessarily speak to value, but it can very commonly speak to performance. It can do quite well for sustained periods of time. Ultimately, over multi year cycles, there's absolutely no question. Testimony history is abundantly clear. And value, profits, cash flows matter.

in longer periods of time, more than popularity and size. It's a very simple thesis and one that I have studied, time tested stress tested, analyzed at great length, and done so with the very best intentions for clients in mind. So right now, when you look at the state of affairs I think tech stocks seem to be in some technical trouble.

They could very well kind of ride through this a bit. There's, there are buyers at certain levels of dip. Their flows, the positioning they have in the market is definitely extreme levels. The weightings are so high, amount of money that's gone in. So there's a vulnerability there that there could be a big run to the exit at certain triggers.

The valuations are obviously extremely expensive. I do think, as we've talked about, that rotation is on the table into consumer staples, into utilities, into value, into small cap. into real estate, into other sectors of the market that had been more underappreciated. I think fundamentally the recession risk in the economy is growing.

I don't think we're going into recession anytime soon, personally. There's reasons I believe that I've written about a lot. But I do think the economy is slowing and I put a chart in Dividend Cafe of the two year treasury yield. There's just no question. It's gone from 5 percent to three and a half percent very quickly.

Now three and a half is still well above 1 percent where it had been for a very long time. And the Fed has not begun cutting yet. And this is obviously the bond market begging the Fed to begin cutting, which they will do at some, they'll start to do at some level next week in the FOMC meeting. But when you take all those factors put together.

With valuations, with flows, with rotation, and with recession risk. I think fundamentally, even apart from all the other common sense arguments I'm trying to make, I think people are very wise to think prudently and avoid the popularity thesis at this time. All right, let me move on to a couple other things and we'll wrap things up.

Home ownership, I found this fascinating. The silent generation, which would be the one that was before baby boomers. And so I don't, I'm assuming it would have started anyone born maybe in the early 1930s up to the mid 1940s, late 1940s. When they were 30 years old, the 55 percent of them owned a home.

When baby boomers who were born from 1946 to 1964, when boomers were 30 years old on average, 48 percent of them owned homes. My own generation X at 30 years old, 42

percent owned homes today, 33 percent of 30 year olds own homes. So obviously the numbers have come way down and I'm fully into the obvious, like one of the quick takeaways that.

But homeownership is a big problem, the affordability thing. I don't know very many macroeconomic analysts that have written about this more than I have. I'm obsessed with this topic. I think it's a failure of public policy and so forth. However, I do want to point out, I don't know that the 33 percent of 30 year olds own homes versus it used to be 55, 48, 42 percent through these successive prior generations.

I don't know that's only a comment about home affordability because Silent Generation, when they were grown adults at 19 years old there's definitely been delays, not just in home ownership, but in marriage, in having kids, in career development where, you know, we do have a more societally accepting attitude towards the 10 years of young adulthood.

That, that launch people in, into the world and therefore I think that just culturally a lot has changed that has resulted in deferred home ownership. You, some may think that's a good thing, some may not, but my point is it's not only an economic story. And this is why I bring it up is because it's kind of right at the nexus of what most animates me.

Is where cultural and economic concerns come together and that's what this is. And so I wanted to bring that to your attention. I thought some of it was anecdotally quite interesting.

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All right, what else do we want to talk about? Please go to dividendcafe.com. I'm going to skip over on the podcast.

Some interesting sidebar on this issue of the amount of foreign born workers that have have received net new jobs in the labor data the last couple of years versus native born. And the nuance around why that data does not necessarily speak to what people think it does. Then finally, the chart of the week refer shows that right now we are at 785 percent of net worth proportionate to disposable income.

It's a chart that the Federal Reserve makes available. It just recently got updated. Bloomberg posted it. As my friend Peter Bovar published it, I thought this would be a great way to make a point. Right before.com, the number was at about, let's see, 614% net worth divided by disposable income. It got as high as 650% by 2006 and in 2006 you had a housing bubble with.com.

Houses hadn't really bubbled at all. But then by 2006, you had a housing bubble, plus you had about three or four years in a row of big stock increases. Then obviously the financial crisis brought that way down, and now it's just sort of steadily come higher. Net worth's growing, and the ratio of net worth's divided by disposable household personal income.

It got as high in 2022 at 850%. It's sitting right now at 785%. So, it's still way higher than it's been pre financialcrisis. com. I think it speaks more to housing prices than even the stock market, but it reflects both. But in 2022, you also had a bunch of

shiny object stuff that was in a bubble. That bubble got deflated, so that brought some of the net worth component down.

And then also, you've now had a couple of years of incomes continuing to grow, which they've grown pretty well. About 4 percent real wage growth. So that's helped counter that ratio. Again, these numbers are still just very high historically and worth bearing out. I don't think it's predictive. I don't think it's a timing mechanism.

But when net worth is growing more than incomes are growing, that means that asset prices are growing. And asset prices are supposed to reflect productivity, cash flows, and at some point things get out of whack. Do with that what you will. I'm going to leave it there for the week. I know it covered a lot of ground.

I appreciate you bearing with me. I really appreciate you listening to and watching not to mention reading The Dividend Cafe. I look forward to being back with you again next week. I don't know at this time if it's going to be next week or the week after that we have our very special edition political white paper.

I think at this point it's going to be two weeks from now because I don't have any travel next week where I will be able to really focus on it. I've already been working on it for months. But the week following, I have some travel that I think will enable me to kind of do the extra dive I want to do a full analysis of the election implications for investors.

So if it isn't next Friday, it will be the Friday after that and I'll leave you in suspense as to what else may be going on. And when I say I'm leaving you in suspense, it's because I myself am in suspense. Have a wonderful weekend. Thanks so much as always for listening to Dividend Cafe.