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Well, hello and welcome to another edition of the Dividend Cafe. I'm your host, David Bahnsen. I am the managing partner here at The Bahnsen Group, and I each and every week have the distinct privilege of bringing you our weekly market commentary on Friday to cover whatever it is that is on my mind and inspiration for that week and Monday going through the set topics of what's happening in the market with the Fed in oil and energy markets with housing and economic data and so forth.

So we got a couple left here on the year but we're getting near the end of the year moment and I'm going to update everyone next week as to what exactly we're going to do and not do in the final holiday weeks of the year, but for today you get a normal dividend cafe. So we're going to get into it.

I'm going to spend the bulk of my time today talking about the subject of optimism, and particularly the optimism that is showing up in the data right now, and then for many it might be showing up anecdotally. Just in terms of vibes in, in conversation and the impressions one has in the business community.

But there's even a more empirical or objective way of looking at data of looking at optimism both with small businesses and with larger more public market oriented businesses in light of the incoming Trump 2.0 administration. And we'll talk about what that might mean and what it might not mean as it pertains to markets, the economy, et cetera.

There's a few other things I'm going to cover to not related to that topic that were just kind of relevant this week. And so I'll I'll come back to those things to make sure that I leave myself the right time. Okay. This is the catalyst to the topic, by the way. that the NFIB small business index this week, absolutely skyrocketed for the month of November.

And it had done the exact same thing back in November, 2016. And so I put the chart at Dividend Cafe this week, where you see the big move higher that was right in the aftermath of the election. And then again small business optimism that had been quite low. In 2016 it was low as a result of just ongoing sluggish economic growth post financial crisis recovery.

Not a lot of productive activity that had been going on at 2015 and 16 there were resurfacing issues maybe around the dollar, maybe around China. Yeah. but just fundamentally a pretty low growth environment. And in 2024, I think a lot of it was related to Fed tightening and just sort of the aftermath of tighter credit conditions.

Not so much. We need to fire a lot of employees, but there's been a lot of difficulties in being able to hire employees. So there's a few factors that have been pretty consistent, but you get this huge spike in optimism. And the uncertainty component declining 12 points in the month of November. So, with all that said, what do we think this means and what does it not mean?

Well, I think on the small business front it's rather easy to say that a big part of it is the expectation for good or for bad, for right or for wrong, that there will be a deregulatory emphasis in a Trump administration. and potentially a tax favorable environment. Various, because a lot of small businesses are taxed as pass through entities, the vast majority are not C Corps whereby they pay their own corporate tax rate.

The vast majority are LLCs and Subchapter S corporations where the profits of the business flow through to the owners and so it's taxed at their individual rate. There's different tax advantages in that structure whether the business deduction or the or the PTET allowance for state taxes.

There's things that can be done within that, but I mean, for the most part, it comes down to individual taxation for a lot of these business owners, and there's a certain relief that some of the individual tax burdens. May not be sun setting back to pre 2018 conditions. So just on a surface and mathematical level, that's a part of it.

But then that deregulatory environment I think is a big piece too. Well, before we go on to what to make of small businesses feeling better about these things, I just want to add that this same dynamic has been playing out. across Wall Street and across Fortune 500 companies. Now these are not subchapter S or LLCs.

These are not family businesses. They're not small businesses. And yet similar reasons may exist in the expectations of a more friendly tax and regulatory environment. But also there was a relief optimism. That is Concerns about what some of the personnel may be, that now a lot of people in the business community, I'm only speaking specifically to kind of the Fortune 500, large cap, public equity world, whether it's technology, Silicon Valley, finance, Wall Street, or any other sector that they fear that some of them are controversial and questionable, Selections of the Trump administration for new cabinet, new staff, new agency, you know, large leadership positions.

Some of those have been outside of the domain of the business concerns. But when you look at the Treasury, Commerce, Trade, EPA, SBA, there's such an alphabet soup here. The NEC, the National Economic Council. You go through all of these different entities and everyone feels pretty good about the personnel.

And you look at what the administration's priorities seem to be. People feel pretty good about that. Now, I recognize, I put a link in dividendcafe.com to a New York Times article, there may be some that it's transactional, that it's pragmatic, concerned, you know, just for the sake of their own business, they would rather be getting along with the administration than not getting along, so they're saying nice things and talking encouraged and maybe it isn't maybe some of it's a bit disingenuous, but no, for the most part, I think there's a sincere, and you see it very evidenced in asset prices.

I think there's a very sincere optimism from both the NFIB small business world and big cap corporate America. And tax regulation and personnel cover a lot of that. There's a hope out there. that with tariffs, I talked about this last week, that some of the worst case scenarios are not very serious.

And my own view is that naturally this kind of hope and this kind of expectation leads to greater confidence. What I will not tell you whether it's small business or big business, that hope or confidence it inevitably leads to positive outcomes. It is often the case that it will. And there is a sense in which if one feels good about the future, they're more likely to spend today in a productive growth oriented manner.

And that's especially true with capital expenditures and making big investments in the future. But I will tell you this, what is more practically significant for markets? Big cap businesses feeling good or a 100 percent expensing you know, a bonus depreciation tax deduction. At the end of the day, there has to be a follow through.

And I'm not suggesting there won't be, I'm not guaranteeing there will be, but I think that the optimism can all at once be rational and not assured. Okay. Of a particular outcome. And this is not a contradictory position. It's a tension that one has to hold, particularly investors. And in our case, investment managers and investors that are viewing these things for what they are.

A feeling does not create an economic activity. It's indicative of a hope for an economic activity. Now most of the things I think they're hoping for. are very likely to pass. Maybe not all. Maybe they're likely to pass, but with a little bit more complicated journey on the way. That is our job.

That's why I will be focusing more. on the tariffs as I focused for, you know, four or five weeks now, rather obsessively on the personnel as we focus on the bills, the legislation, the regulations, some of the specific priorities, the optimism and confidence are not the thing. They look to the thing.

And I put another chart that I absolutely love in Dividend Cafe this week where I want you to notice the incredible correlation between small business optimism and actual ISM services, the PMI, and actual ISM manufacturing, the PMI. What I'm trying to tell you is that people tend to feel really good when they're producing more goods and services.

When they live in an economy that is producing more goods and services, it then creates economic activity that creates The a follow through of good feeling that is justifiable. So what you see in the chart is that those things have correlated together up and down for a long time. And now you see a big spike up in optimism.

And if you get a spike up in goods manufacturing and services, then that really rationalizes the optimism if you do not. No, I do not think people are going to stay optimistic you can only feel good about feeling good for so long, but I do think that there is a necessarily rational component to this around tax regulation policy so far and where, excuse me, tax regulation personnel Where there are certain personnel people that I think others could have a reasonable reason to say, I'm not thrilled about the defense the Director of National Intelligence or the FBI Director or the Secretary of Defense.

People have, can have reasons to like or dislike these folks, but they don't the markets, small business, big cap business doesn't feel those things are core. and the way that they do about some of the very key and significant regulatory and cabinet economic oriented categories. So that's where I would leave things in terms of the discussion of optimism.

Let me go through a few other nuggets for you this week. Just, I've brought it up before, but it's gotten even more profound, I want to reiterate. The company of Nvidia right now, which we talk about a lot based on it getting to, like, a 3.4 trillion dollar market cap. It is larger than all of Canada's stock market. It is larger than all of Australia's. It is larger than all of France's. It is larger than all of Germany's. It is larger than all of Italy, Spain, and Portugal combined. It is larger than all of Scandinavia combined. It is larger than all of Switzerland. It is larger than all of the United Kingdom. Now why is David Bahnsen telling us something else about NVIDIA's market cap?

It is not because I'm suggesting it's bad. It is not because I'm suggesting it's good. It is not something I'm saying, bringing up for any other reason than for you to know. That there is a company that's reasonably new that has a larger value than countries that are, you know, the entire public markets of countries that are centuries old.

And it is interesting. No matter what you think the takeaway is, it's interesting. The financial deregulation theme is going to be a big part of what I'm doing going into 2025. I am really convinced that companies their valuation, their their operating performance with return on equity that there is a lot on the line around the regulatory environment.

And I think that I'm trying to tease out some of the things that are going to be in my year behind, year ahead white paper that'll come out January 10th, that if you accept the premise that regulation compresses return on equity, then you're and that growing return on equity grows the price to book value multiple.

There is a lot on the line on the regulation side, and we're kind of in between a place of very hyper regulation right in the aftermath of the crisis, and very lax regulation prior to the crisis, and right now there's a kind of fork in the road moment for the valuations of financial services companies, banks, and banks.

This is not a theme I would be ignoring, and it's even going to play into some of the stuff like IPOs. You know there were 500 billion dollars of IPOs in 2020 and 21 put together? There has not been even 70 billion dollars of IPOs in 2022, 23, and 24 put together. Now, 2020 and 2021 were an anomaly because of the SPAC craze that ended with a whole lot of people getting their face ripped off.

But, even if you look to the 10 years prior, you were averaging something around 70 billion a year and now you're averaging somewhere around 20 25 billion a year. Is financial deregulation, is stronger capital markets, lower interest rates going to lead to more IPO activity. I think there's a lot to talk about there that it goes beyond just M& A exit multiples, interest rates but speaks to kind of a risk environment in the market.

The other thing I want to bring up is CPI and PPI. Cause it's talked a lot about in the context of what inflation is and that, you know, you get the number of inflation. You want to look at what inflation is and. Some could say, oh, this shows inflation has really been beat, or others could say it shows inflation still is sticky, or some could say, wow, this number really is worthless because the shelter number is so disproportionate and mismanaged.

Whatever. I would just like to point out that the delta between the two has come down an awful lot. And a high delta speaks to a very high profit margin when the consumer prices are growing a lot more than producer prices, that does speak to the ability to really capture a lot of that in profit margins.

And when the delta comes through, it's not perfectly linear. There's nuances here I won't get into, but my point is we have a lot riding in the market. on the sustainability of very elevated profit margins. And if the CPI to PPI Delta, the spread were to come down, I think you have to call that into question a little bit.

Finally, a little market history and we're going to leave it there. I will be flying back to New York for all next week and I'll be with you in the Dividend Cafe again on Monday and again next Friday. But as I close out this week, You know that the market is about to close the year up over 20 percent two years in a row.

As we sit here right now, it's up over 25 percent two years in a row. You go, wow, that's unheard of what's gonna happen in the third year. Well, actually over the last hundred years, it's happened seven different times. That the market's been up over 20 percent two years in a row. And in one of those occasions, it was five years in a row, 1995 to 1999.

When my career was beginning, you had over 20 percent returns five years in a row. So basically, between the first year or second year, or in that case, five years, about 20 percent of the time over the last century, the market's been in, in one of these periods of the kind of 20 percent plus two years in a row or more environment.

What does that mean for the third year? Well, it will not shock you, I hope, to know that half of the time the third year has been lower and half of the time the third year has been higher. So I think that's a worthless statistic, predictively, as so many things are. We'll have a lot more to say about 2025 as we go into 2025.

In the meantime, I hope you are ready for a wonderful weekend of Christmas shopping and wrapping and all these things as we get closer still to this magical time of year in our holiday season yet to come. I will be on an airplane, and I will be reading and writing, and I will be looking forward to you sending any questions you may have.

In the meantime, thank you for listening, watching, and reading The Dividend Cafe.
