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Hello, and welcome to this week's Dividend Cafe. I am David Bahnsen, Managing Partner of the Bahnsen Group, and the weekly writer of this Dividend Cafe, and I am extremely excited to talk to you today about not one, not two, not three, not four, but five things.

Here is the problem. These are the same five things that I've been talking about a lot lately And today I want to walk through each one of them and talk to you about why they matter And why each of them do not matter. The setup of all this is the dividend cafe is basically quite often Something where I have a particular topic and I plan to write about it and I go do a big exhaustive treatment on a given topic and I do hope that both that topic itself and the things I'm writing about that topic or saying about that topic will prove to be evergreen.

That it's a permanent principle in the way we think about investing and financial management and all that good stuff. There are other times or something that came up that week or something going on right away. You recall some of the election and post election additions that we did a few months ago issues around the tariff week of a few weeks back the week in which the deep seek story around AI.

became very prominent. There's events in the news cycle, geopolitical disruptions that, require me to devote a dividend cafe to those things that sometimes I might even do one. This happens quite a bit where I'm just Not covering one particular topic, whether it was timely to that week or evergreen, that there's a whole multitude of things to cover.

So I like the flexibility of being able to go in any of these different directions in the way I approached it in cafe. I have my own favorites as well. And perhaps you as a reader or listener have yours too. But what I've noticed is that lately when you're talking about, or when I'm talking about.

The valuations in the market, the heavy concentration that is formulated in the market, the questions about AI and the heavy investment in the AI space and vulnerabilities that story represents in the market. On the policy front, the huge questions around tariffs dominate a lot of media coverage, dominate a lot of my own analysis, and then of course the issues around a tax bill and tax reform and what that could represent.

I think in those five different stories, some of which are more connected to one another than others, but we'll treat them as five separate stories. That's been the predominant, not only themes in the dividend cafe, but even more so dominant themes in broader media coverage and a lot of investor contemplation.

I think that it is a good summary of the five major things most people are thinking about and for good reason. And that's what I want to get into when I talk about good reason is why each of these stories matters, but also make a case, particularly by the way, with a special focus on. A case for from our vantage point as to why some of these things matter less with the right mentality or point of view or framework do not need to be week by week obsessions.

And so there's a lot to chew on here, but I'm going to get into this and I hope we'll come out of it. Let's say not only smarter, but calmer, if you will. Look, the S and P appears I'm recording right now, Friday morning before the market is opened. So we're in the very last day of the month of February and anything can happen today.

Futures right now point that they're going to be opening slightly up today, but it looks like the S and P is going to be down. Close to 3 percent for the month of February. So my lame attempted humor is to say good news for S and P investors worried about valuation. You entered the month 22 and a half times forward earnings, and you might be ending the month at only 21.

9 times forward earnings.

We're in a frothy market with excess in certain sections of the stock market that are leading to a broader valuation story. And I believe that there's a number of ways this could end up going and that throughout history, there are periods in which you have a very sudden and violent correction to excess valuation.

And what happened to the NASDAQ in March of 2000. Is career forming things in my life and journey. And for many of you as investors, the, this is a historical event that will be talked about forever for good reason. And likewise, the housing bubble in 2008, and it's violent and there are other, less systemic, but nevertheless, significant.

isolated cases particular pockets that were in excess evaluation, whether it's something as niche as plant based meat companies in 2022, I still laugh when I say it. And obviously the whole broader thing out of the COVID moment of all these work from home stocks and whatnot, that as a kind of basket of various things that went way up in 2020, and then just got hammered in 2022.

Various remote activity types things. So there's micro, less micro, and then there's macro stuff that can be violently corrected but really there's a lot of precedent history where the correction's not violent, where it is over time. A reversion in the mean evaluation where earnings keep growing, but valuations are coming down, offsetting one another, and it results in an extended period of muted returns.

That's a more benign outcome versus a violent correction. And sometimes it can be a little bit of both. A correction followed by a period of muted returns. I think that we're very likely. In a period in a number of years. I don't know if it's in three years, seven years. I think that at the end of 2021, we began a period where there will be movements up and down, but a lot of just sideways movement as a byproduct of earnings growing.

Which is a good thing, but multiples contracting, which mathematically offsets now, That's the good outcome. Okay recession is when both things are going backwards multiples are coming In and earnings themselves are contracting corporate profits declining thus far. We haven't had that so I think that there is, in a period of valuation excess for index investors, a reason why I believe it matters, is because you're often choosing between either a quick correction that could be deep, or not a quick deep correction, but just a prolonged period of very muted and subpar returns.

Now, why does this not matter? First of all, it's not a timing vehicle. You don't know when that could happen. Could we end this year at 25 times earnings? You get double digit earnings growth and more multiple expansion. Of course we could. I personally wouldn't be betting on that. Could you get A situation where maybe you don't get more multiple expansion, but the multiple contraction doesn't come or we just reprice to a, that high of a market multiple shirt, who knows?

And maybe everything I'm talking about will end up happening, but it won't happen this year. And so an investor's plan might be, I'm going to ride it out further and I will time an exit and I will exit before some sort of mean reversion takes place. And that's all going to work out great for you.

All those things are possible. In that case, the valuation excess I write about wouldn't matter. More important to us, it's less relevant because we simply aren't participating in that valuation excess or at least have a lot more muted participation. Certainly. Where the heavy excess valuations sit in the market are not areas we happen to be invested in.

We, as across our dividend growth portfolio, we have a focus on lower beta, lower market sensitivity and lower valuations, on across all metrics. I think there's a lot of room. To be unconcerned with excess valuation when you're trying not to participate in excess valuation. But I always want to remind investors what a valuation is.

The multiple is simply the PE ratio is simply when you say, I'm paying 16 times for earnings, you expect to get paid back. If you were receiving a hundred percent of the earnings of what you've bought, you expect to get paid back in that many years. So right now it's 21, 22 years. But of course, that's not really true because you expect the earnings rate to grow itself.

And so future years, I'll have even more earnings than this year goes. Now that's fine. But of course, then that comes at certain levels of risk. And when you combine the two together, both the earnings growth you expect with the P. E. you're paying for that earnings growth, you're still dealing with a risk of what could go wrong in the future and time value.

We've been at a historical average of 16 times for a reason. And when you go above a historical average and significantly above it, mean reversion. Is not something I consider to be very controversial. I consider it inevitable, but I don't consider it timeable. At the end of the day, some investors believe no, I'm not worried about valuation.

If there's a stock, you own it 138 times earnings. I'm not going to wait 138 years to get my money back. And I'm not making a call on how much they're going to grow earnings on the way, but there's some other sucker who will pay even more than that. And that could be their strategy.

And so we call it greater fool theory and rather one believes there's going to be a hyper growth in earnings of companies already growing earnings a lot from this level so in other words, you're going to grow into a valuation or you believe you'll just find someone else to take you out at a higher price.

Still, both of those are strategies that have a long precedent of working out for some people in certain times, and both have a precedent of leaving people with their faces ripped off, bloodied on the side of a road. Both of them are not what I believe and what my company believes, what our investment team believes, what our advisors believe about managing client money.

So to the extent that we would be willing to not care about participating in excess moves of valuation that when it's outside of our philosophical orientation, we identify valuation in the dividend yield the free cash flow yield. And then of course, the growth of the free cash flow and the growth of the dividend payment itself, not the stock price.

Valuation considerations limited into that world become more fundamental, more knowable, and less exposed to this entire story about excess valuation that an index investor is intrinsically more connected to. So therein lies our rationale for being less susceptible and concerned about the valuation story.

Concentration matters right now, and I've written time and time again about how excessive the top heaviness of the market is. I went a lot of my life with there being no companies at over 3 percent of the S& P 500 or the total weighting of companies that were over 3 percent was somewhere between 5 and 10 percent total.

There may have been a 4 percent here and two threes there. But right now it's over 30 percent of the market. It made up a companies that are over 3 percent of the S and P it's come down a little bit because of the underperformance of some of these big companies in the last two months. But we entered 2025 with more or less 10 companies being 40 percent of the S and P 500 and 490 companies being 60%.

And so I bring it up all the time because it is not a statement that those 10 companies are going to go down. It is a statement that the risk reward, the diversification benefits embedded in SMP are just dramatically different than what many people expected them to be and what many people bought.

And that needs to be understood. Why does it? Not matter to us because we're not index investors. We don't have this concentration dispersion. We don't have some companies that are 6 percent of our portfolio while a whole bunch of other companies are 0. 01%. There is a much tighter relationship, heavier weighted companies and lower weighted companies still contribute to attribution.

And so we, we don't have any difference in our concentration relationships within our portfolio versus what we've always had. Where the S& P is a categorically different investment when it comes to concentration right now. And so that's the theme. A risk reward dynamic that is simply changed. This third issue about AI capital expenditures.

It matters when an investment theme is somewhat in a feedback loop with itself. Hyperscalers are spending a lot of money on AI investment. So companies receiving that CapEx benefit while the hyperscalers benefit because of what they're trying to get out of it. And then if there ends up being vulnerability to this, either because they cut back on that investment, that capital expenditure, or maybe they don't cut back, but the rate of growth of increase of it comes in a little more than expected, or they're not getting the return on this capital expenditure they expected.

And so that impacts their own return on investment. There is a vulnerability in this story. I wrote about, I did a dividend cafe at the end of January in this very theme. Now I would point out there's adjacent relevance to in data centers and utilities. It's not merely the companies themselves that are directly engaged in that hyperscaler and hyperscaler customer relationship.

There's adjacent economic impact that matters. So the story matters. But then when I say it doesn't matter, I, you can mitigate it by not being overly levered to it. And also by being nimble enough to rotate because the story may very well change. I think it's inevitable it'll change. I cannot remember a technological evolution where the initial thesis played out exactly right.

Something's going to be wrong and then there will be a different way in which AI goes about being monetized being developed different, some of the potential winners become losers, but then some companies not on the radar become winners. That isn't a negative to me. That's an inevitable reality of a creatively destructive economy, a creatively destructive market.

So we embrace that. But along the way, we don't want to be overly levered to a story that could, in the way it plays out, rip someone's face off. And so that's, to me where I can very confidently say it doesn't matter. I use that there's a link to this in Dividend Cafe. I use it a lot as an example.

People have talked about Myspace and social media became a success story, but the early Dockers did not. But here's the thing. Apple's iPhone, it's a very famous story that Jobs was not really bullish on apps in the app store. And that's just trillions of dollars of revenue and enterprise value future looking.

But at the time, they thought Safari in the web browser was the big story. And of course, That ended up evolving and pivoting still to the same benefit of the company and still the same benefit of developers in the market and investors, but in a different way than originally seen. I don't know how this AI CapEx stuff goes, but I don't expect it to play out how a lot of people right now might be thinking.

But my point is that it matters when you're all in on that story. And that's become a very pro cyclical theme in markets. And it doesn't matter when one has. Risk mitigated approach and nimbleness to adjust as is warranted. The tariff thing I can go through quickly. When I say our fourth issue that many people are talking about right now is how much tariffs matter.

I've already said that tariffs matter if they are implemented and tariffs matter much less if they're not. And tariffs that do get implemented matter to the extent they're doing certain amounts of economic damage. And then they matter less if they get rescinded. They matter when there's uncertainty that the talk and threat of tariffs creates.

They matter less when tariffs aren't necessarily implemented or when they're used as a negotiating tactic. The whole conversation matters. I've written about it. That was another different cafe we did a few weeks ago, fully devoted to the topic. But where is it that tariffs don't matter? They don't matter, again, if they are used only as a negotiating tactic, if they're not implemented, or if when they are implemented, they're rescinded.

And I think that there's percentage odds in one of those scenarios being the outcome here. But along the way, they matter. There's unpredictability, there's a certain headwind that they create . Tax cuts matter. And I'm never going to say anything differently. I believe that there is a significant benefit to the economy and extending the 2017 Trump tax cuts.

And I think there's an extensive benefit in getting certainty around those things that enable individuals and especially businesses to invest and make decisions and do economic calculation with greater certainty around what the playing field will be. But I also believe that in 2017, we saw a lot of iterations as to how this was going to go.

A lot of pump fakes, a lot of up and downs, a lot of failures. And eventually you ended up getting a bill. A lot of these things I'm talking about, the risk may be that there's a volatility because of uncertainty on the way. And that what ends up not mattering is you get to an outcome in the end. So the volatility matters on the way and the outcome ends up being positive.

The point is you don't ever know in the midst of volatility that the outcome will end up being positive. That is a concluding statement. Not one that we can say along the way. I happen to be optimistic that a tax bill will come. This week went pretty well for the possibility of getting it done sooner than later.

In one bill that doesn't require us to wait through the end of the year. But when I say it doesn't matter, it does, but you are probably looking at the choice between clarity and certainty and something really good early versus not clarity and something still getting done later and maybe not as good.

So that, to me, is an ambiguity. I'm going to keep discussing it and unwinding it, but we're not dealing with a binary outcome of something that's going to be great for markets and something that's going to tank markets. I think that there is truth in the middle of these two things. So out of these five subjects, all five were in our ongoing discussion and reflection, and all of them have components that matter, and all of them have components that matter much less, particularly to the way we feel about investing.

Capital with the Bahnsen group. These themes are playing out in markets. We're going to be considering these things, but we are going to be investing our client capital. Along the lines of first principles that transcend politics, headlines, tweets and certainly transcends these things that cannot be known.

The more your portfolio is tethered to things that are principle driven and less tethered to these unknowable headline issues. the better off you're going to be. So we are going to work to that end. That's what we're always doing. And I look forward to continuing discussing these five things and much more.

Here in the Dividend Cafe. I am leaving Nashville shortly. I returned to New York City tonight where I'll be for the next few weeks There is a lot going on in markets. It's been an exciting first couple months to the year I cannot wait for the month of March and yes, that does involve some degree of college basketball But it also is just a lovely month And look forward to being back with you in the Dividend Cafe next week.

Reach out with questions anytime. Thank you for listening. Thank you for watching. And thank you especially for reading. There's a lot to chew on reading this week. The Dividend Cafe.