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SLIMMON'S TAKE > TAKEAWAYS & KEY EXPECTATIONS

Andrew Slimmon February 2021 Equity Market Commentary

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I loved the pizza lunches.

When I was a financial advisor in the 1990s, asset managers would come to our office, present one or two of their investment products, and buy us pizza for lunch. *Chicago has really good pizza.* But the pizza wasn't all that drove my attendance, it was more the investment information I gleaned.

Like all good salespeople, asset managers would sell what they thought would interest our clients. Today they serve salads more often than pizza, but not much else has really changed. Granted, during this WFH pandemic period, free lunches are tougher to come by, but they will return eventually.

For those readers who are advisors, have you **ever** heard an asset management salesperson say, "you should buy this product because it has performed so **badly** over the last three years?" I **never** did in the 1990s, and my bet is this has not changed. To be clear, if I were an asset management salesperson, I would never say that. *Investors simply refuse to buy products that have done poorly.* Yet, isn't the goal to "buy low"?

Human behavior does not change, and that is why I believe there is such consistency to the investing business. Collectively, we don't buy low and sell high; *we buy high and hope like hell "it" will go higher.*

So when is "high" too high? When are strategies vulnerable? To me, as good a sign as any was when multiple asset managers presented similar strategies at those lunches.

Let me give you a few recent examples. *Master Limited Products (MLPs)* were red hot in 2011-2014. Asset managers rolled out SMAs, closed-end funds, etc, which were focused on MLPs, and then oil prices crashed. That was the end of the MLP era. What about Tactical Allocation Strategies that could time the market? Those were very popular after the horrible bear market of 2008. The problem was

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when the next great, new bull market began, and it paid to stay invested, those strategies were too often on the sidelines. Even more recently, Defensive/Dividend Growth strategies claiming to protect the downside? Pretty popular, and yet the S&P 500 is up 70%+ off the 2020 lows, and with interest rates moving higher, those strategies have been left in the dust.

Ask yourself, “*if I were back in the office today, being served salad/pizza, what would be today’s MLPs?*” (I am quite sure it’s not MLPs by the way. They returned a horrendous -37% over the last three years (2018-2020) but are up 14% YTD¹.)

My bet is that salespeople are presenting products that use buzzwords such as “*Digital Innovation*”, “*Total Addressable Market*”, or “*Disruptive Technologies*” to describe the types of stocks these strategies invest in. These products are so red hot currently that their brochures would burn right through the pizza boxes. To be clear, the outlook for many of these companies is **very** bright. But when an investment thesis becomes this crowded, and the P/E multiples so expensive, it can take years of growth to catch up to inevitable P/E declines. Keep in mind, Microsoft’s stock peaked in Dec 1999, and the next time it reached that peak price was in 2015.²

For two years in a row, the IT sector has returned over 40%. Since 1928, one sector produced consecutive 40%+ returns eleven times. This would be the twelfth. Historically, in that following third year, the average return of that same sector was -21% and the best return was 0%.³

¹ Bloomberg as of February 22nd, 2020. As measured by the total return of the AMLP ETF. This is shown for illustrative purposes only..

² Bloomberg

³ Sentiment Trader, December 29, 2020.

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As I said, you can’t blame asset managers. They have limited windows to present product and they will quickly lose the advisors’ attention if they show strategies with poor performance. Likewise, you can’t blame financial advisors. The problem with the “buy low, sell high” concept is that investment strategies can remain low a really long time. Being a pure “contrarian investor” has some intellectual panache, but there tends to be a mismatch between the period of time contrarian strategies can remain out of favor and investors’ duration of patience to stick with the strategy.

If contrarian strategies don’t really work because an out-of-favor strategy can remain unpopular for a long time, and buying what’s popular can be very dangerous, then are we doomed to never adding any alpha?

No way.

Here are some simple investment concepts we believe in:

1. Stick with best of breed companies.
2. Buy stocks in investment styles when they are ignored and not mentioned at the lunches.
3. Increase exposure when you first start to hear any mention of them.
4. Trim when you hear them presented at almost every lunch.
5. Above all, remain flexible and open minded. No rigid investment approach works all the time.

I have been in this business 34 years and I have seen:

- A. Growth hot (*sizzling now*)/growth cold.
- B. Value hot/value cold (*improving now*),
- C. Defensive quality popular/ defensive quality unpopular (*nearing a bottom at some point*).

So where is the opportunity today? What are we doing for the Applied Equity strategies?

Two thoughts:

1. My bet is if you were in the office, *you would start to hear mention of value strategies for the*

first time in a long time. In my mind, that would be a sign to increase exposure to banks, energy and REITS.

2. *I also bet you would not hear much about quality defensive strategies.* As I said before, they have woefully underperformed. That is a sign to begin to nibble on consumer staples, health care and other stable groups. There are definitely some great companies that are simply “too safe”, in our opinion, for the risk-on environment we have experienced over the last year.

As for those lunches? Good for pizza, but better for investment insights.

Andrew

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