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INVESTMENTS

THE TENGLER REPORT

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Chief Investment Officer

Confession: I am not a Trekkie. But it is impossible not to remember Captain Kirk's command to the beloved Scotty: "I need warp speed in three minutes or we're all dead." Witness the U.S. stock market in 2020: the quickest and most violent bear market sell-off in history and, oh, by the way, the most dramatic and speedy recovery on record. From the bottom on March 23rd (just a few short months ago), the S&P 500 is already up 57.7% through August 31st.

Warp speed, Scotty!

Even more interesting, this is just the fifth time in the history of the S&P 500 where the market has traded to a new all-time high while the economy was in a recession (thank you, Chris Verrone, Strategas!). And, if this epic rally back wasn't enough, each time the market has rallied to a new high in the midst of a recession, one month later the average (additional) return for the SPX was over 11%.

I had the good fortune to take a flight from London to New York on the Concorde in the 1990s—Mach 2.04, twice the speed of sound!—yet, it feels analogous to a horse and buggy when compared to the rapidity of change we have witnessed this year. Speed is heady but can be dangerous.

That said, on July 15th I penned a commentary entitled "Why this rally may have legs". Since then, the S&P 500 is up 8.7%. But there is a hue and cry that the market's rally is an afront to the regular, main-street economy. We are not here to debate this point. The fact is markets often beat to their own drummer. That proverbial wall of worry is tough to measure. More often than not, markets scale it with ease while the rest of us wring our hands.

Highly illogical.

For example, you may have read that hedge fund managers are bearish. Yet, the cohort hasn't outperformed the market as measured by the S&P 500 since 2008, and the group isn't outperforming year-to-date either according to Strategas and the HFRI Equity Hedge index. Prior to that, hedge fund managers outperformed 12 of 19 years from 1990 to 2008. The point? Disagreement is what makes markets.

Here are the things we are watching:

COVID
You cannot form a view of the market without having a view on COVID.
This just in from the CDC (posted 8/26/2020):

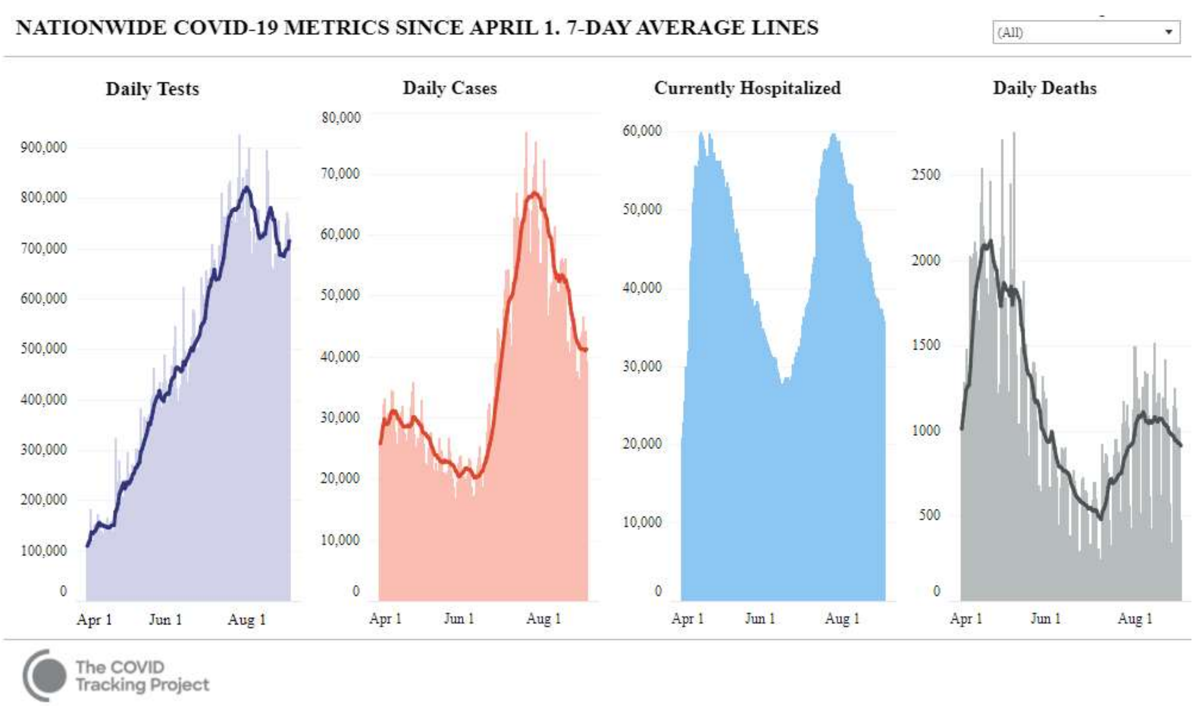
Comorbidities:

- Table 3 shows the types of health conditions and contributing causes mentioned in conjunction with deaths involving coronavirus disease 2019 (COVID-19). For 6% of the deaths, COVID-19 was the only cause mentioned. For deaths with conditions or causes in addition to COVID-19, on average, there were 2.6 additional conditions or causes per death. The number of deaths with each condition or cause is shown for all deaths and by age groups.

Click here to view the entire report.

I found the report thanks to a tweet from Blake Shelton, the country music legend…go figure. Haven't seen any news reports. But the good news in the report is that despite the tragedy of over 150K in American deaths, 94% of those—according to the death certificate—had contributing causes or comorbidity conditions. Only 6% were due to COVID alone. If that isn't good news for future treatment and safety management, I don't know what is.

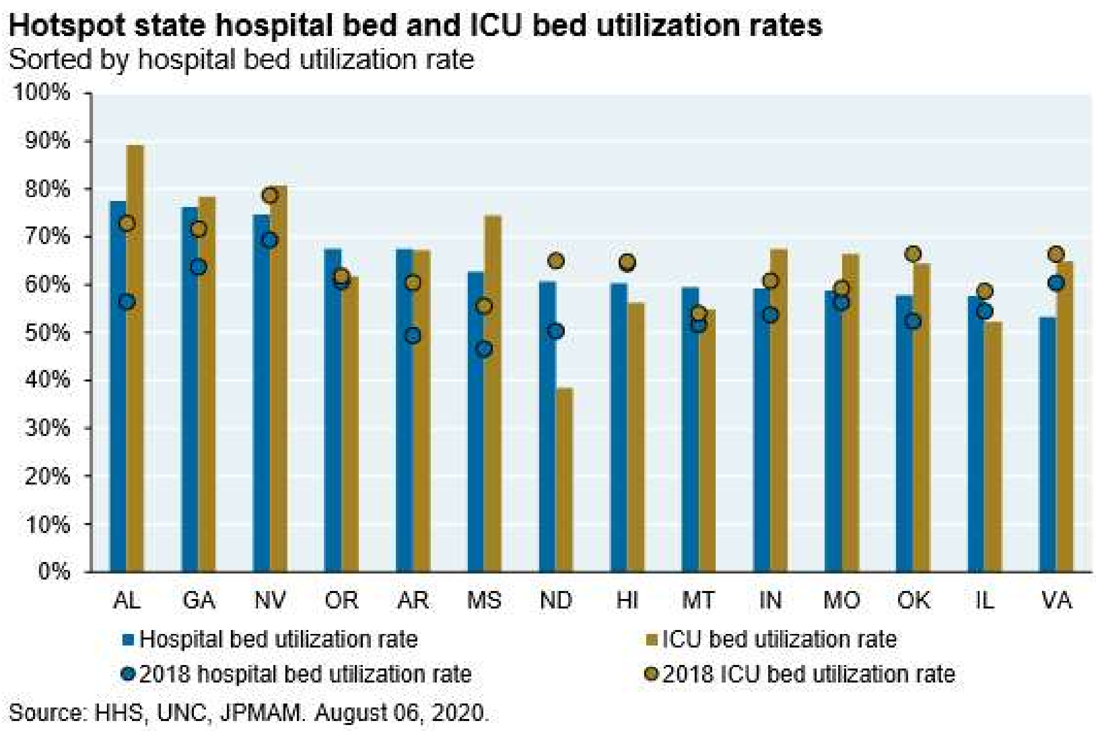
The COVID Tracking Project data below is familiar to readers of The Tengler Report. The trends are encouraging.



Source: The COVID Tracking Project, 8/31/2020

Note: The CDC recently provided guidance to include in "cases" what they are calling probable cases rather than positive cases. A probable case includes a combination of clinical, laboratory or epidemiological criteria. Not simply positive test results. Even with that expanded definition—the metrics are improving. Significantly.

Hospital capacity was cited as a primary reason to shut down the economy last spring. The data (below) show current utilization rates compared to 2018 as of early August. Since then, hospitalizations have declined further.



Valuation

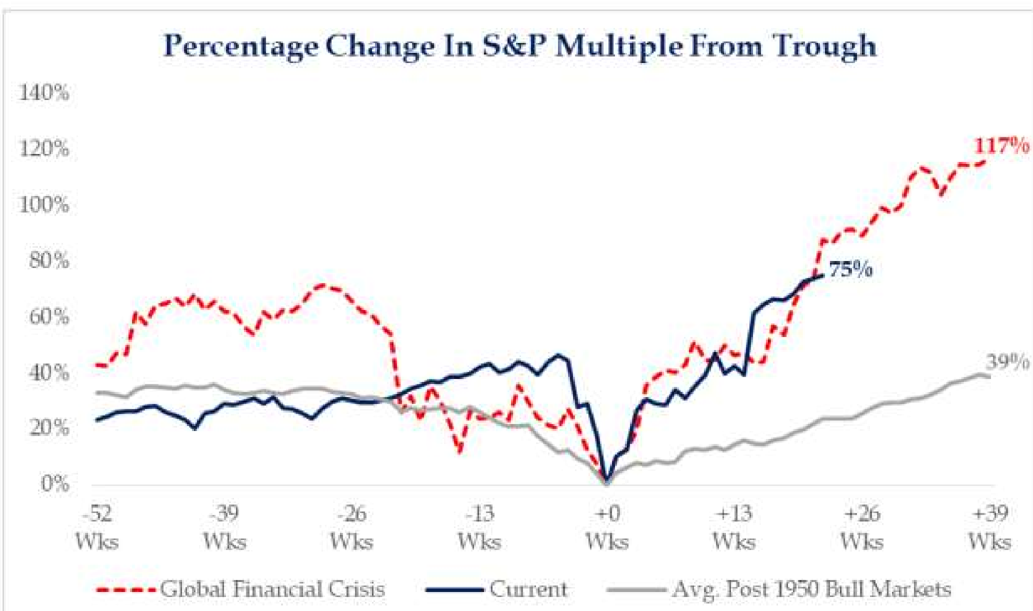
Acknowledging that markets are forever climbing the proverbial wall of worry, we continue to believe that liquidity is driving the rally. As discussed above, our primary premise in our July 15th commentary was that massive amounts of liquidity is driving the markets higher as the economy continues its stair step recovery. Since then we have been impressed with the earnings reports for the companies we own. We think better than expected revenue and earnings growth coupled with margins may continue to drive the winners. Nonetheless, increases in global monetary and fiscal stimulus are breathtaking—with the U.S. increasing the pair to 44% of GDP from February to August of 2020 and global stimulus at 29% of global GDP.

Global Monetary And Fiscal Stimulus To Fight COVID-19 Impact 2020 Feb to Aug (CSM)	Potential Central Bank Liquidity Injection		Potential Fiscal Stimulus		Central Bank Liquidity Injection and Fiscal Stimulus	
	$ Tln	% GDP	$ Tln	% GDP	$ Tln	% GDP
U.S.***	$6.21	29.0%	$3.30	15.4%	$9.51	44.4%
Eurozone	$1.78	13.3%	$4.14	31.1%	$5.91	44.4%
Japan**	$1.03	20.0%	$2.08	40.3%	$3.11	60.3%
U.K.	$0.37	13.6%	$0.19	6.9%	$0.56	20.5%
China****	$1.43	10.0%	$1.22	8.4%	$2.64	18.4%
Others*	$0.84		$2.84		$3.68	
Global	$11.66	13.5%	$13.76	15.9%	$25.42	29.4%

*incl RoW and ADB, IMF, WB ****China CB stimulus incl liq injections and other activities, e.g. re-lending, RRR, direct small biz lending, etc

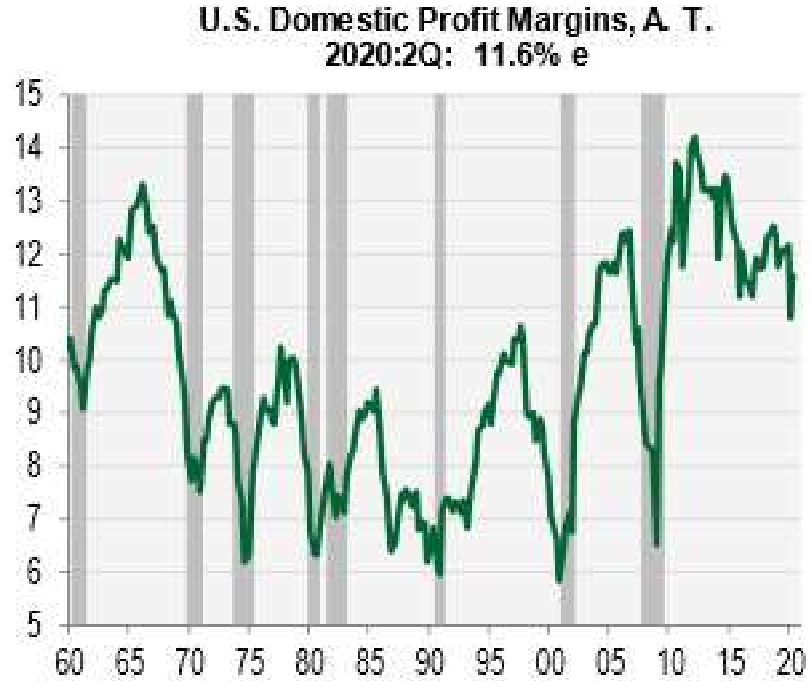
Source: Cornerstone Macro, 8/25/2020

Liquidity aside, you can see from the chart below that this market run, as measured by multiple expansion, is on track with the Great Financial Crisis but well ahead of the average bull market. So, not crazy and definitely not yet frothy.



Source: Strategas, 8/24/2020

Profit margins have never been this high during previous recessions.

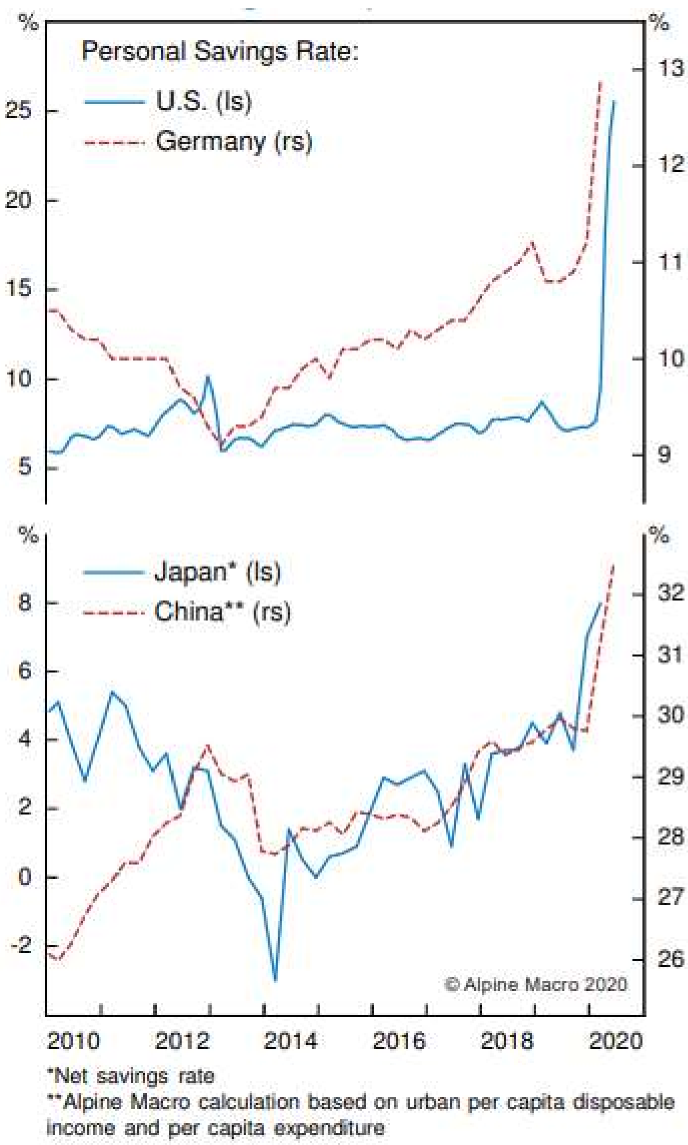


Source: Cornerstone Macro, 8/1§/2020

The same goes for consumer confidence compared to previous recessions.

Source: Strateegas, 8/20/2020

And then there is this: consumers entered this recession with very strong balance sheets. Global savings rates have skyrocketed indicating that once the smoke clears there could be a significant amount of pent-up demand.

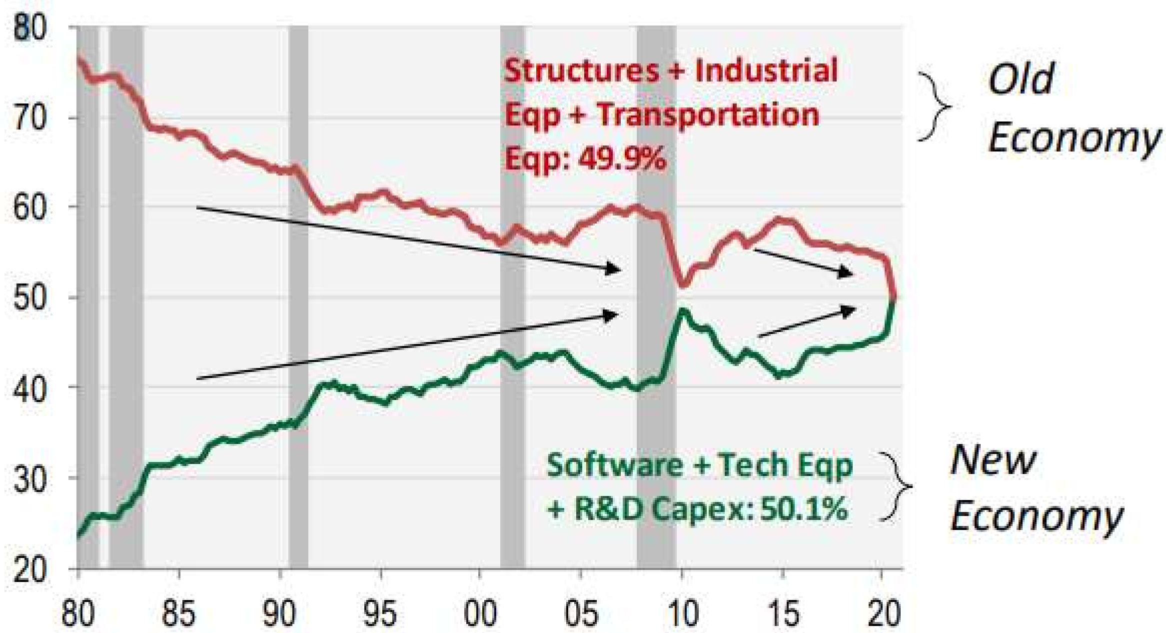


Source: Alpine Macro, 8/24/2020

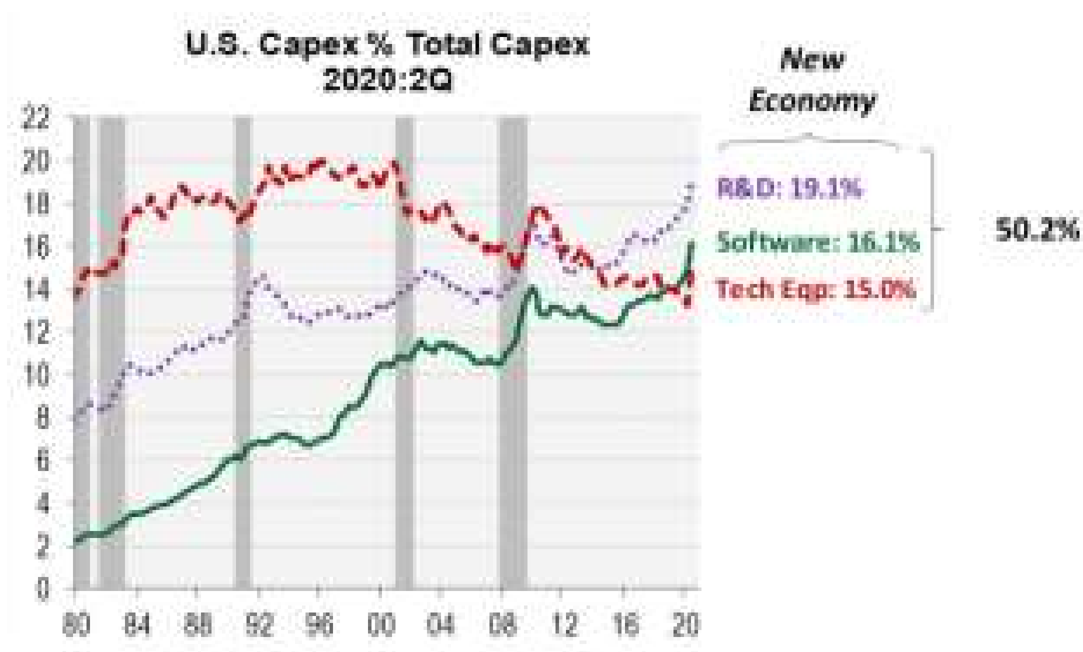
Technology

We have argued that if tech doesn't work, nothing works. We continue to believe that. Technology increases productivity and improving productivity supports margins. Many are calling for a rotation of leadership in the market. That may, in fact, happen but it doesn't necessarily mean technology stocks will slide—they may just appreciate less in the near term.

But you don't have to be a programmer to realize that technology and the digital economy is embedded in every aspect of our lives: our cars, shopping habits, transportation, entertainment, ordering food; I need a smart phone to turn on my pool filter. The digitization of our economy is just getting started. And over the long haul we believe investors must be exposed to the technology space.



Source: Cornerstone Macro, 8/25/2020



Source: Cornerstone Macro, 8/25/2020

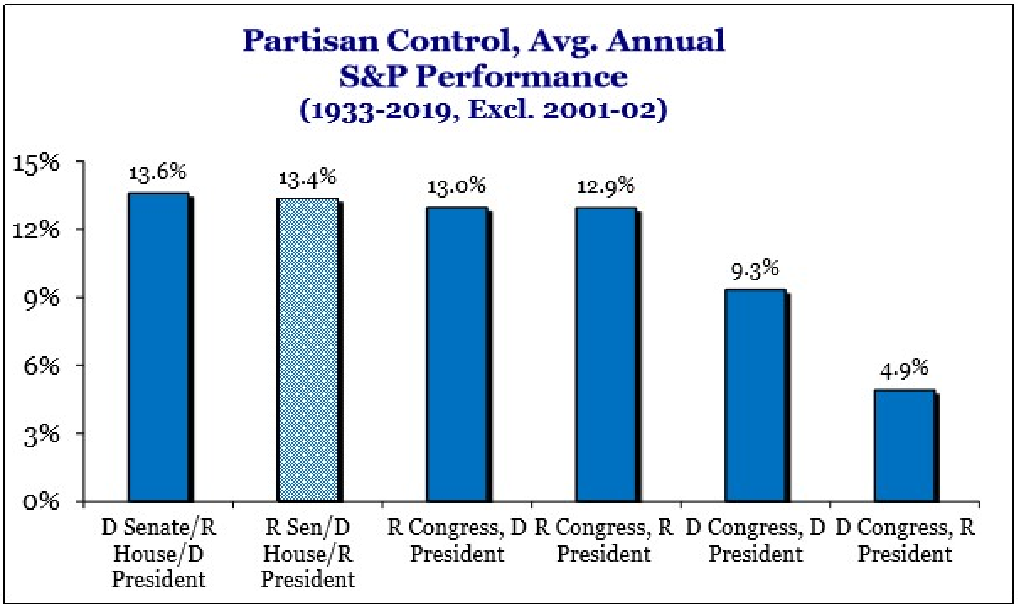
Oh, for the robust 1990s and early 2000s when productivity growth averaged above roughly 3%. Prior to COVID we were moving in the right direction. We believe the trend will continue, thanks to a steady and dramatic increase in tech capex.

Source: Cornerstone Macro, 8/25/2020

Politics

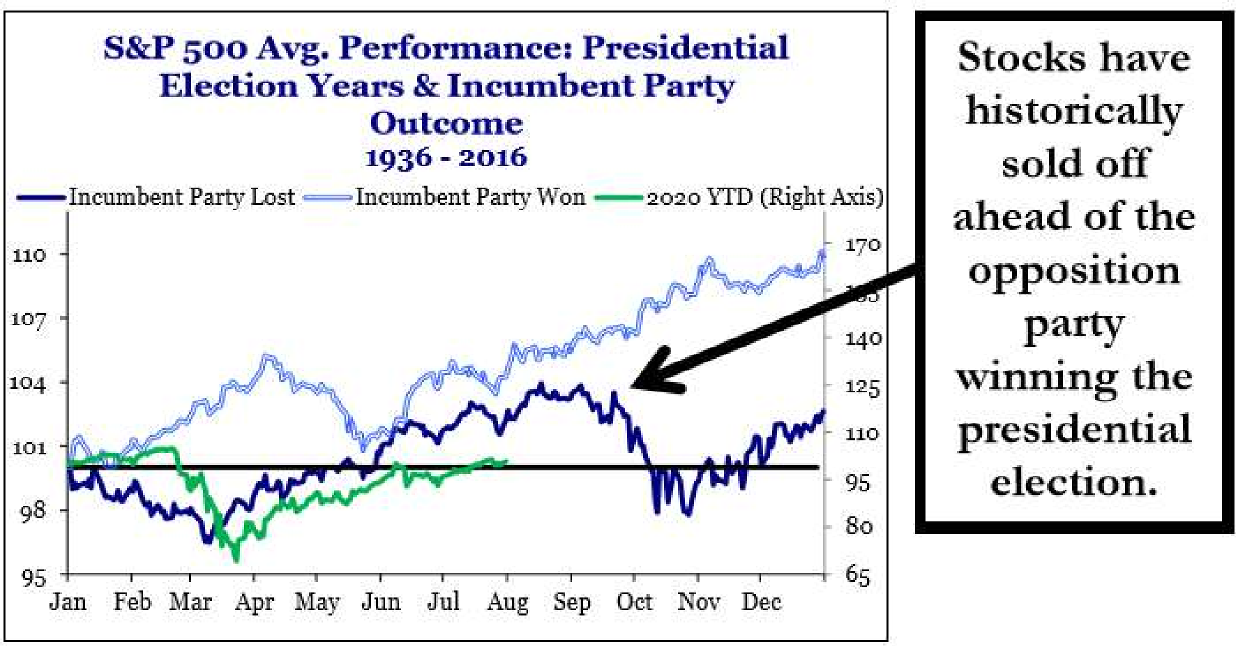
The election is front and center on people's minds. First and foremost—despite the temptation—never invest your politics. The chart below shows that investors can make money in any political environment though some are better than others.

Our friends at Strategas calculated the data for the S&P 500 from 1933-2019 according to the corresponding partisan combination. (2001-2002 are excluded because Senator Jeffords switched parties in June of 2001 creating a Democratic Senate with a Republican House and Republican White House for 1.5 years of data –too short to form any conclusion. Ah, politics!)



Source: Strageetas, August 3, 2020

The old saw that market returns from August 1st through October are predictive of presidential elections has historically been accurate. A rising market augurs well for the incumbent party and a declining market for the challenger. Although this chart (below) only covers the first three days of August, stocks closed out August with a 7.25% return. That would indicate (so far, with two months—a lifetime in politics—to go) reelection for President Trump. But if we have learned anything in 2020, it's that past may no longer be prologue. Stay tuned. This is going to be a hard-fought race.



Source: Strageetas, August 3, 2020

The polling looks eerily similar to 2016. Maybe polls have gone the way of other COVID relics. We will see.

Things we worry about: unemployment and a surge in announced layoffs

Every recession has its casualties (after the Great Financial Crisis, housing took years to recover). This time it is leisure and housing. Retail, restaurants, recreation and air travel account for a little over 18MM jobs. We believe it will take years for this segment of the economy to return to pre-COVID levels. The sectors of strength like grocery stores, technology, health care, manufacturing and construction should continue to experience growth and currently account for 47.4MM jobs.

We are watching employment.

We are also worried about a Fed who believes it can re-inflate the economy. Chairman Powell's most recent announcement of "average inflation targeting" is cause for concern for anyone who has experienced inflation. When inflation takes hold, it spreads through the economy like wildfire. Higher inflation hurts lower income workers and benefits borrowers (think: the U.S. government) and financial markets. The deficit is expected to hit $3.7T for the fiscal year ending 9/30/2020.

And with the central bank printing money to purchase treasuries to fund the massive deficit spending, the Fed has de facto embraced Modern Monetary Theory. We wonder where it ends. Finally, we are worried that no matter the outcome of the election we may not know for weeks after election day. That would not be good for anyone, let alone the markets.

What we do know is the market will correct at some point, which is why we retain our hedge. But according to our work on the importance of not trying to time the market and a recent study by Savita Subramanian of Bank of America, investors have a 46% chance of losing money invested in the market for just one day. But, just a 6% chance of losing money invested for ten years.

If I might take poetic liberty by rephrasing Dr. Spock—I think what he would have said about the markets is that "since insufficient facts always invite danger," one way to mitigate that danger is to invest long and prosper.

CHECK OUT MY LATEST ARTICLES FROM USA TODAY

The Markets Just Reached All-Time Highs in the Midst of a Recession (August 23)
COVID-19 Thrown a Wrench into Retirement Planning? Don't Panic. (August 9)
Here's What My Childhood Taught Me About Money (July 26)

LINKS TO MY RECENT MEDIA APPEARANCES

Podcast: Record Markets and 'Cheap' Stocks Aren't Exclusive (Money Life, August 31)
How the Fed's Inflation Policy Shift Impacts the Gold Rally (CNBC, August 28)
One Record-Breaking Payment Stock Up 150% This Year (CNBC, August 28)
Gold Falls After Fed Signals Lower Rates for All (CNBC, August 27)
Mizuho Initiates Coverage of 9 Payment Stocks (CNBC, August 27)
Apple Stock is Ripe for a Pullback Soon (Yahoo! Finance, August 24)
Markets Open Higher with Earnings, Election in Focus (Yahoo! Finance, August 24)
Traders Highlight Best Opportunities in Global Markets (CNBC, August 14)
This Small Beauty Stock Might be a 'Big Bang for the Buck' (CNBC, August 14)
Estee Lauder Gets an Upgrade. What to Make of the Beauty Space (CNBC, August 13)
Global Stock Markets March Back to 2020 Highs (CNBC, August 13)
What's Driving the Market is Liquidity (CNBC, August 7)
European Stocks End Week with Gains on Telecoms (Reuters, August 7)

THE LAFFER TENGLER INVESTMENT DISCIPLINE

Discipline is key to sustainable long-term total returns:

- At Laffer Tengler Investments we use two, time-proven stock valuation metrics (both pioneered by our team) that are consistent and robust indicators of value: Relative Dividend Yield (RDY) and Relative-Price-to-Sales Ratio (RPSR).

- Why not use earnings like almost everyone else? Because earnings are often an unreliable indicator of value. In May of 2016, I published the following:

Earnings reported by corporations have always been subject to the vagaries of accounting gimmickry. You don't have to be a novice to scratch your head at the way managements (or governments for that matter!) account for various items.

A recent case in point: The Wall Street Journal (Thursday, February 25, 2016) reported that according to FactSet, pro forma earnings for S&P 500 companies rose 0.4% in 2015. Using generally accepted accounting principles or GAAP, earnings per share actually fell 12.7% in 2015 (this according to S&P Dow Jones Indices). The author's point is that according to GAAP earnings, investors are paying a great deal more for stocks than they think. The price-to-earnings ratio (P/E) on pro forma earnings (which is the most commonly accepted method) is 17x 2015 earnings. But when GAAP earnings are considered, the P/E jumps to more than 21x.

It is important to remember that the P/E ratio for any given stock is only as good as the price input (a fact) and the reported earnings input (apparently not a fact at all).

- RDY measures the yield of a particular stock compared to the yield on the S&P 500 and does so over long periods of time. Since a stock's relative yield and relative price are inverse, we can generally conclude that as a stock's yield is rising, its price is declining, similar to a bond. Consequently, a rising RDY provides an opportunity for investors to at least consider an underperforming, cheaply valued stock for purchase.

- Company managements and boards of directors pay the dividend out of free cash flow, not earnings. In maturing U.S. companies these seasoned professionals often operate within a “dividend paying culture” and set the dividend as a portion of long-term, sustainable *real* earnings power because management teams are loathed to cut dividends.

- The relative nature of the RDY metric is also important because it measures the relative attractiveness of a stock compared to its own history and compared to the S&P 500. (In 1992, I co-authored *Relative Dividend Yield, Common Stock Investing for Income and Appreciation* with Tony Spare)

- RPSR: In fallen-angel growth companies where the dividend is less of a factor in management’s calculus, we look at sales—a fact. Rarely are sales manipulated and when they are someone usually goes to jail. The price-to-sales ratio measures how much investors are paying for a unit of sales, the *relative* price-to-sales ratio reveals what investors have historically paid for a particular company’s sales compared to what they are paying for the sales of all the companies in the S&P 500. In 2003, I authored *New Era Value Investing,* John Wiley & Sons where I outline the benefits of RPSR in stock selection.

- Discipline, in summary, is the only way to navigate volatile markets. We remain disciplined and over time that consistency generates excess return.

Fundamental Research reduces the ownership of terminally cheap companies:
Meet the 12 Fundamental Factors.
Our proprietary research approach analyzes fundamental qualitative and quantitative factors.

- Qualitative Factors: Buggy Whip Factor (product obsolescence), Niche/Franchise Value, Management and the Board.

- Quantitative Factors: Sales Growth, Operating Margins, Positive and Growing Free Cash Flow, Dividend Coverage and Dividend Growth, Asset Turnover/Quality, Investment in Business/ROIC, Equity Leverage/Balance Sheet, Relative P/E and Financial Risk.

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There is no assurance that a portfolio will achieve its investment objective.

Definitions and Indices

The S&P 500 Index is a stock market index based on the market capitalization of 500 leading companies publicly traded in the U.S. stock market, as determined by Standard & Poor's.
Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions, or other expenses of investing. Investors cannot make direct investments into any index.

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