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INVESTMENTS

THE TENGLER REPORT
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3rd Quarter Commentary

While most investors are focused on the election, we are choosing to focus on the secular economic trends we believe will sustain no matter which party takes the White House. These trends represent secular changes that will have a profound impact on economic growth for years, even decades to come.

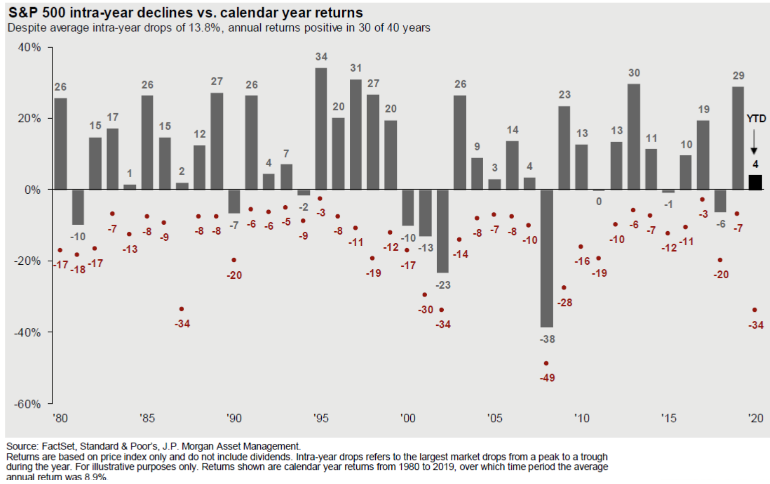
First a recap of the year-to-date. 2020 has been a year of firsts. The most rapid and violent bear market in history (23 trading days), the quickest bounce back and return from bear to bull market. A global pandemic resulting in a nationwide economic shutdown and massive job losses, then a sharp economic recovery. Unprecedented monetary and fiscal stimulus not just in the U.S., but, globally. In 2020 from February to August, announced monetary and fiscal stimulus totaled $25 trillion or 29.4% of global GDP!

Yikes.

From the beginning of the bear market on February 19, 2020 until the stock market bottomed on March 23, 2020, the S&P 500 declined -33.8%. By August 17th the market had rallied to close above the previous high achieved on February 19th marking the beginning of a new bull market. Since the bottom through the end of the third quarter, the S&P rallied 47.3%. Year-to-date the market is up a positive 7.4%.

Head-snapping but hardly unusual.

The chart below reveals what any investor needs to know about corrections and rallies. Since 1980, every intra-year decline in stocks is shown in red. The gray bars reflect the performance for the S&P 500 for the entire year. Note that in 30 of the 40 years measured, stocks produced positive returns, in spite of sometimes violent selloffs like, say… 2020. This reinforces our thesis to remain long stocks while attempting to insure against inevitable drawdowns with options.

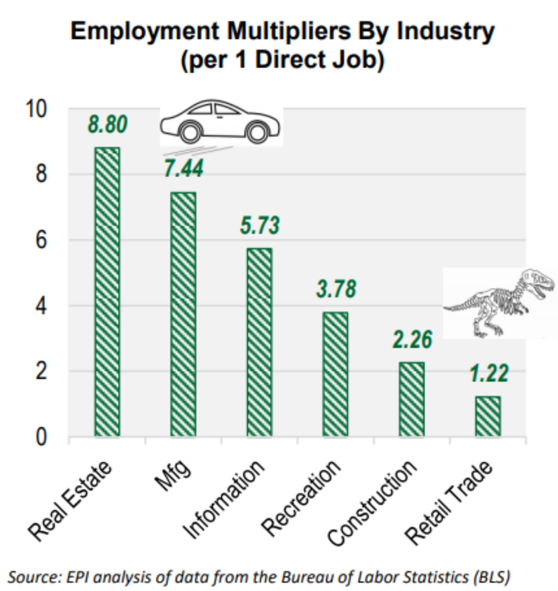


Source: J.P. Morgan, 9/30/2020

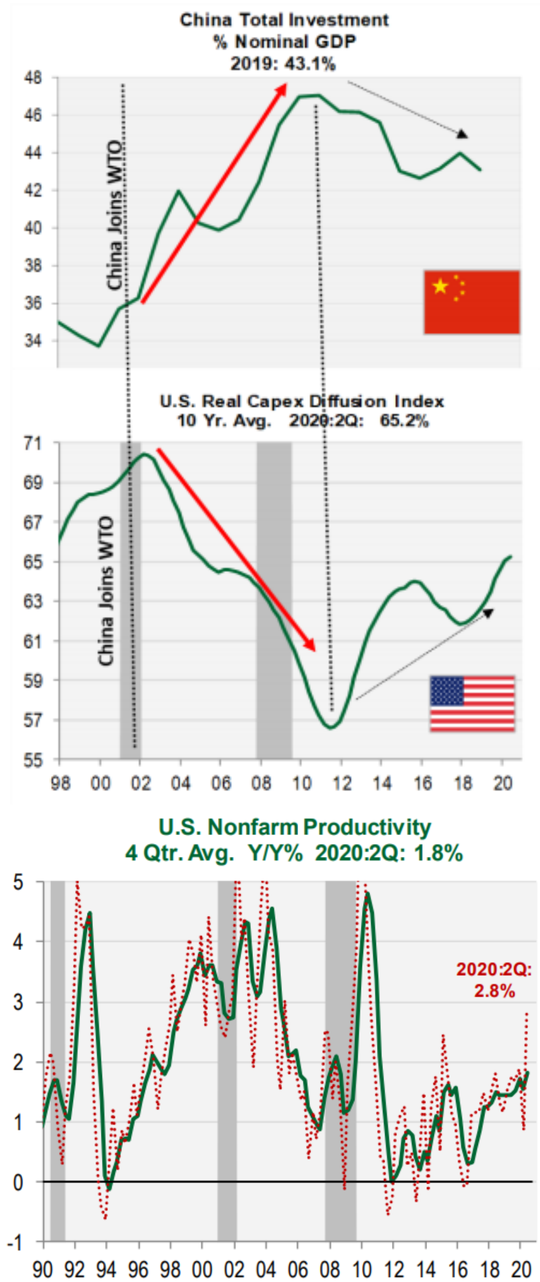
Three Key Secular Trends We Are Watching:

Fade the consumer economy, U.S. manufacturing is on the rise. We are in the camp expecting a growing manufacturing economy which will drive employment, productivity and corporate margins. When measured by the job multiplier data shown below you can see that manufacturing jobs multiply by 7.5x while retail/consumer jobs create 1.2 additional jobs. While the loss of retail, entertainment and travel-related jobs is tragic, the total impact to the economy will be less dramatic than during the first decade of this century when manufacturing jobs were being exported to China.

This is not to say the U.S. consumer is dead—indeed U.S. consumer spending is 25% greater than the combined spending in China, Japan, Germany and the U.K. What we are saying is the marginal growth in the economy and jobs will come from manufacturing as companies return jobs to the U.S.



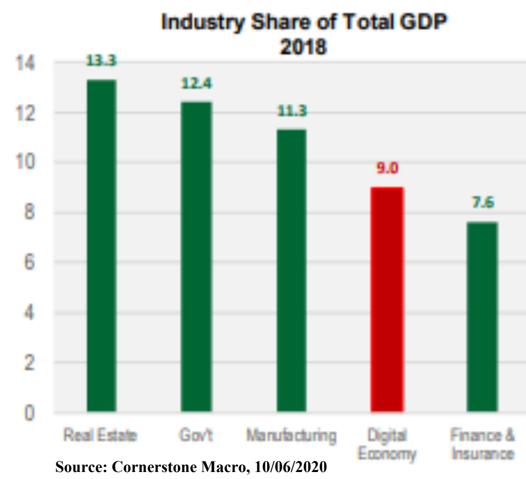
The charts below show capex spending in the U.S. declined dramatically once China joined the WTO, destroying manufacturing jobs in droves (experts estimate over 2 million jobs were lost). The correlation is sobering. But, once China's cost advantage began to fade, corporations began to spend again. The spending was political party neutral: capex spending turned up during President Obama's administration and continued under President Trump. Since then, productivity has been rising.



Source: Cornerstone Macro, 10/03/2020

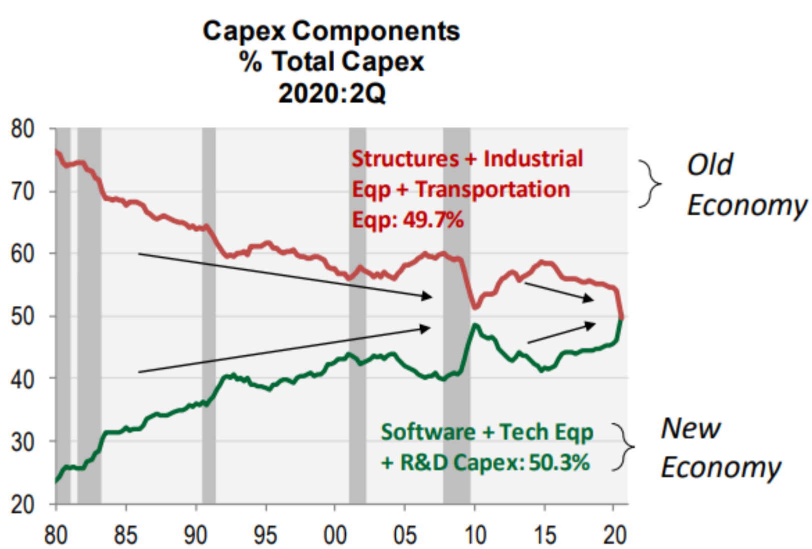
Don't fade tech. Corporations are digitizing en masse. Companies as diverse as McDonald's, Honeywell, Ecolab and Walmart, to name a few, are aggressively digitizing their business models. The trend is accelerating not stalling. Work and shop from home, online banking and payment systems, streaming and gaming, 5G, automobiles chockablock full of semiconductors, cloud, data aggregation and cybersecurity—these companies are generating strong and sustainable top-line growth.

The digital economy now comprises 9% of GDP. (2018 is the most recent data available.)



Source: Cornerstone Macro, 10/06/2020

Even more important, "new economy" capex spending (software + tech equipment +R&D) has exceeded "old economy" spending on structures, industrial equipment and transportation equipment.



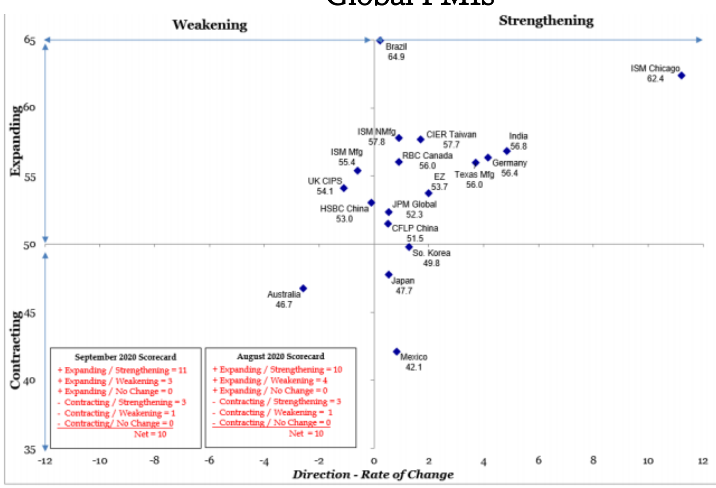
Source: Cornerstone Macro, 10/03/2020

We continue to believe that technology growth companies selling at reasonable prices have a long way to go. Many comparisons have been made to the tech bubble that burst in 1999/2000. We disagree. Today's high multiples are based on trough earnings in an easy monetary policy environment. In 1999 the Fed was in tightening mode with the Fed Funds rate hitting 5.5% by the end of 1999. In addition, Cisco (CSCO), for example, traded at a multiple well in excess of 130x on peak earnings; when the bubble burst the stock sold off over 80%.

We are focused on companies who are growing sales in the sweet spot of the accelerating, secular, sustainable trends outlined above.

Cameo: Global Synchronized growth re-appears. Global synchronized growth may be on the horizon. Below are the global PMIs (purchasing manager indices) for September. Fourteen of 18 regions are strengthening or expanding. If we are indeed starting a new expansion and the monthly numbers indicate that is the case—a typical economic expansion lasts, on average, 8 years. Global PMIs, it should be further noted, are highly correlated to corporate profits. Good news for the nascent bull market.

Global PMIs

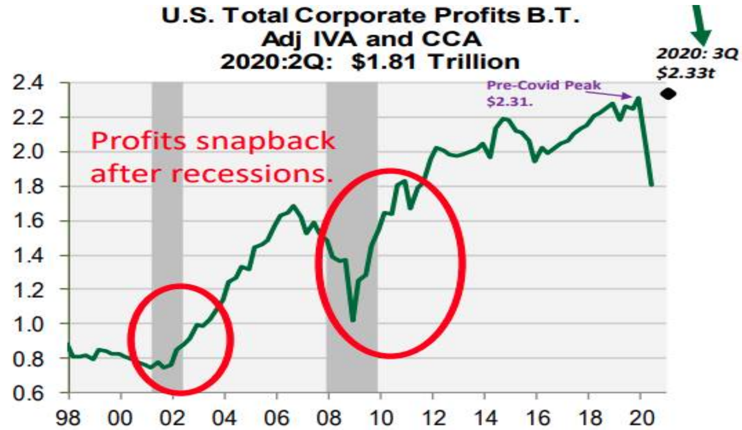


Source: Strategas, 10/05/2020

A further catalyst for Q4 economic growth is the fact customer inventories came in at 37.9 in the September report which is a signal that inventory restocking is on the horizon.

The election is likely to be a disruptive force in the near term. Yet money supply is up well over 20% this year and the massive amounts of monetary and fiscal stimulus have a lagged effect stretching over 12 months (we are just six months in); liquidity tends to find its way into risk assets (read: stocks).

Once the stimulus effects wear off, likely in the second quarter—without assuming additional stimulus—we will likely experience improving corporate earnings which will potentially provide another catalyst for stocks. The chart below chronicles the strong growth in profits after the two recessions so far in the 21st century.



Source: Cornerstone Macro, 10/08/2020

Strap in. The next few months may be turbulent but we are watching the data and navigating the storm for you. Elections do, indeed, have consequences but these trends are embedded in the economy and will continue to emerge despite where the political winds blow.

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Nancy Tengler on Massive Tech Sell-Off: We've Been Adding to Industrials, Consumer Discretionary (CNBC, Sept 18)
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Podcast: Record Markets and 'Cheap' Stocks Aren't Exclusive (Money Life, August 31)
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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)

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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