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INVESTMENTS

THE TENGLER REPORT

June 30, 2021

Commentary by:
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"Ah, but I was so much older then, I'm younger than that now."
Bob Dylan, My Back Pages

Maybe it's just nostalgia, but the older I get, the more I turn to the wisdom of the rock and roll lyrics of my youth. Those of us who came of age during that long and dreary period of stagflation in the 1970s, grew up fast. Rock and roll lyrics reflected the melancholy of the times. In the home of a single mother who worked two jobs to keep the lights on and keep food on the table, it wasn't a question of whether to work, the question was how to work as much as possible. By the time I was sixteen I had a handful of regular jobs.

One Christmas, I was hired by two competing retail stores in my hometown of Walnut Creek, Calif., – "didn't I just see you across the street?" asked one observant patron. Those jobs were a bonus, so I accepted both and kept my fingers crossed the scheduling would work out (it didn't). I returned to cleaning houses, babysitting and pet sitting with a waitress gig on Saturday mornings. There was no college fund, no clothing allowance, no car filled with gas.

Ah, but I was so much older then.

Which is why I am naturally suspicious of a Fed who believes they can control the burn of inflation. Muscle memory tells me otherwise. A controlled burn, as any firefighter knows, can quickly become a wildfire. Rising inflation and slow growth courtesy of the 1970s can be only one policy mistake away.

During the prosperity of the late 1980s and 1990s, I was younger. Optimistic. Carefree. The most important contributor to economic growth during the second half of the 1990s, was improving productivity which allowed for wage growth without putting upward pressure on inflation. Think: the perfect storm for the iconic yuppies of the 1980s and 1990s. The chart to the right (Fig. 1) from our friends at Strategas memorializes the robust increases in productivity in the 1990s. It was an economic party to be sure.

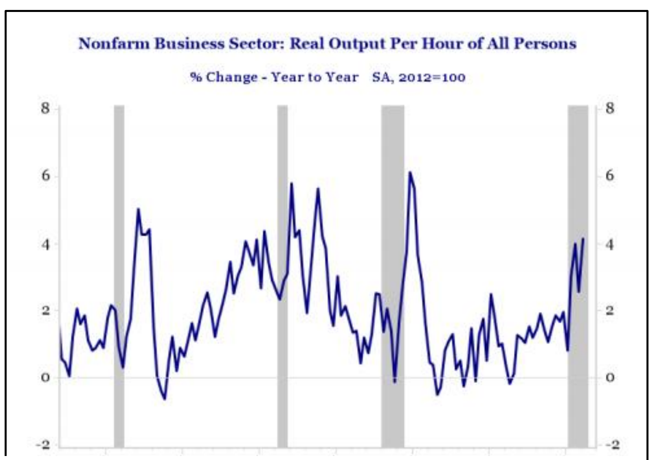

Fig. 1: Bureau of Labor Statistics, Strategas Research, 6/24/2021

Fast forward to 2021. Walt Disney Company is a snapshot of increasing productivity in real time. The company is adopting COVID procedures permanently and leaving an increasing amount of the client experience digital. Though they have announced that they will be hiring a few hundred more employees with the parks open and at full capacity, the company is staffed at approximately 15,000 associates vs. 32,000 pre-COVID. Talk about productivity – virtually half the workers are running the parks post-pandemic.

If companies continue to invest in tech capex (which improves worker productivity) we may well be able to see a 1990s like expansion, ex bad policies out of Washington. Too much spending, increasing taxes on individuals and corporations and potentially excessive regulations will put the brakes on the expansion. Remember, economic growth is all but certain to slow next year simply because of the massive reopening growth in GDP and corporate earnings produced in 2021. It's just math.

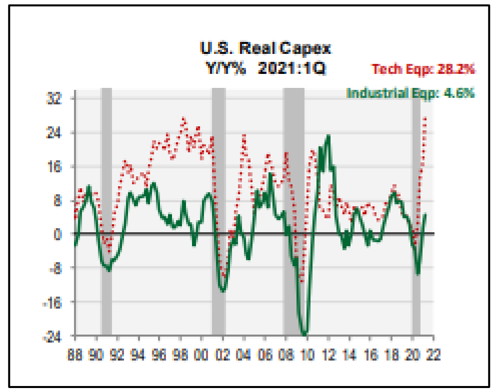

Fig. 2: Cornerstone Macro, 6/6/21

Consequently, the last thing we need as growth slows naturally, is bad policy coming out of Washington. Unfavorable policy changes could include:

- The Fed raising rates
- Washington imposing a doubling of the GILTI tax; this would hurt healthcare and technology – which includes the chip makers.
- Additional increases in the corporate tax rate – which raises prices for consumers.
- Increasing the tax burden of individuals and families – which reduces disposable income.

This is not a narrative about tax policy, but as our dear friend, Dr. Arthur Laffer, rightly points out, collecting and then redistributing a single tax dollar costs the government (and therefore, by definition, the taxpayer) a significant amount above the actual taxes paid. Read this report from the Laffer Center. Taking those dollars out of the real economy only slows growth further. Slow growth reduces employment opportunities and so the spiral begins.

Fiscal policy has already resulted in the largest transfer of payments to individuals in U.S. history (9x greater than in 2007-2009!). We all understand the reasons for the stimulus and applaud the effect. However, transferring dollars into consumer wallets was bound to be inflationary and if we expect to see inflation subside, adding to those transfer payments will only fuel the inflationary fire.

In Fig. 3 from Dr. Jeremy Siegel, you can clearly see the implications – M2 (think: savings) grew at a record pace in 2020. Historically, there is a strong correlation between M2 growth and inflation. Today we are experiencing a record difference. Dr. Siegel estimates that

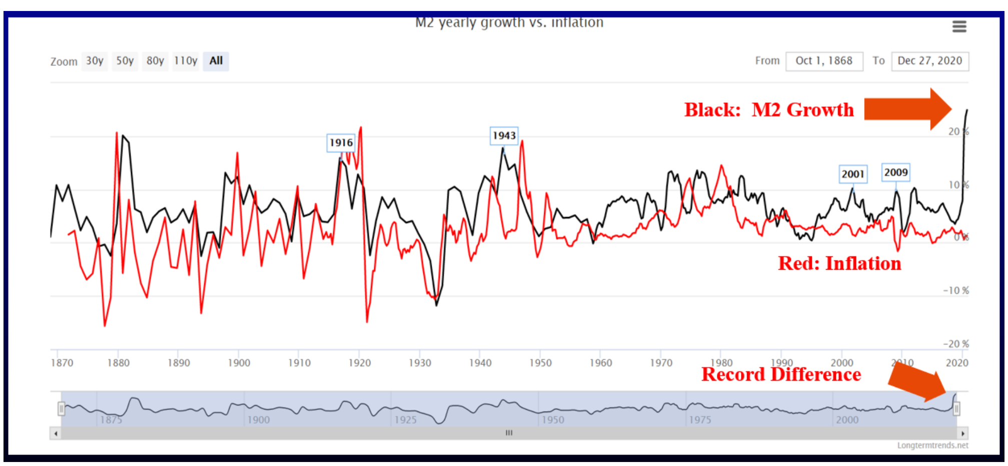

Fig. 3: Dr. Jeremy Siegel, 5/2021

there will be an additional 20% or so in inflation to work through the system in the coming years. If he is right, inflation will be hardly transitory.

Though we are worried about sticky inflation sticking, we expect to see productivity improvements continue, if not moderate some. But we do know that stimulus-boosted demand is still outpacing supply.

So, we are watching. Carefully.

We believe, as we have telegraphed for some time, that the value trade is cyclical, and the secular trends still favor growth stocks trading at reasonable prices. We have been transitioning our portfolios accordingly. Companies with growing dividends are central to our equity portfolio holdings. Our alternative strategy – Global Revolution – is focused on the sweet spot of a transition to green energy hedged with – what else? – oil.

Arthur Laffer, Jr. has a long-term track record running our Dynamic U.S. Inflation Strategy. Our Convertibles and Fixed Income strategies also serve an important place in portfolios. Contact your relationship team if you'd like to discuss any of the Laffer Tengler Investments strategies.

I combed the rest of Bob Dylan's *My Back Pages* lyrics in hopes of finding a suitable closing but, apparently, I am not that deep. Or perhaps, I am just too young. When I discovered the song in the 70s, it seemed to make perfect sense.

Ah, but I was so much older then…

Recent Media Appearances

Nancy Tengler Talks About The Importance Of Growth Picks (AmeriTrade Network, June 25)

Recent USA Today Article

Companies are playing down price hikes. Smart investors need to embrace them. (June 22)

THE LAFFER TENGLER INVESTMENTS 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:** Catalyst for Outperformance, Franchise Value & Market Growth, Top Management/Board of Directors.
- **Quantitative Factors**: Sales Growth, Operating Margins, Relative P/E, Positive Free Cash Flow, Dividend Coverage/Growth, Asset Turnover Ratio, Use of Cash (buyback, debt, div.), Leverage, Financial Risk.

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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