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INVESTMENTS

THE TENGLER REPORT
September 21, 2021

September's Back to School Sale—it's a stock market tradition!

From Nancy Tengler, Portfolio Manager and Chief Investment Officer

Deep breath. Market corrections always sound better in theory than they feel in real time. Any student of the market knows stock prices can reach extreme levels and remain there for some time—defying the odds—until an exogenous event causes investors to course correct. Excluding recessions, the market experiences a correction (greater than a 10% decline) on average, every 12 months. This we know.

What we don't know is when or what will spark a correction. Faithful readers of The Tengler Report know we have been expecting the market to pause for some time.

After the relentless bull run from March 23, 2020 to September 20, 2021, the S&P 500 (SPX) has returned 99.5%. Since last fall, we have seen only one pullback above 5%. Enter September of 2021. On September 2nd, the SPX hit its 54th record this year at 4536.95. Since then, stocks have declined -5.3%, but if you were watching the financial news, it feels a great deal worse. Breathless reporting of the Dow's 600 plus point decline yesterday neglected to point out the percentage decline was only 1.78%.

Brian Reynolds of Reynolds Strategy measures five lesser pullbacks this year. In January, February, March and May, the market has had episodes of decline hovering under 5%. We have written about these shallow sell-offs citing retail investors and company's buying back their own stock—establishing a floor for the market.

And, let's not forgot in 2021 alone the SPX is up 16.0%. Hardly a disaster. So, what do we make of it all?

The culprit in Monday's decline was Evergrande's debt crisis in the face of the Chinese government's debt crackdown. Talk about a national check kiting scheme—this company with upwards of $300B in debt (owed to more than 128 banks and 121 non-bank institutions) and $200B of prepaid, yet incomplete apartments will undoubtedly be restructured, to put it nicely. How and when is what got under the market's skin. References were made throughout the trading day to the collapse of Lehman Brothers. We don't think this is that.

Still, Evergrande's epic failure will have ripple effects through the Chinese market—the global implications are still unknown. None of us should be surprised that China's debt crackdown was, in particular, targeted toward Evergrande. The government has expressed concerns re: rapidly rising housing prices. President Xi Jing Ping has been upending the Chinese economy over the past few months: for-profit schools were obliterated to make education more affordable for the middle class, then the internet and transportation company crackdown with effective confiscation of all user data (China's six largest technology stocks have lost more than

$1.1 trillion in market value as a result). Of course, in the interest of Common Prosperity, wealth has been confiscated from the wealthy and from corporations. Add to that the government's intervention in pricing affordability and the Macau gambling crackdown and now Evergrande.

Westerners tend to see this self-inflicted slowdown as an unforced error but, in fact, we believe it is a deliberate and calculated plan by the Chinese government to 1) reduce the boom bust cycle that has characterized China's growth 2) exert stronger control over the economy and individuals and 3) empower the Party.

Stocks are a claim on the real assets of corporations. When investors begin competing with the Chinese government, take note! Today's China is not the China investors have dealt with historically.

At Laffer Tengler Investments, we have examined each of our large cap portfolios in terms of total revenue compared to the % of each company's revenue coming from China. Our exposure is modest—well under 10%, and we intend to keep it that way.

We have been writing for months of expected increases in stock market volatility. September is also the best month for corrections. We are vigilant.

Nancy Tengler

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Nancy Tengler's Recent USA Today Articles
Consider These Three Investments To Add To Your Portfolio (Aug 24)
Volatility is Not a Bubble. Here's Why the Market Will Likely Continue to Be Bullish (Feb 24)

Nancy Tengler's Recent Media Appearances
"I Wouldn't Get Near China" For Some Time (CNBC, Sept 20)
Trader Flags Warning Sign In Chart Of Natural Gas Prices (CNBC, Sept 16)
Nancy Tengler Talks GARP Stocks (CNN Markets Now, Sept 8)
Digital Economy Growth - Assessing Market Valuation Measures (TD Ameritrade, Sept 3)
Will Weakening Data Wreck The Rally (Sept 3)
S&P 500 Financials Up In August. Will It Continue In September? (CNBC, Sept 1)
Why Nancy Tengler Likes Honeywell and Salesforce Stock (CNBC, Sept 1)
Sector-By-Sector Stock Showdown with Nancy Tengler (CNBC, Aug 25)
Nasdaq And S&P 500 Close at Record Highs (CNBC, Aug 25)
Experts Weigh in On Market Concerns Amid Afghanistan Conflict (Fox Business, Aug 23)
Traders Share the Sectors They're Picking After Infrastructure Bill Passes Senate (CNBC, Aug 10)

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.

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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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