



History Doesn't Repeat
Itself, But It Often Rhymes.

– *Mark Twain*

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Key Issues for U.S. Equity Investors

01

HOW HEALTHY
IS THE MARKET
BACKDROP ?

02

SO, WHAT
HAPPENS GOING
FORWARD ?

03

WHOA! THAT
SOUNDS LIKE A
VERY DIFFICULT
BACKDROP FOR
EQUITIES...

How Attractive is the Equity Market Currently?

SKY-HIGH VALUATIONS



- At 24.5X and 21.5X, respectively, consensus EPS expectations for '20 and '21 for the S&P 500 are among the most challenging for investors I've seen.
- I see **LITTLE** margin of safety.

WATER, WATER EVERYWHERE, NOR ANY DROP TO DRINK



- Will Central Banks' grand monetary experiment succeed?
- Can both the cost of money and the rate of inflation be managed?
- Liquidity provided in excess of the real economy's needs has, as it did in 1998 - 1999, driven the performance of speculative assets, such as stocks and high yield bonds.
- With U.S. Debt/GDP at post-Marshall Plan high of 1.0X+ are investors losing faith in the U.S. Dollar (which is -11.0% YTD)? If so, what will this do to demand for long-dated U.S. financial assets?

A WORD OF CAUTION...

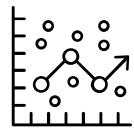


- If Dollar weakness continues, what will be the **impact on inflation**?
- “Canaries in the coalmine” suggest caution:
 - a. The Dow Jones Commodity Index is +8.2% YTD, but +59.0% since May 2020;
 - b. Gold, despite a recent pullback is +20% YTD, after peaking +34%;
 - c. Lumber is +62% YTD, after having peaked at +150% in Q3. **Industrial metals** have screamed, beginning in Q3.
- Equity markets have **fully bought into** the notion to “**never fight the Fed**”. The old saw is still embraced, despite it having been a disastrous strategy from 2008 to mid-2009.

Whoa! That Sounds Like a Really Bad Backdrop for Equities...



If this thesis plays out long-only investors will have a difficult time posting absolute returns, but there is a **HUGE** opportunity to generate ALPHA.



Growth vs. Value

- Historically, Growth and Value have swapped market leadership in 5 – 7 year cycles.
- This Growth cycle has played out over a record 10 years.
- The longevity of this cycle has been driven by progressively lower interest rates since the Financial Crisis. The Russell 1000 Value has underperformed by 53% since 2010, almost all of that has occurred since 2017.

Calling the End of Market Trends is a Fool's Errand...

HOWEVER

Thoughtful investors should consider the following factors,

which give me high confidence that **VALUE** is poised to lead the market going forward



1

Valuations are at EXTREMES: The Russell 1000 Growth and Value indices trade at 29.3X and 17.8X '21 consensus EPS, respectively. A 40% discount is consistent with what prevailed in the 1999 Value bottom.

2

Value's outperformance looks timely, as monetary and economic drivers seem in place. Value has outperformed when interest rates are rising:

- i. the main driver is that shorter-dated cash flows become more valuable in widely followed DDM's.
- ii. Value begins to outperform when economic recovery becomes evident. Historically, outperformance begins about 2Qs into recessions.

3

Investors are at record levels of **UNDEREXPOSURE** to Value: this is much like 1998-1999. Value outperformance should drive enormous allocation shifts. Investors missed 50% of Value's relative outperformance, which occurred in the first two years.

4

All stripes of fiduciaries have made the easy decision and trend-followed. When an investment thesis is widely accepted, **who is the Marginal Buyer?**

Where to Look for New Ideas?

Despite being a huge Value bull, a cautious stance on the broad market keeps me focused on stock-specific drivers.



I seek idiosyncratic investment opportunities, which have reasons to appreciate due to internal drivers.



It is very hard to find stocks with my requisite 30%+ total return hurdle rate over 12-18 months.



Recent illustrative purchases have been:

1. A fallen-angel retailer with an underappreciated, highly accretive rent roll opportunity.
2. An underperforming, consumer-oriented industrial company with a new CEO who has sterling turnaround credentials. Both cost-cutting and competitive positioning improvements look very material.

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