



PORTFOLIO NOTES

May 2021

To our Business Partners:

- **TULIPS ANYONE?** It has been said that those who fail to learn from history are condemned to repeat it. With that thought in mind, we reread the classic Extraordinary Popular Delusions and the Madness of Crowds, written in 1841 by Charles Mackay. In it, Mackay recounts many examples of the irrational behavior of crowds. One such episode is known as "The Tulipomania," occurring in Western Europe in the mid 1600's, primarily in Holland. During that period, the price of tulips and tulip bulbs skyrocketed, drawing in people from all walks of life. Some even sold all their possessions to buy tulips, with prices reaching the price of a home. Trading markets were established, and normal economic activity slowed, as much of the population participated in this madness. Some were even using tulips as a currency. Needless to say, this ended badly, with prices collapsing, trades disavowed, and many people losing everything.

To demonstrate why human nature and crowd psychology never change, we introduce the current rage – cryptocurrencies. According to Investopedia, "A cryptocurrency is a form of digital asset based on a network that is distributed across a large number of computers ... the word "cryptocurrency" is derived from the encryption techniques which are used to secure the network .. cryptocurrencies are systems that allow for secure payments online."

The first and best known crypto is called Bitcoin, although there are many others, notably Dogecoin and Ethereum. As their names suggest, they are being promoted as alternative currencies or forms of payment for goods and services. Unfortunately, long story short, they fail virtually every test for an acceptable medium of exchange. One interesting fact is that, apparently, the computer-generated energy required to "mine" and maintain Bitcoin exceeds that of Sweden!

Both tulips and cryptocurrencies share one significant characteristic: neither asset produces anything of value. While each had/has experienced significant price gains, there was for tulip bulbs and is for Bitcoin, no way to place a value on either. As with many extremely popular alternative assets, you must depend on what someone else will pay for it (the "Greater Fool"). With no ability to calculate value, one is at the mercy of the crowd and its' participants' irrational emotions. Like all other manias written about by Mackay and others since, the cryptocurrency fad is likely to end in tears.

- **VALUATION.** As a group, our widely-held stocks* are selling at 95% of a conservative calculation of their estimated worth. This means, if you bought the group today, the expected annualized return over 3-5 years (if the group rose to full value) would be 1.3-1.7%. Obviously, that's not a satisfactory return to compensate for the risks of owning stocks, nor does it produce an acceptable margin of safety. What we need – still – is for stock prices to decline to the point where they yield a much higher theoretical rate of return. What we remain – still – is patient and disciplined.
- **RECENT RESULTS.** Stock prices rose in April, with market returns ranging from 2-5%. The tech-heavy NASDAQ recovered from a flat March to gain 5.4%. Year to date, smaller company indexes have been the best performers with 18-20% gains versus 8-11% for the big-cap indexes. Over the last twelve months, all indexes are up significantly due to easy comparisons against the depressed markets of a year ago. The smaller company indexes have surged the most this year, as they suffered the largest declines in 2020. Year-over-year advances are significant, ranging from 40-70%. Our group of widely held stocks* continues to perform well this year, ahead of most of the indexes.

Steve Nichols, CFA Bill Warnke, CFA

*The group of "portfolio stocks" -- our Equity Composite for the purpose of evaluating investment performance -- consists of 18 stocks that are held in our clients' accounts. Portfolios might hold some or all of these stocks, depending on investment guidelines unique to each client, the timing of purchases and sales, and start dates of accounts. The performance of this group of stocks is a good proxy for our equity performance but might vary widely among accounts. Of course, past performance is not necessarily indicative of future results.

We hereby offer to deliver to you without charge a copy of our current Form ADV Part 2, in accordance with the U.S. Securities and Exchange Commission's "Brochure Rule." Please contact us if you would like us to send you a copy.

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