Warnke/Nichols Ltd.
Investment Management

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PORTFOLIO NOTES **OCTOBER 2021**

To our Business Partners:

- ***SEPTEMBER 30, 1981.*** On this date 40 years ago, interest rates set a record high, when the benchmark 20-year US Treasury bond yielded a whopping 15.8%. Lesser quality issues provided even higher yields. From there, one of the longest bull markets in bond market history began. Bond prices rose steadily, to the point where, today, that same 20-year Treasury yield is a mere 2%. (Remember that bond yields fall when bond prices rise.) Similarly, long-term bonds issued by corporations saw a more than two-fold increase in yields.

  Remarkably, during late-1981, investors were extremely bearish on bonds and therefore reluctant to commit capital to the bond market, even at such enormous yields. In other words, seemingly no one wanted to lock in a 15+% coupon rate for, in our example, 20 years! Many new high-quality bonds issued at the time didn't have enough demand to sell the entire inventory for sale. Prospective investors were spooked because inflation (rising prices of goods and services) was still a major problem, leading to significant declines in bond prices the previous several months.

  What seems inconceivable today is that few investors were willing to lock in those big juicy yields. Instead, they were likely fixated on the most recent price declines and high inflation, anticipating more of the same. Relatedly, stocks also suffered from the same lack of interest. The 1980-82 stock market setback took earnings-to-price ratios to extremes mirroring bond interest rates. Over the ensuing 40 years, like bonds, stocks' earnings yields plummeted (the inverse, price-to-earnings ratios, skyrocketed).

  Today, we are near the opposite end of the spectrum: record low bond and stock yields. Many investors are now assuming this is the new normal in the marketplace; that rates will remain depressed, stocks aren't too richly valued, and the recent spike in the rate of inflation is "transitory." Take a look back over financial market history, however, and you'll find that The Herd usually does the wrong thing at price extremes (wrongly bullish at the tops, and wrongly bearish at the bottoms). Are investors making the same mistakes they made 40 years ago, only this time in the opposite direction?

- ***VALUATION.*** Despite the recent pullback in the stock market indexes, individual stocks remain quite expensive and therefore yield unsatisfactory future returns. What you pay, for what you get, matters.

- ***RECENT RESULTS.*** Stock market indexes moved lower in September, with declines of 2.5-5%. Generally, the smaller cap indexes fared somewhat better than their larger cap brethren. Through the first three quarters of the year indexes have gained in a broad range of 11-19%. Over the last twelve months, the smaller cap indexes are up 45-55% versus 22-30% for the large company indexes. Our group* of portfolio stocks compare favorably with the market indexes over the month, year-to-date, and trailing year time frames.

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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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