Warnke/Nichols Ltd.
Investment Management

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PORTFOLIO NOTES **DECEMBER 2021**

To our Business Partners:

- ***WHO SHOULD YOU BELIEVE?*** Two recent *Wall Street Journal* articles have caught our attention which, taken together, highlight issues that should concern investors. The first reported that company insiders – top-level executives and directors – have been selling their own shares in the companies they manage at a record clip, 50% higher than the prior year. The last time this happened was during the dot-com boom of 2000. This is considered the "smart money," as insiders seemingly know best what is going on within their own company.

  The second article reports that companies set a record in the third quarter for share buybacks. Companies repurchased almost $235 billion of their own stock, topping the previous record of $223 billion set in the fourth quarter of 2018. Even at the loftiest valuation levels in history, companies somehow consider this the best use of corporate capital.

  Taken together these are not necessarily a good thing. Corporate insiders are selling their personal holdings of stock at the same time many companies are repurchasing stock. In some cases, the selling insiders are also actively overseeing their own companies' buyback programs. While there are many reasons for an insider to sell stock, they have historically been very good at selecting the opportune times to do so. Conversely, history isn't so kind when looking at corporate buybacks. In aggregate, companies have done a very poor job, often buying near highs, and scaling back repurchases when prices are low. (Is this "smart" people making collectively "dumb" decisions on behalf of shareholders?)

  Stock buybacks only are beneficial if they are done at prices below the intrinsic value of the company. Buying back shares at lofty prices destroys shareholder value, committing corporate capital to below-average returns. Unfortunately, with record low interest rates, many companies have taken on enormous levels of debt and used the proceeds to buy back stock. While this financial engineering provides a short-term boost to earnings, it may be detrimental to long-term value. That's why insider selling at the same time is likely not in the best interest of the shareholders.

- ***PORTFOLIO VALUATION.*** The aggregate price to intrinsic value of our portfolio companies* is 99%. There will be a time again when we'll be able to buy a dollar's worth of a company for 60-70 cents. There needs to be a significant markdown in prices for that to happen.

- ***RECENT RESULTS.*** Most stock market indexes retreated in November, in the range of 3-4%. The one exception was the NASDAQ Composite which eked out a gain of 0.3%, compared to the S&P 500's decline of 0.8%. In general, large company indexes did slightly better than the small and mid-sized company indexes. Through November, indexes have gained from 12-22%, with no clear advantage by company size. Our group* of portfolio stocks compare favorably with the market indexes over the same periods.

- ***WE WISH YOU A SAFE AND HEALTHY HOLIDAY SEASON!***

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.***

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